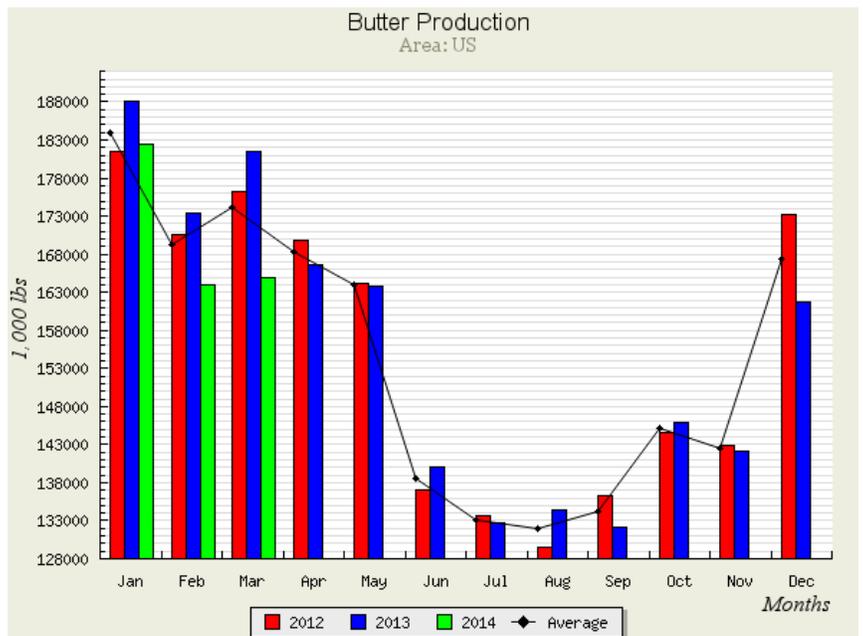
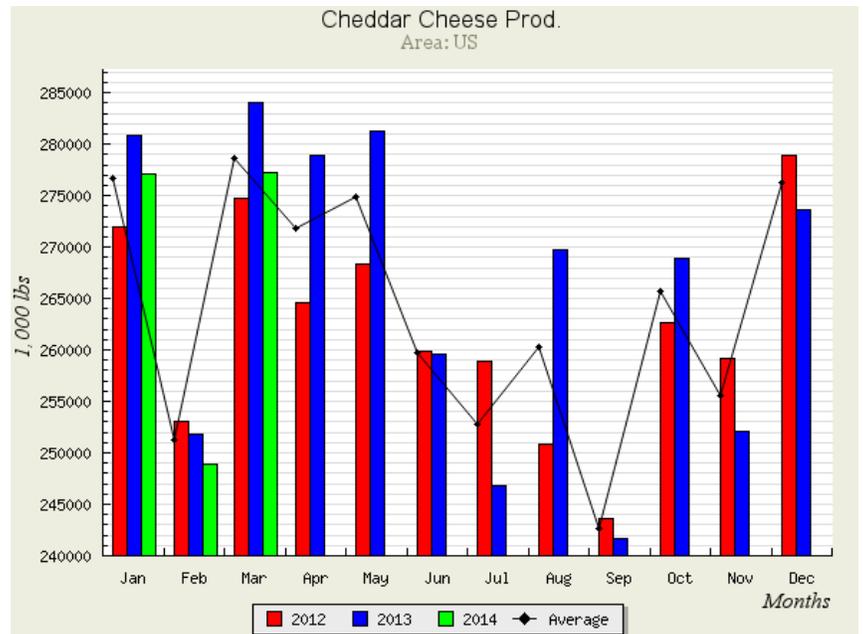


