

The KDM Dairy Report – December 6th, 2013

What's Bullish:

- Spot Market: Blocks finished ¼¢ lower on the week to settle at \$1.87¼/lb on just 4 trades, but barrels jumped 5½¢ to close at \$1.83¼/lb on no trades. Butter picked up ½¢ to \$1.64¼/lb on heavy trading of 23 cars, while Grade A NDM shot up 5¼¢ to \$2.05¼/lb on 7 trades.
- Dairy Products Report: American cheese output in October was down 0.6% vs. the prior year, well below analysts' average guess of a 1% increase. Output of skim milk powder jumped 36.7% year-over-year, showing that more milk is being pulled from cheese production and into powder production to serve the international market.

Futures Month	Class III 12/06	Class III 11/27	Change	Dry Whey 12/06	Dry Whey 11/27	Change	Cheese 12/06	Cheese 11/27	Change
Dec-13	\$19.08	\$18.47	\$0.61	59.50¢	58.68¢	0.83¢	\$1.873	\$1.814	\$0.059
Jan-14	\$18.55	\$17.72	\$0.83	60.50¢	57.75¢	2.75¢	\$1.822	\$1.750	\$0.072
Feb-14	\$18.00	\$17.28	\$0.72	63.00¢	57.50¢	5.50¢	\$1.752	\$1.702	\$0.050
Mar-14	\$17.68	\$17.00	\$0.68	61.00¢	56.75¢	4.25¢	\$1.723	\$1.681	\$0.042
Apr-14	\$17.42	\$16.91	\$0.51	60.00¢	55.78¢	4.23¢	\$1.711	\$1.675	\$0.036
May-14	\$17.27	\$16.84	\$0.43	59.00¢	55.25¢	3.75¢	\$1.703	\$1.672	\$0.031
Jun-14	\$17.23	\$16.92	\$0.31	58.00¢	54.53¢	3.48¢	\$1.699	\$1.689	\$0.010
Jul-14	\$17.32	\$17.17	\$0.15	57.50¢	54.00¢	3.50¢	\$1.719	\$1.712	\$0.007
Aug-14	\$17.36	\$17.20	\$0.16	56.00¢	53.28¢	2.73¢	\$1.722	\$1.720	\$0.002
Sep-14	\$17.41	\$17.22	\$0.19	56.50¢	53.00¢	3.50¢	\$1.727	\$1.732	(\$0.005)
Oct-14	\$17.34	\$17.24	\$0.10	54.50¢	52.00¢	2.50¢	\$1.730	\$1.734	(\$0.004)
Nov-14	\$17.27	\$17.20	\$0.07	54.50¢	51.25¢	3.25¢	\$1.733	\$1.733	\$0.000
12 Mo Avg	\$17.66	\$17.26	\$0.40	58.33¢	54.98¢	3.35¢	\$1.743	\$1.718	\$0.025

