

**The KDM Dairy Report – May 30<sup>th</sup>, 2014**

**What's Bullish:**

- Ag Prices Report: The milk-feed ratio for May was preliminarily estimated at 2.28, down from 2.43 in April. It's the 3<sup>rd</sup> consecutive month the ratio has declined. Despite lower feed costs, milk prices have fallen even more quickly.
- Butter: Prices are stronger on a bullish market. Many butter operators in the Northeast and Central regions churned at higher rates during the holiday weekend with additional milk and cream available. In the West, churning is mostly steady as milk production is past peak and some operators elect to sell cream to ice cream makers. Prior export orders of 82% are being filled, but sales are reduced as U.S. butter prices are no longer competitive with most international markets. Current prices have slowed some domestic sales, but better than expected demand has inhibited manufacturers from rebuilding inventories to comfortable levels. Bulk butter spot load availability is limited.
- Dry Whey Northeast: Prices continued to trend upwards this week. Heavy milk supplies going to cheese manufacturers increased dry whey production rates across the region, but buyers are reporting that dry whey is relatively hard to find. More transactions are occurring through resellers. Demand for dry whey is good with loads being channeled to ice cream production. The market tone is firm.
- Dry Whey West: Increased milk delivered to cheese plants over the holiday weekend is helping to increase and/or maintain dry whey production. Whey stocks are increasing with manufacturers able to catch up on some back orders. However, export demand is good. Buyers are looking to increase purchases, but tight stocks are limiting availability.
- NDM Central: Milk processors dried additional volumes over the holiday weekend. Buyers are becoming more comfortable with current prices, making bigger orders. Domestic demand is active. Low/medium heat NDM stocks are moderate. High heat NDM prices decreased on lower spot trading. The market tone is unsettled as buyer interest is picking up, but supplies are difficult to secure. Production rates are at reduced levels.
- Cheese Midwest: A number of Wisconsin cheese manufacturers operating retail outlets as part of plant facilities, commented on particularly busy plant store sales over the Memorial Day weekend. The sales volume last weekend was a welcome addition to already strong overall sales. Surplus holiday milk availability over the holiday weekend was not a big factor for many Midwest cheese plants with contracted milk supplies, or for cooperative cheese plants handling member milk. Most plants were already scheduled at full or near full production before the weekend began, using already available milk. More cheddar is moving into aging programs at current price levels. For some plants, this has helped bridge what is traditionally more of a lull period for food service sales, which typically will increase moving toward fall. Some cheese manufacturers, in commenting on overall buyer interest, have mentioned recent interest in barrels as being particularly strong.
- Cheese West: Cheese plants continue to operate at near capacity. However, cheese demand is good with manufacturers able to clear inventories on a regular basis. Export sales are slowing as international competition increases, but retail demand is steady with some increased food service ordering.
- International: Total cheese output in March for Australia was down 7.3% vs. a year ago and down 11.3% YTD. Cheddar output declined 9.8% and 7.5% respectively.
- Spot Market: Butter jumped 12¢ with 15 trades during the week to settle at \$2.30/lb. Grade A NDM gained 5¼¢ on 5 trades to close at \$1.84¼/lb.