**The KDM Dairy Report – May 2<sup>nd</sup>, 2014**

**What's Bullish:**

- Dairy Products Report: Butter output in March was down 9% vs. 2013, according to USDA. Total cheese output increased 1%, but Cheddar cheese output was down 2.4% and American cheese output declined 1.4% over the same period.
- CWT has accepted 26 requests for export assistance to sell 873,031 lbs of Cheddar, Gouda and Monterey Jack cheese, 3.748 million lbs of 82% butter and 2.668 million lbs of whole milk powder to customers in Asia, Africa, Central and South American, Europe, the Middle East, and North Africa. The product will be delivered April through October 2014.
- Several news stories this week report ag analysts Rabobank forecast a steady decline in dairy prices over the next year as supplies increase from exporting countries and the growth in demand from China slows due to slower economic growth.
- Fluid Milk Central: Milk production at the farm is maintaining to slightly higher, but below expectations. Bottling orders are flat, but buyer interest for cream is active, keeping supplies relatively tight.
- Fluid Milk West: CA milk production is beyond the seasonal peak in most areas. Sales volumes into bottling plants are declining, but condensed skim sales into ice cream and frozen dessert manufacturing plants are on the rise. Strong winds moved through NM over the weekend, carrying dust and debris. The wind disrupted cow comfort in many areas of the state and daily milk production moved lower. Some manufacturing plants experienced wind damage and power outages, resulting in lost processing times. Fewer loads of out-of-state milk cleared into NM manufacturing plants. AZ milk production has peaked, with processors reporting milk intakes receding from recent highpoints. Class I demand is light, but cream demand is active in the West as some butter churn operators are rebuilding inventories before summer. Other plants are churning to fill current international orders.
- Butter: Prices moved higher as sales improved domestically while export orders are active. The market tone is bullish. Butter production is mostly steady with a few increases as milk supplies are becoming readily available. Competition for spot loads of cream is increasing in the Central and Western regions. Given the current market conditions, many butter manufacturers have not built inventories like they have in previous years. Stocks of butter are light.
- Dry Whey Central: Prices moved higher this week on a firm market. Buyers are actively looking for supplies, but facing stiff competition in the spot market and having to resort to the resale market in some cases. Manufacturers are fulfilling contract commitments for export. Inventories of dry whey are being managed closely to ensure obligations in the near and mid-term are met.

Futures Month	Class III 05/02	Class III 4/25	Change	Dry Whey 05/02	Dry Whey 4/25	Change	Cheese 05/02	Cheese 4/25	Change
May-14	\$22.75	\$22.70	\$0.05	68.025c	66.750c	1.28c	\$2.187	\$2.198	(\$0.011)
Jun-14	\$21.55	\$20.83	\$0.72	67.000c	66.475c	0.53c	\$2.065	\$2.010	\$0.055
Jul-14	\$20.55	\$20.23	\$0.32	65.000c	62.250c	2.75c	\$1.979	\$1.963	\$0.016
Aug-14	\$19.94	\$19.83	\$0.11	63.500c	59.500c	4.00c	\$1.930	\$1.936	(\$0.006)
Sep-14	\$19.87	\$19.68	\$0.19	62.000c	57.750c	4.25c	\$1.933	\$1.936	(\$0.003)
Oct-14	\$19.51	\$19.26	\$0.25	59.550c	57.000c	2.55c	\$1.910	\$1.886	\$0.024
Nov-14	\$19.05	\$18.80	\$0.25	58.750c	56.250c	2.50c	\$1.857	\$1.841	\$0.016
Dec-14	\$18.62	\$18.58	\$0.04	57.500c	56.250c	1.25c	\$1.830	\$1.825	\$0.005
Jan-15	\$18.25	\$18.08	\$0.17	54.750c	55.000c	(0.25c)	\$1.812	\$1.805	\$0.007
Feb-15	\$18.15	\$18.01	\$0.14	53.975c	53.975c	0.00c	\$1.810	\$1.817	(\$0.007)
Mar-15	\$18.05	\$17.93	\$0.12	53.000c	53.000c	0.00c	\$1.810	\$1.799	\$0.011
Apr-15	\$17.98	\$17.90	\$0.08	52.500c	52.500c	0.00c	\$1.800	\$1.800	\$0.000
<b>12 Mo Avg</b>	<b>\$19.52</b>	<b>\$19.32</b>	<b>\$0.20</b>	<b>59.629c</b>	<b>58.058c</b>	<b>1.57c</b>	<b>\$1.910</b>	<b>\$1.901</b>	<b>\$0.009</b>



- Dry Whey West: Domestic prices are firming as whey stocks are tight. The bulk of domestic production is committed and there are few reports of spot whey available from manufacturers. Demand is good for domestic whey, but prices are keeping many buyers in a short position. Export sales are continuing, although buyers are cautious about buying too far ahead.
- Spot Market: Butter was the lone gainer, shooting up 16½¢ on just 1 trade during the week, to settle at \$2.07½/lb.

