

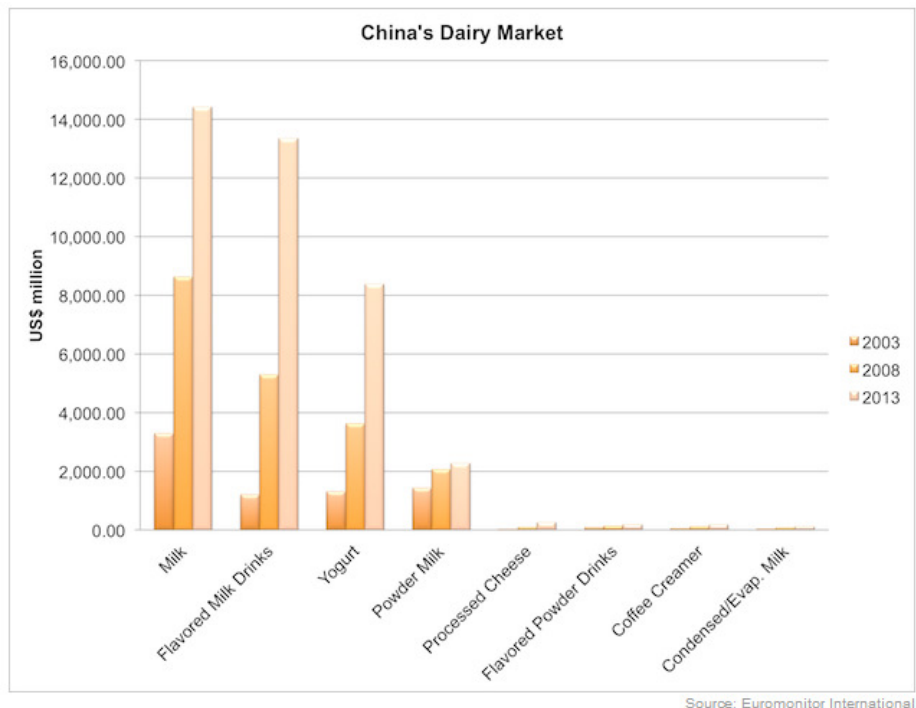
**The KDM Dairy Report – March 28<sup>th</sup>, 2014**

**What's Bullish:**

- Weekly cold storage numbers continue to support a drawdown in cheese stocks this month. For the period 03/01 through 03/24, cheese holdings at USDA-selected storage centers has declined 7%, or 6 million lbs.
- Fluid Milk East: Unpredictable winter-like weather continues to bombard the Northeast and Mid-Atlantic regions in the form of frigid temperatures and snowfall. Northeast region's milk supplies are sufficient, but somewhat sluggish in the Mid-Atlantic region. Contacts in the Southeast report a slight increase in milk production, but not at anticipated levels. Most bottling plants are operating at full capacity. Cream supplies are reported tight throughout the East.
- Fluid Milk Central: The temperatures in the Midwest are averaging about 5 degrees below normal, while the Southern Plains are facing unfavorable dry, windy conditions as a series of dust storms with winds reaching over 50 mph. Milk production in the Central region is mostly steady, with few producers noting any uptick in the milk tank. Bottling demand is softening, but various Class II products such as whipping cream, soft serve, and cultured products are seeing increases in demand. Ice cream makers are busy building inventories for upcoming seasonal demand. Many Class II and Class IV manufacturers are taking extra cream supplies.
- Fluid Milk West: Farm milk production in CA is uneven, with some handlers believing the peak may be in already. Bottler demand is seasonally lower, but volumes of condensed skim clearing into Class 3 production lines are ramping up to match increasing orders. Some condensed skim loads are traveling out-of-state to meet supply gaps in various areas. Milk production in NM is gradually ascending toward the seasonal peak, but at a slower pace compared to the last few weeks. Orders from bottlers are lower, as anticipated due to school spring break schedules, but there's been a steady to higher interest from ice cream and frozen dessert manufacturers. Cream demand into frozen dessert production lines is steady to rising and butter producers are also actively taking in cream volumes ahead of upcoming observances. Cream loads continue to travel outside the Western region to fill Class II demand in the Central region.
- Fluid Milk Pacific Northwest: Milk production in the region continues to gradually increase, but manufacturing milk supplies are short of desired levels in some cases. Some loads of condensed solids are being brought into the region to fortify manufacturing supplies. Dairies continue evaluating various strategies to increase production to meet demand.
- Butter: Prices of butter are steady to higher on strong seasonal demand and very good export orders. The market tone is firm as butter manufacturers finish Easter/Passover retail orders. Production rates are mixed amongst the regions as cream supplies tighten and cream pricing increased. Butter makers look to replenish light inventories.
- Dry Whey Northeast: Inventories are tight, with reports indicating that whey streams are being processed into higher protein powders. The market undertone remains firm.
- Dry Whey Central: Many buyers are having difficulties locating and securing supplies. Domestic interest is very good. However, at current prices, dry whey buyers are only purchasing enough supplies for short-term needs. International demand is moderate, though recent drops in comparable global prices are slowing export orders. Dry whey stocks are adequate for current commitments, but have minimal spot loads available.
- Cheese Northeast: Manufacturers in the region are producing cheese volumes that fulfill their termed contracts, with milk supply levels slightly below what some manufacturers had anticipated. Domestic demand is steady to rising as mozzarella cheese sales increase. Export demand is strong, with added forward sales.
- Cheese Midwest: Some large cheese manufacturers continue to operate at full production levels, with sales commitments running months ahead of production. An official of a fully scheduled multi-plant cheese manufacturer noted that more milk is available, but it is not taken because cheese production is already maxed out. Overall, the majority of manufacturers continue to have strong cheese sales. Some manufacturers have also moved barrels getting some age into the spot market to meet current cheese demand.
- Cheese West: The market is somewhat unsettled as new record prices are counter to typical seasonal trends, but cheese demand is strong. Some buyers are limiting purchases to immediate needs, but export demand is good and pulling stocks to fill previous sales. Cheese production is below year ago levels and mostly steady with January volumes. Competition from butter/powder plants for milk supplies, continues to restrict milk available for cheese production.
- CWT has accepted 15 requests for export assistance to sell 2.094 million lbs of Cheddar cheese, 1.185 million lbs of 82% butter and 308,647 lbs of whole milk powder to customers in Africa, Asia, Central America, the Middle East and North Africa. The product will be delivered March through August 2014.
- The drought in California could continue to drive up dairy and feed prices, according to a news article this week. Food companies are watching the situation very closely. If milk output in California drops, given the global demand that's out there, it could lead to some significant increases on an already high dairy market. The drought could also drive up feed prices sharply in California, which might incentivize producers to sell animals because it costs too much to feed them.
- The demand for cheese is expected to grow at a compound annual growth rate of 7.3% over the next six years, according to a new market report. The global cheese market has witnessed growth in recent years due to a growing fast food industry and its high nutritional value.
- Despite an all-milk price above \$20/cwt since September and sustained income over feed costs of \$7/cwt that normally triggers expansion, milk production increases have been minimal. The slow response to favorable conditions has surprised analysts, even when recognizing a lag time for lower feed costs, forage quality issues and different market and weather conditions in different parts of the country. In addition to a harsh winter, dairymen are catching up with deferred equipment replacement and facility maintenance on top of trying to pay down debt to the bank. They also remember the expansions of 2008, followed by the prices in 2009. Today's milk prices would have spurred new 1,000-cow dairies in the past, but expansions just aren't happening.