Futures Month	Class III 05/30	Class III 05/23	Change	Dry Whey 05/30	Dry Whey 05/23	Change	Cheese 05/30	Cheese 05/23	Change
May-14	\$22.63	\$22.58	\$0.05	67.500¢	67.650¢	(0.15¢)	\$2.171	\$2.172	(\$0.001)
Jun-14	\$20.83	\$21.06	(\$0.23)	67.225¢	66.500¢	0.72¢	\$1.981	\$2.008	(\$0.027)
Jul-14	\$20.62	\$20.58	\$0.04	64.950¢	62.875¢	2.08¢	\$1.968	\$1.990	(\$0.022)
Aug-14	\$20.30	\$20.23	\$0.07	60.875¢	61.750¢	(0.88¢)	\$1.966	\$1.970	(\$0.004)
Sep-14	\$20.34	\$20.31	\$0.03	58.500¢	59.775¢	(1.28¢)	\$2.004	\$1.982	\$0.022
Oct-14	\$19.98	\$19.99	(\$0.01)	58.750¢	59.000¢	(0.25¢)	\$1.975	\$1.970	\$0.005
Nov-14	\$19.52	\$19.49	\$0.03	57.550¢	58.250¢	(0.70¢)	\$1.929	\$1.923	\$0.006
Dec-14	\$19.01	\$18.94	\$0.07	56.275¢	56.275¢	0.00¢	\$1.886	\$1.870	\$0.016
Jan-15	\$18.50	\$18.47	\$0.03	54.950¢	55.000¢	(0.05¢)	\$1.840	\$1.840	\$0.000
Feb-15	\$18.26	\$18.23	\$0.03	54.425¢	53.475¢	0.95¢	\$1.825	\$1.825	\$0.000
Mar-15	\$18.20	\$18.15	\$0.05	52.500¢	52.500¢	0.00¢	\$1.840	\$1.840	\$0.000
Apr-15	\$18.20	\$18.14	\$0.06	52.000¢	52.000¢	0.00¢	\$1.830	\$1.832	(\$0.002)
<b>12 Mo Avg</b>	<b>\$19.70</b>	<b>\$19.68</b>	<b>\$0.02</b>	<b>58.792¢</b>	<b>58.754¢</b>	<b>0.04¢</b>	<b>\$1.935</b>	<b>\$1.935</b>	<b>(\$0.001)</b>

**What's Bearish:**

- Spot Market: Blocks fell 6¢ for the week to settle at \$1.96/lb while barrels gave up 8¼¢ to close at \$1.93¼/lb. There were 6 trades each for blocks and barrels.
- Weekly cold storage numbers show cheese stocks increased 2% and butter stocks increased 4% over the period 05/01 through 05/26.
- Dairy cow slaughter for the week ending 05/17 totaled just 47,900 head, the lowest weekly number since the first week in Jan.
- Fluid Milk Northeast: Manufacturers in the Northeast and Mid-Atlantic report heavy volumes for processing. Some balancing plants were unable to receive discounted milk offerings due to heavy volumes already in the plants. Class I demand has not held up as school closings and the Memorial Day Holiday period influenced sales.
- Fluid Milk Southeast: Though hot wet weather conditions are influencing cow comfort levels and milk output is lower, declines in bottling orders due to school closings has resulted in heavy manufacturing milk supplies in the region. Florida milk production is also seeing steady declines, with high temperatures during the day and night affecting cow comfort. However, again because of a significant crop in Class I demand due to the Memorial Day holiday and the impact of schools letting out, milk supply/demand dynamics favor stronger supplies. 150 spot loads were exported this week, up 30 loads from last week. Condensed skim supplies easily exceed demand. Prices are being pressured lower with offerings near Class I in the spot market. Dryer operations are running full schedules to handle the increase in supplies.
- Fluid Milk Central: The cows are responding to the warmer temperatures with increased production rates. Spot loads of milk are readily available with many discounts during and after the holiday weekend. Milk spot loads prices are lower, ranging from \$4.00 under to \$1.00 over Class. Bottlers report slower sales from a combination of the holiday weekend, increasing number of educational institutions closing for the school year, and higher retail prices causing consumer pushbacks. Some milk processors skimmed and/or sent additional volumes towards cheese production during the Memorial Day weekend. Condensed skim supplies are heavy and further discounted.