#### What's Bearish:

- Spot Market: Blocks fell 14¢ during the week on 15 trades, settling at \$2.07/lb while barrels gave up 12½¢ on 4 trades to close at \$2.05½/lb. Grade A NDM lost 3¼¢ on 3 trades to settle at \$1.77¾/lb.
- Fluid Milk East: Manufacturing milk supplies in the Northeast and Mid-Atlantic regions are seeing significant increases with current upticks in milk production volumes. Balancing plants have increased production schedules for some dairy products in order to handle additional milk volumes. The Southeast region is experiencing steady gains in milk production volumes as mild temperatures improve cow comfort levels. Bottling sales have fallen off. Florida's milk production is leveling off in response to hot humid weather conditions, but milk exports are rising, with 180 spot loads transferring compared to 143 last week. Condensed skim supplies are heavy and demand is sluggish. Loads are being offered at discounts, and finding homes in other regions.
- Dry Whey Northeast: Production rates are higher with increasing milk volumes made available to cheese plants. Spot market activity is limited while demand is mixed. Inventories are building.
- NDM East: Prices moved lower this week as strong increases in manufacturing milk volumes increase production. Inventory levels are expanding as surplus volumes of condensed skim channel to low heat nonfat powder operations. Buyers are making NDM purchases for immediate needs, careful not to expand inventories as the market trends downward.
- NDM Central: Prices moved lower in a softening market. Buyers are in a "wait and see" approach, generally purchasing loads to meet immediate needs and not much more. Milk supplies are becoming increasingly available, causing some milk processors to dry increasing amounts of NDM. Domestic demand is weak.
- Cheese: Production is steady to building slowly depending on local milk intakes. More plants are working longer hours where milk is available. The increased cheese production is helping to build some inventory. Block and barrel stocks are said to be in a better balance for current demand. Cheese prices are mixed with a weaker undertone developing. Domestic demand is good with some buyers looking to purchase additional inventory on price breaks. Export demand is steady with cheese plants servicing existing orders. Increased cheese production in the European Union is being noted in export circles.
- Cheese and butter stocks are starting to build. Weekly cold storage numbers indicate cheese stocks at USDA-selected storage centers are now up 2%, or 1.349 million lbs, over the period 04/01 through 04/29. Butter stocks over the same period are up 10%, or 1.815 million lbs.
- Dairy cow slaughter for the week ended 04/19 totaled just 52,000 head, the lowest weekly total since the second week in January, and a decline of 16.5% vs. the same period last year.

#### Recommendation:

For the third consecutive month in 2014, both cheddar and butter output have lagged prior year levels, according to this week's Dairy Products Report (see charts above). Butter output has been hit particularly hard as U.S. milk production focused on powder production to supply export demand. But the tide appears to be turning, at least in the short term. The entire Eastern part of the country is awash with milk, with balancing plants running on longer schedules to handle the surplus. The strength in NDM is gone and cheese prices took quite a hit this week in the spot market as well. Butter is the lone bullish milk component as inventories remain light and the export bid is still there. Output in the Midwest is finally picking up as warmer weather arrives, but the West is already past the peak. While overall we see some weakness ahead, weather/drought may play a key role in supporting milk prices longer term as that region of the country struggles with their water supply and growing feed costs. June futures saw solid gains this week as it was sitting at more than a \$2 discount to the spot market on Monday. With just two weeks to go until it would start pricing, traders decided to close the spread. But after peaking at \$21.89 on Thursday, continuously weakening cheese prices in the spot market nearly closed the spread, with June settling down 27¢ on Friday. Current spot prices work out to about \$21.66, with June futures settling at \$21.55. Should cheese prices continue to fade next week, June will no doubt head lower as well. We would aggressively get some PUT coverage done for June and July. Grab the June 20.25 PUT for 20-25¢ and try to get the July 19.00 PUT at 25-30¢. Beyond July, futures are already predicting further weakness as all contracts are below \$20. We wouldn't sell these months at this point. As mentioned above, weather could yet play quite a role, and demand from China will most likely pick up again, short of a real economic crisis. Buy PUTs when you CAN, not when you HAVE to!

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