- Fluid Milk Southeast: Florida has experienced a significant increase in Class I demand, due to the early arrival of seasonal residents. Retail sales of dairy products were strong over the holiday period. Milk production is increasing, but at a slower pace than anticipated. Imported shipments of milk increased to 79 loads this week (up from 47 last week), due to the increase in consumer demand for milk and other dairy products. Manufacturing milk supplies in the Southeast region are at minimal levels as milk supplies are in balance with Class I demand.
- Fluid Milk Central: Milk production is only marginally increasing which is keeping supplies tight, with little extra milk available. Bottling demand loosened some, but eggnog production has picked up considerably. Interest for Class II remains strong with good orders coming in to meet holiday demand. Butter churners were able to secure extra cream supplies over the holiday, but are finding supplies tighter this week. Some milk processors reported to see additional farm sellouts over the past few weeks.
- Fluid Milk Southwest: Manufacturing milk volumes were easily accommodated within the region over the holiday weekend. Butter/powder plants were active, but haulers note fewer milk loads are clearing into NDM during this post-holiday week. Manufacturers of bottled milk, ice cream/sour cream and other holiday-related products are stepping up milk load orders as those production lines put in more hours prior to the end of the month. Farm milk production in CA is only able to marginally increase as temperatures moderate. Fluid sales are active as retailers run promotions for plain and flavored milk as well as holiday dairy drinks. In AZ and NM, milk production was steady to higher in the first half of the week, but a cold front, accompanied by freezing rain/snow, passed through the region at mid-week and hindered cow comfort going through the balance of the week. Bottling demand is building as various flavored milks and milk-based holiday drink orders increase seasonally. Processors report demand from bottlers this week stepped higher as retailers placed orders to refill coolers. Sales of milk into Class II end uses are gradually trending higher. Spot cream availability is tight in some areas as cream cheese, ice cream, sour cream, and aerated cream production gears up for the December holidays. A few churn operators are bringing cream loads across state lines, where economically feasible, to bolster butter production before the December holidays.
- Fluid Milk Pacific Northwest: Milk production is near or at the bottom of the year levels. There were few problems handling milk supplies over the holiday week with manufacturing plants welcoming any additional milk that came their way over the holiday.
- Butter: In the Northeast, domestic demand for butter is seasonally strong with orders being filled from current production. Export demand has increased compared to recent weeks, prompting the production of 82%. Prices for butter in the Central region remain firm as orders have been good to strong. Some butter manufacturers have had to turn away orders due to production constraints. A few butter plants are electing to sell cream at current high prices, leaving production rates reduced. Many butter makers were able to secure extra cream supplies over last week's holiday, but churn rates have been significantly reduced compared to years past, leaving operators to pick up the slack through microfixing bulk butter supplies. Microfixing and holiday orders have left inventories depleted for most manufacturers. Western butter production is limited by tight cream supplies. Demand following the Thanksgiving holiday is good as retailers look to resupply and build stocks for yearend holidays. Export demand is also described as good and manufacturers are balancing export orders with domestic demand. Butter stocks are tightening in response to the good demand.
- Dry Whey Northeast: Prices are moving higher. Production is increasing following the holiday week, but so is demand. Dry whey is seen as being the lowest priced dairy protein on a per unit basis. Supplies are tightening with some manufacturers sold out through the end of the year. Export interest remains good. The market undertone continues to be firm.
- Dry Whey West: Prices are higher and the market tone is firm, while fewer loads being offered to the market. Recent sales of whey have cleared much of the excess product from the market. Whey production is lower as cheese plants are working reduced schedules due to competition for available milk supplies. Demand for whey is good as buyers look to obtain protein to substitute for higher priced nonfat dry milk.
- NDM East: Prices for nonfat dry milk moved higher this week in a firm market. Production increased over the holiday period, but declined going into the week, because of increased Class I demand and improved demand for milk from other dairy product manufacturers. Supplies are very tight with prospective buyers having difficulty sourcing product. Most supplies are committed through the end of 2013. Purchases outside the region are limited, due to the high cost of transportation. Export demand remains active. The market undertone remains firm.
- NDM Central: The market tone is firm with few spot loads available and premiums paid on the loads secured. Some end users are taking advantage of the high prices and electing to sell NDM instead of using it for production. Most NDM manufacturers' stocks are spoken for, through contract obligations.

