

The KDM Dairy Report – January 31st, 2014

What's Bullish:

- Spot Market: Blocks picked up 6¢ this week to a new all-time record of \$2.36/lb on 4 trades while barrels gained 4½¢ to \$2.32/lb on 3 trades.
- AMS survey prices are finally catching up to the Spot market. 40-lb cheddar blocks averaged \$2.14/lb this week, up 6.9¢ from last week. 500-lb barrels jumped 10.7¢ to \$2.15/lb. Butter increased 4.5¢ to average \$1.67/lb, dry whey gained 1.3¢ to 60.9¢/lb and NDM averaged \$2.04/lb, up 0.8¢.
- Despite rapidly rising cheese prices in January, weekly cold storage numbers indicate cheese stocks at USDA-selected storage centers fell 2%, or 2.2 million lbs over the period 01/01 through 01/27.
- Fluid Milk East: Milk production is increasing in the Northeast region and manufacturing volumes are adequate at most plants. However, severe winter weather in the Southeast and coastal regions is having significant impact on milk transports, as they experience major delays, unable to make scheduled drop offs. Florida Class I demand is active. Producers are speculating that the impact of winter storm will cause cow stress, resulting in reduced milk volumes. The magnitude of the storm has surged Class I demand causing bottling plant orders to move upward with consumer retail purchases. Cream demand is expanded. Condensed skim supplies remain tight with significant milk supplies being pulled to bottling operations. Some manufacturers are directing volumes to Class IV production as they rebuild those inventories.
- Fluid Milk Central: Farm milk production in the region has been stagnant for the most part due to the recent cold weather. Milk supplies loosened some this week as multiple cheese makers are backing off on orders, and bottling demand took a step back due to school delays and cancellations. Cream demand is mixed, but overall tighter than expected. Some ice cream makers have started to acquire additional cream supplies a little early due to the concern of not being able to secure ample supplies or having to pay a higher price in the future. Condensed skim demand and production is increasing with good pulls coming from cheese and ice cream manufacturers.
- Butter: Manufactures are focusing on rebuilding inventories, but a mix of tight cream supplies, good domestic demand, and active export sales are hindering the process. The market tone is firm with light print and bulk butter stocks.
- Dry Whey: In the Northeast, dry whey production is mostly steady to slightly lower, as further severe weather caused some plant closings in the region. Inventories are tight, but adequate for fulfilling current contracts. Export sales continue to drive demand, with less active interest from domestic buyers. The market tone is steady to firm. In the Central region, prices were higher this week and the market tone is firm as supplies are tightening behind increased sales. Production rates of dry whey are steady to slightly lower. Good domestic and steady export demand keep product moving readily. End users and feed blenders are reported using additional whey protein concentrate 80%, requiring extra dry whey in formulations. Contracts are pulling strong on manufacturer inventories, leaving little excess for the spot market. In the West, prices firmed as competing dairy protein products continue at high price levels. Whey production is mostly steady, but lower than hoped for due to tighter overall whey supplies. Good export demand and continues to pull Western whey out of the country.
- Cheese Northeast: Some cheese manufactures are working 5-6 day production schedules as they fulfill 1Q 2014 contracts and rebuild tight inventories. Export sales continue to drive the demand for cheese as winter weather conditions in parts of the region impede domestic retail and food service purchases. The market tone is firm.
- Cheese West: Tight cheese supplies are driving prices higher as demand is well above amounts offered. Lower than expected milk production and strong demand from competing products are limiting milk available to cheese plants. One prominent manufacturer announced layoffs this week due to tight milk supplies. Production is sufficient for most contracted needs but is limiting spot offerings. Good export demand is also adding to the tight inventories.
- CWT announced export assistance this week for 5.8 million lbs of cheese for delivery from January to June.
- International: The SMP market in Western Europe has firmed, supported by strong global demand. Production is expanding as milk volumes are increasing, but demand far exceeds supply. First quarter production is largely under contract. Second quarter negotiations are ongoing with manufacturers in no hurry to make deals on an upward trending market. Available supplies are held with confidence. Global supplies remain tight, giving the market a firm undertone. Export interest from the Middle East and North Africa is increasing as those countries seek to build supplies prior to Ramadan.
- International: Little has changed in the Oceania SMP market during the past fortnight with prices firming, continued strong demand and tight supplies. Some manufacturers are finding the combined margins of butter and SMP are equal to or above WMP and are attempting to channel more milk to SMP and butter production. Demand is good coming from Southeast Asia, the Middle East and North Africa. Some buyers have intimated that customers are tiring of high prices and may be looking for alternative products to lower their costs. The continued good sales of SMP would seem to indicate that some easing in demand from one region is quickly filled with demand from another. As production slows in Oceania, buyers are beginning to search in earnest for buying opportunities in the northern hemisphere.
- International: Demand for Oceania WMP continues to be strong with major buying interest coming from China. China's January import levels are expected to exceed the strong November and December tonnage. The increase in January's market activity was to build up stocks prior to the Chinese New Year. The Middle East and North Africa are also adding to the demand for WMP.