- Fluid Milk Southwest: Farm milk production in CA is past peak intakes, but is holding mostly steady along expected volumes. Some additional milk was available over the holiday weekend, but no problems were reported in handling it. Class I interest is moderate with schools closing soon in many districts. Nonfat dry milk plants are busy as dryers are running full schedules to clear supplies of skim. NM milk production is mostly steady. Some increased milk for processing is being offered as schools end their semester. Cheese plants are comfortable with the extra supplies to fill orders. Temperatures remained in a comfortable range as cooler nighttime temperatures moderated any highs for the day. First crop and early second crop alfalfa are being harvested. Daytime temperatures reached triple digits this week across much of AZ, but milk supplies remain plentiful. Dryers are running at near full schedules to clear skim milk supplies.
- Fluid Milk Pacific Northwest: Milk volumes continue to slowly increase in the region. Class I demand is slowing as many schools are nearing the end of the semester. UT and ID milk production is also slowly increasing and nearing peak production for the year. Processing capacity in the region is sufficient to handle the current milk supplies. Alfalfa harvesting is progressing and the irrigation season is in full swing with mostly good to excellent spring supplies.
- Dry Whey Central: Spot load availability improved as higher cheese production resulted in increased supplies of whey heading into the dryer. Domestic demand is moderate with purchasing actions mixed depending upon buyer inventory situation. Some end users are in a wait and see approach to see what the prices will do while others are taking advantage of reduced offering prices. International interest is light as U.S. whey prices are currently not competitive with other global markets.
- NDM East: Price levels for low/medium nonfat dry milk continue to descend at the top of the range due to lower priced indices. Available milk supplies remain heavy in the region, keeping dryers running. Buyers anticipate a further weakening of prices as some suppliers move according to the downward pressure on the market. Some buyers, in preparation of a flat market, are extending their inventories.
- NDM West: Prices moved lower this week. Recent large sales at lower prices leave some buyers looking for more offers at even lower prices. Manufacturers are mostly content with current inventories in spite of the current elevated production. Low/medium heat production is heavy in the West with the bulk of production geared towards clearing milk supplies as quickly as possible.
- Cheese Northeast: Milk supplies were very strong throughout the weekend, leading to increases in cheese production rates as some manufacturers continue full production schedules following the holiday period. Some cheese manufacturers report milkfat component levels are down and reducing cheese yields. Inventories are adequate for established market channels. Export demand and trade interest is active.
- International: National Australia Bank analysts predict the dairy price retreat has further to go. Moderating Chinese imports and increasing global milk production were cited as the primary causes. Prices have recently fallen 20% from the highs in Feb, with another 20% drop predicted.

#### **Recommendation:**

July Class III finished the week up 4¢, but it took a wild path to get there as volatility ratcheted higher in this holiday-shortened week. Spot barrels fell sharply on Wednesday, precipitating a limit move lower. Follow through selling on Thursday saw the contract move from a high on Wed of \$21.44, to a low on Thursday of \$20.08, an impressive \$1.36 range in 24 hours. Finally, on Friday, bidders came back for barrels and the contract settled up 38¢ for the day, or a net 4¢ for the week! Nearby Class III contracts saw similar volatility. The market is clearly nervous as it wrestles with bearish supply fundamentals vs. surprisingly robust domestic demand. In particular, butter buyers didn't seem to care that U.S. prices are well above international levels as spot buyers pushed the price up 12¢ this week to \$2.30/lb. Spot NDM saw some strength as well. With falling cheese prices, the result has been a widening spread between Class III and Class IV, with Class IV once again taking a leadership role. Current spot prices work out to about \$20.50/cwt for Class III and \$23.65/cwt for Class IV. The spread of over \$3/cwt should work to attract milk away from cheese production and into the churn/dryers, supporting cheese prices longer term. It also works to avoid a negative PPD situation for producers. In the near term, the extra milk available over the Memorial Day weekend, combined with school closings en-masse, may result in abundant manufacturing milk supplies. We wouldn't be surprised to see active sales over the coming weeks in the spot market. However, it appears domestic cheese sales are very good, with strong barrel demand coinciding with the grilling season finally getting under way. We would expect there to be buyers to snap up product on price breaks. And then, much will be up to Mother Nature as the grains look like they are off to a fine start which will lower feed costs, but unexpected heat and continuing drought would work to curtail milk production. We continue to recommend a PUT option strategy to establish a floor price for your milk. Decide what you are willing to spend each month, whether that is 15¢ or 35¢ or something else. See what level of protection you can purchase, or enter target orders for minimum levels that are acceptable for your operation. But get a plan in place as it looks like we might be in for a bumpy ride for awhile.

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