- NDM West: The market tone is firm. Industry participants report domestic demand for December NDM is active, but availability remains limited from producers. Resellers also report they are limiting sales volumes beyond loads going to their regular customers. Contracting for 2014 is up for discussion between producers and buyers. Some buyers are hesitant to commit at current pricing, but that also leaves them subject to firm pricing in the near term with no guarantee of NDM availability.
- Cheese Northeast: Seasonal demand for cheese remains strong, especially for aged. Inventories are being worked lower as most plants fill year-end orders.
- Cheese Midwest: Manufacturers are seeing steady to strong interest in retail orders, filling last minute gift boxes. Milk supplies have been hard to come by, with premiums being paid to secure loads to meet current holiday obligations. Cheese production rates are steady and near or at capacity for most cheese makers, but stocks of cheese are being reduced for many plants as orders are being shipped out.
- Cheese West: Prices are strengthening this week as buyers look to fill in inventories after the Thanksgiving holiday and prepare for last minute orders for end of the year needs. Block demand is good with manufacturers reporting increased orders. Barrel demand is lackluster with buyer resistance at higher prices. Cheese production is steady with seasonally limited milk supplies.
- International: Tuesday's Global Dairy Trade auction resulted in a strong 3.9% increase in the dairy price index over the previous event two weeks ago. Demand for powder continues to be a theme, with skim milk powder up 5.6% and whole milk powder up 3.4%. Cheddar cheese actually declined 1.5%, but was still at a U.S. equivalent \$2.04/lb.
- International: Demand for dairy products in Western Europe is very good across the board ahead of the upcoming yearend holidays. Buyers who have previously opted to restrict purchases of butter and skim milk powder, in hopes of lower prices, are coming back into the market with the realization that prices are unlikely to fall significantly in the short term. Despite the possible penalties, many producers who are above quota are maintaining or increasing production levels, due to the good demand, prices and margins. Cream supplies remain tight while supplies of butter are below year ago levels.
- International: Australian milk production data for October showed declines in all six states, compared to last season, with production down 4.1%. Dairy Australia has revised its 2013-14 seasonal milk production estimates to range from 0-2.2% below the previous season. These projections assume improvements in the current trends. Declines in production are partly due to adverse weather conditions, especially in the Northern regions where limited rains have reduced pasture and crop growth. Another factor limiting milk production has been that many producers were rebuilding their financial underpinnings this season and were adverse to the increased risk and debt incurred with any major dairy expansion. The current seasonal milk production peak in October was significantly below last year's levels.
- International: Butter availability in Oceania is very limited with nearly all supplies committed through the end of the year. Negotiations for Q1 and Q2 orders are ongoing with a majority of Q1 supplies having been already contracted. Production of butter has been reduced by the lower milk production output in Australia and also due to reduced cream availability in New Zealand as whole milk powder production has increased. The skim milk powder market became more active over the last two weeks with prices moving higher. Comments from traders indicated the increased activity and higher prices were in part a result of the disappearance of discounts on U.S. sourced product. However, production is down as milk supplies have moved into their seasonal decline, and supplies are very tight with nearly all output committed through Q1 of 2014. Whole milk powder prices moved higher as demand has improved compared to two weeks ago. The improved demand is, in part, a result of the diminishing supplies of alternative sources. Demand has also been bolstered as some buyers need to get back into the market after previously purchasing only for their short term needs. Production is active as manufacturers try to channel more milk into WMP, but good buying interest from China and Southeast Asia has most supplies into Q1 of 2014 already booked. With most milk going into SMP and WMP, cheddar cheese production in Oceania is trending lower and supplies are tight. Negotiations are ongoing with Japan for Q1 and Q2 supplies. Prices were higher this week, to a U.S. equivalent \$2.15/lb.

What's Bearish:

- Fluid Milk Northeast: Manufacturing milk supplies were heavy in the Northeast and Mid-Atlantic regions over the holiday period and into the first part of this week. The lack of any major storms in the Northeast allowed manufacturers to work through the increased supplies without major delays.
- Dry Whey Central: Prices moved higher this week, but demand mostly steady and made of up existing contracts. Inventories are increasing.
- International: New Zealand milk production continues to be robust and above year ago levels. Production estimates for October are nearly 5% above the previous year's pace. Favorable weather patterns are holding up over most regions of the country.

Recommendation:

Ok, we're going to be short and sweet here. In the U.S., NDM – sold out, SMP – sold out, butter – strong demand, inventories falling quickly, cheese – strong demand, inventories falling, milk – tight. In Europe, strong demand. In Oceania, Aussie milk output down, New Zealand output up, butter – supplies tight and sold out through Q1, into Q2, SMP – sold out through Q1, WMP – sold out through Q1, cheese – tight. Are you catching a theme here? Sold out! We don't know how long this will last, but until milk output in the U.S. starts gaining some traction, continued holiday demand and aggressive Asian demand is likely to keep 2014 milk prices on an upward path. Spot NDM hit \$2.05¼/lb this week, putting Class IV at about \$22.75/cwt. Despite some volatile moves in spot cheese the past couple weeks, buyers seem ready to jump on any offers (with the exception of barrels) if prices move too low. Class III now sits at about \$19.10/cwt basis spot prices. Holiday demand will end and there will be a New Year's lull in international interest, but the fact that many dairy products are now sold out through Q1 tells us international demand is here to stay for a while. Producers should look at hedging on price spikes higher, while end users need to be buying on any price weakness, in our opinion. Jan futures made a contract high of \$18.82 this week. Look to sell some production at \$18.99 or higher or get into PUT-buying mode. At this point, we believe there is more long-term upside risk than downside. Go after the 17.00 PUTs for Q1 at an average of 15¢ each (settled at 22¢ today). Keep your upside open. We'd leave Q2-Q4 alone for now. Have a great weekend!

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