Futures Month	Class III 01/31	Class III 01/24	Change	Dry Whey 01/31	Dry Whey 01/24	Change	Cheese 01/31	Cheese 01/24	Change
Jan-14	\$21.12	\$21.05	\$0.07	59.78¢	59.70¢	0.07¢	\$2.080	\$2.072	\$0.008
Feb-14	\$23.11	\$22.45	\$0.66	62.73¢	62.70¢	0.02¢	\$2.271	\$2.190	\$0.081
Mar-14	\$21.47	\$20.47	\$1.00	61.50¢	63.10¢	(1.60¢)	\$2.101	\$1.982	\$0.119
Apr-14	\$20.04	\$19.44	\$0.60	62.50¢	63.00¢	(0.50¢)	\$1.956	\$1.880	\$0.076
May-14	\$19.20	\$19.06	\$0.14	60.75¢	62.00¢	(1.25¢)	\$1.875	\$1.853	\$0.022
Jun-14	\$18.88	\$18.75	\$0.13	61.00¢	61.25¢	(0.25¢)	\$1.850	\$1.830	\$0.020
Jul-14	\$18.73	\$18.47	\$0.26	59.55¢	59.75¢	(0.20¢)	\$1.836	\$1.822	\$0.014
Aug-14	\$18.64	\$18.32	\$0.32	59.00¢	59.00¢	0.00¢	\$1.830	\$1.800	\$0.030
Sep-14	\$18.46	\$18.29	\$0.17	58.00¢	58.00¢	0.00¢	\$1.812	\$1.800	\$0.012
Oct-14	\$18.17	\$18.03	\$0.14	57.00¢	57.50¢	(0.50¢)	\$1.796	\$1.782	\$0.014
Nov-14	\$17.94	\$17.85	\$0.09	57.00¢	57.25¢	(0.25¢)	\$1.773	\$1.765	\$0.008
Dec-14	\$17.70	\$17.62	\$0.08	56.80¢	57.13¢	(0.33¢)	\$1.753	\$1.743	\$0.010
12 Mo Avg	\$19.46	\$19.15	\$0.31	59.63¢	60.03¢	(0.40¢)	\$1.911	\$1.877	\$0.034

- International: The Oceania cheddar market is receiving support from the increases seen in other dairy product prices. Current production is covering immediate needs and future commitments. Export demand is fairly strong with continued good interest from Russia and China. Milk continues to be diverted away from cheese manufacturing to whole milk powder production, because of price advantages and quicker turnover. Supplies are seen as tight with limited availability on the spot market.
- International: Australian milk production is facing weather related challenges that are accelerating the seasonal decline in milk volumes. Another heat event is covering a majority of Victoria and New South Wales with temperatures in the high 30's to mid-40's Celsius (+100 Fahrenheit). The current heat wave comes at a time when milk production was experiencing a rebound from a previous heat event 7 to 10 days ago. The intense heat has caused milk production reductions of 10% or better in some areas along with isolated instances of cattle fatalities due to heat exhaustion. Prices for dairy products are stable to firm, supported by good demand and tight supplies. China continues to be very active in all dairy markets and appears to pursue any and all dairy products available on the market.
- International: New Zealand exports to China soared 45% last year, due to huge demand for milk powder. Meanwhile, exports to Australia were down 8% and down 4% to the U.S.
- International: Cows in India are producing contaminated milk because they are allowed to eat garbage in the street, according to a news article this week. Many cattle owners allow their cows to wander throughout India's roads and cities where they graze on rubbish dumps and eat plastic bags and other waste products. When they return to their dairies their milk is adulterated with paint, detergents, caustic soda, urea and shampoo.