Futures Month	Class III 03/28	Class III 03/21	Change	Dry Whey 03/28	Dry Whey 03/21	Change	Cheese 03/28	Cheese 03/21	Change
Mar-14	\$23.26	\$23.29	(\$0.03)	65.20c	65.10c	0.10c	\$2.269	\$2.270	(\$0.001)
Apr-14	\$23.81	\$23.53	\$0.28	65.75c	65.75c	0.00c	\$2.320	\$2.283	\$0.037
May-14	\$21.64	\$21.74	(\$0.10)	63.50c	65.10c	(1.60c)	\$2.105	\$2.099	\$0.006
Jun-14	\$20.49	\$20.87	(\$0.38)	61.55c	63.50c	(1.95c)	\$2.000	\$2.028	(\$0.028)
Jul-14	\$20.30	\$20.60	(\$0.30)	59.13c	60.68c	(1.55c)	\$1.993	\$2.024	(\$0.031)
Aug-14	\$20.04	\$20.29	(\$0.25)	58.13c	60.00c	(1.88c)	\$1.972	\$1.995	(\$0.023)
Sep-14	\$19.73	\$19.92	(\$0.19)	57.63c	58.58c	(0.95c)	\$1.945	\$1.963	(\$0.018)
Oct-14	\$19.37	\$19.50	(\$0.13)	57.75c	57.70c	0.05c	\$1.908	\$1.915	(\$0.007)
Nov-14	\$18.88	\$19.05	(\$0.17)	57.38c	57.30c	0.08c	\$1.865	\$1.866	(\$0.001)
Dec-14	\$18.59	\$18.67	(\$0.08)	57.38c	57.18c	0.20c	\$1.830	\$1.830	\$0.000
Jan-15	\$18.30	\$18.35	(\$0.05)	56.05c	56.05c	0.00c	\$1.820	\$1.800	\$0.020
Feb-15	\$18.08	\$18.05	\$0.03	54.00c	54.00c	0.00c	\$1.820	\$1.800	\$0.020
12 Mo Avg	\$20.21	\$20.32	(\$0.11)	59.45c	60.08c	(0.62c)	\$1.987	\$1.989	(\$0.002)