What's Bearish:

- Spot market: While cheese was higher, butter lost a penny to close at \$1.88/lb on 10 trades and Grade A NDM was also down 1 cent to \$2.04/lb on 23 trades.
- Ag Prices Report: The preliminary Jan milk-feed ratio came out at 2.44 today, the highest number since Jan '08. Yikes!
- Weekly cold storage numbers indicate butter stocks at USDA-selected storage centers increased 19%, or 1.4 million lbs, over the period 01/01 through 01/27.
- Fluid Milk West: Milk production is trending upward, and milk components are also increasing. Manufacturing plant managers also report the drawdown on milk supplies from bottlers is lower than in recent weeks. Some fluid milk handlers/processors are pushing back on previously ordered loads, and those volumes are also clearing into manufacturing. Milk production in CA is continuing a steady trend, moving higher. Dairy operators report temperatures in the state are supporting farm milk production, but they are facing the challenges of water restrictions and shortages as well as an extended wildfire season. December 2013 pool receipts of milk in CA totaled 3.35 billion pounds, 1.3% higher compared to December last year, according to CDFA. Dairy cows in NM are responding to warm daytime and comfortable nighttime temperatures. Farm milk intake volumes continue climbing at balancing plants, and plant operators report they are experiencing light demand from bottling plants. Milk production in AZ continues to climb higher. Manufacturers indicate they are handling in-state as well as some out-of-state milk volumes. Intake volumes are well within the capacity of manufacturing operations.
- Fluid Milk Pacific Northwest: Milk intakes in the region are increasing along seasonally expected volumes. Milk production in UT and ID is mostly steady to higher. Favorable weather for dairies is helping to keep milk volumes up. Good prices for farm milk have producers holding cows in the herd longer to increase volumes.
- Cheese Midwest: Record cheese price levels are resulting in some cheese manufacturers reducing current cheese production from what several weeks ago they had thought it would be now. A number of cheese manufacturers report decreasing sales to both retail outlets and institutional/food service. One manufacturer commented that a number of food service outlets are experimenting with reducing or removing cheese from some menu options, to reduce their need to purchase cheese. Grocery stores are resisting buying more than needed to keep shelves stocked, in the view of almost all manufacturers.
- International: Eurostat reported November milk production in the EU-28 up 4.4%, compared to the same period last year. Changes in November milk output from a year ago for selected countries are: Ireland, +19.7%; Netherlands, +5.9%; Germany, +3.6%; and France +3.7%. Current milk production in Western Europe is increasing along the seasonal trend with some countries 3-5% above week to week comparisons from a year ago. Weather this winter has been comprised of mostly mild and wet conditions, and generally supportive of milk production. Dairy producers appear to be doing all they can to increase milk production to assist in filling the global demand for dairy products. The increase in milk production is throwing fat supplies out of balance and pressuring butter prices lower.
- International: New Zealand milk production in November was reported by DCANZ at 2.96 million tons, up 4.0% from November 2012 and 11.9% higher than two years ago. Current milk production levels are holding up as weather has not been a factor. Recent rains on the North Island have been beneficial to those areas that had been dry over the past few weeks. If the weather continues to be a non-factor, some producers are estimating that milk production could be as high as 8% over last year's drought stricken season.

Recommendation:

Feb-Apr Class III saw big gains this week as spot cheese made new record highs, but we are starting to see evidence of demand destruction in slower cheese sales, with pushback on prices. In addition, spot butter and Grade A NDM were lower for the week. While the larger and long-term fundamentals are still bullish, a near-term correction is certainly possible and maybe likely. This week saw a few loads of both blocks and barrels shake loose in the spot market, while a drop of even 30¢/lb in cheese would still leave us above \$2/lb. We've written previously about a "mini" correction, and it's feeling like a stronger possibility now. A hedger should certainly look into protecting the front months. Sell Mar at \$21.40 or better, or buy Mar \$20.25 PUT options for 25¢. Sell April at \$20.00 or better, or buy April 18.75 PUTs at 35¢. We wouldn't do much beyond that for now as there is still too much uncertainty further on out. Feb has two weeks of its calculation under its belt at above \$23/cwt. Current spot prices work out to about \$24/cwt. Should spot hold a bit longer, Feb will be forced higher, but a correction in spot will cause it to drop. It should be interesting next week.

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