- Grains: Chinese pigs eating soybeans have cut the U.S. supply to a 1965 low, according to an article in the WSJ this week. Barge convoys are heading to export depots at a record pace as demand surges from pig farmers in China. One Illinois-based terminal owner expects to be out of soybeans by the end of April. The unexpected demand has led to the second biggest rally to start the year since 2005.
- International: Global demand for dairy commodities such as milk powders and infant formulas has been surging on growing Asian dairy consumption. Despite the strength of demand, the milk supply in Australia has been flat. Aussie milk processors expect intense competition for milk for the next several years and are working to secure long-term supply agreements with producers. Some are even helping to finance growth projects for dairy farmers.
- International: The shortfall in Chinese milk output, which has sent imports soaring, will continue until at least 2015, according to the country's top dairy supplier, China Mengniu Dairy. The shortfall in Chinese milk output - attributed to poor weather, disease and a government drive to close backyard groups in favor of larger operators whose quality control can be better monitored - has driven the country to record dairy imports, supporting international prices in turn. Imports as a proportion of the country's dairy consumption has soared 10-fold to some 20%. That proportion is expected to nudge even higher this year, as it is estimated China's dairy imports in 2014 will be equivalent to 13.4% of the world total.
- International: China's fluid milk consumption is expected to increase 7% as a result of population growth, urbanization, and rising income, according to the USDA, and will need more imports to support this demand. Growth in flavored milk and yogurt are also seeing steep demand increases (see chart). Yogurt sales surpassed those of powdered milk back in 2005, and now accounts for almost 18% of China's total drinking of fluid milk products.



#### What's Bearish:

- Spot Market: Blocks finished the week down 4¢ to settle at \$2.38½/lb on 5 trades, while barrels lost 2¢ to close at \$2.29/lb on 11 trades. Butter shot up 8¢ to settle at \$2.00/lb on just 5 sales, but Grade A NDM was down 2¢ to \$2.03/lb on 2 trades.
- Dairy cow slaughter for the week ended 03/15 totaled 60,800 head, down 6.9% (4,500 head) vs. the same period a year ago.
- Florida's farm production is fairly flat, but Class I demand is down due to spring break, which is resulting in heavy milk supplies. 120 loads were exported this week, up from 98 last week.
- Dry Whey West: Despite current tight supplies, increased competition from the EU at lower prices has put pressure on U.S. sales. Brokers report resistance from export buyers at current price levels.
- NDM: The market tone is weak as domestic demand is slowing and some buyers are concerned about a potential drop in prices. Many end users are only buying supplies they need. Demand from bottlers is edging lower, which is freeing up some milk intake volumes for drying.
- South Dakota granted permits for additional 24,000 head of dairy cattle on various farms along mostly the state's eastern border.
- International: January milk production in Western Europe was up 5.1% from January 2013. Spring has come early to Western Europe with some cows in Holland already on pastures. The new quota year begins April 1 and producers are entering the new production year with strong production. Weather, milk prices, and feed costs are very good from the producer perspective. Increases in milk volumes are maximizing capacities at some plants. Additional drying facilities are anticipated to come on line in the near term. Dairy product prices are under downward pressure, due to the significant increase in milk supplies, a stronger Euro, weaker demand from China for milk powders, and uncertainty regarding future trade with Russia. Most countries in Eastern Europe are showing increases in milk production with Poland, the largest producer, showing a 7.3% gain in January. Production is filling domestic needs and expanding supplies available for export. Export demand is unsettled, primarily due to the uncertainty with Russian trade.
- International: Australian late season milk production is above year ago levels. Good milk prices are prompting producers to extend late season production with supplemental feeding. Efforts are being made to expand milk powder production in Australia by various entities. New Zealand milk production in January was up 7.4% from January 2013 and 12% higher than two years ago. The expanded year end volumes are allowing manufacturers to fill their contracted orders with additional supplies available for the spot market. Oceania butter prices worked lower over the past fortnight as global supplies have become more readily available. Demand from Russia has declined as the ruble has weakened. Southeast Asian demand remains fairly good, however, some buyers are holding off purchases in hopes that increased supplies in the Northern Hemisphere will pressure prices lower.

#### Recommendation:

Spot cheese climbed to new record levels, but then eased back the rest of the week. Blocks saw their first trades since Feb. With cheese prices at levels that are attracting a few loads in the spot market, we may be in for some more pressure next week. Instead of a plunge lower like we've seen in the past, however, we'd expect buyers to support the market on the way down. Of some concern is our powder market. Prices declined in the last GDT auction, while weakness is seen in European prices. As milk production increases in the Midwest and Northeast, there will be more supply for vat, churn and dryers. Buyers are likely to be less aggressive. There are lots of long-term bullish fundamentals still in play, but the market is due for some type of correction. We don't know when, but producers should be loading up on PUT options while they can! Consider entering the following target orders: May 20.25 PUT at 25¢, June 19.00 PUT at 35¢, July 18.75 PUT at 35¢. Be more aggressive in getting the front months done!

This material has been prepared by a sales or trading employee or agent of KDM Trading, Inc. and is, or is in the nature of, a solicitation. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that KDM Trading, Inc. believes are reliable. We do not guarantee that such information is accurate or complete and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades.