

**The KDM Dairy Report – June 6<sup>th</sup>, 2014**

**What's Bullish:**

- Spot Market: Blocks gained 9¢ for the week on just 6 trades to settle at \$2.06/lb. Barrels were up 3½¢ to \$1.96¼/lb on heavier trade of 18 loads. NDM inched 1¼¢ higher to \$1.85¼/lb on 3 trades, while butter fell 7¼¢ to \$2.22¼/lb, with 29 loads exchanging hands.
- Dairy Products Report: While cheese output saw an annual increase, butter output in April was down 4.9% vs. April '13 and fell 4.2% from March. Total dry whey production was down 12.8% from a year ago and manufacturers had 18.8% fewer stocks on hand at the end of the month.

Futures Month	Class III 06/06	Class III 05/30	Change	Dry Whey 06/06	Dry Whey 05/30	Change	Cheese 06/06	Cheese 05/30	Change
Jun-14	\$21.24	\$20.83	<b>\$0.41</b>	67.575c	67.225c	<b>0.35c</b>	\$2.026	\$1.981	<b>\$0.045</b>
Jul-14	\$20.38	\$20.62	<b>(\$0.24)</b>	64.750c	64.950c	<b>(0.20c)</b>	\$1.965	\$1.968	<b>(\$0.003)</b>
Aug-14	\$20.33	\$20.30	<b>\$0.03</b>	61.900c	60.875c	<b>1.03c</b>	\$1.987	\$1.966	<b>\$0.021</b>
Sep-14	\$20.32	\$20.34	<b>(\$0.02)</b>	58.500c	58.500c	<b>0.00c</b>	\$2.000	\$2.004	<b>(\$0.004)</b>
Oct-14	\$20.05	\$19.98	<b>\$0.07</b>	58.975c	58.750c	<b>0.23c</b>	\$1.977	\$1.975	<b>\$0.002</b>
Nov-14	\$19.53	\$19.52	<b>\$0.01</b>	57.525c	57.550c	<b>(0.02c)</b>	\$1.932	\$1.929	<b>\$0.003</b>
Dec-14	\$19.05	\$19.01	<b>\$0.04</b>	56.100c	56.275c	<b>(0.17c)</b>	\$1.894	\$1.886	<b>\$0.008</b>
Jan-15	\$18.49	\$18.50	<b>(\$0.01)</b>	54.950c	54.950c	<b>0.00c</b>	\$1.840	\$1.840	<b>\$0.000</b>
Feb-15	\$18.26	\$18.26	<b>\$0.00</b>	54.000c	54.425c	<b>(0.42c)</b>	\$1.837	\$1.825	<b>\$0.012</b>
Mar-15	\$18.27	\$18.20	<b>\$0.07</b>	52.500c	52.500c	<b>0.00c</b>	\$1.840	\$1.840	<b>\$0.000</b>
Apr-15	\$18.28	\$18.20	<b>\$0.08</b>	52.000c	52.000c	<b>0.00c</b>	\$1.840	\$1.830	<b>\$0.010</b>
May-15	\$18.24	\$18.24	<b>\$0.00</b>	52.000c	52.000c	<b>0.00c</b>	\$1.840	\$1.830	<b>\$0.010</b>
<b>12 Mo Avg</b>	<b>\$19.37</b>	<b>\$19.33</b>	<b>\$0.04</b>	<b>57.565c</b>	<b>57.500c</b>	<b>0.06c</b>	<b>\$1.915</b>	<b>\$1.906</b>	<b>\$0.009</b>

- Outlook for U.S. Ag Trade Report: USDA expects 2014 Ag Exports to reach a record \$149.5 billion, up \$6.9 billion from their last estimate. Dairy products were raised \$500 million to \$6.8 billion as exports are higher than anticipated due to continuing strong global demand.
- Despite higher prices and good margins, dairy farmers have been slow to expand, according to a news report this week. Dairy producers are still playing catch-up from 2009 and continue to be cautious with their expansions plans.
- Fluid Milk Southwest: Milk production in NM is trending downward as daytime temperatures heat up. Ice cream/frozen dessert orders increased this week, while orders for custom soft serve mixes are steady to higher. In AZ, farm milk intakes are trending lower. Processors indicate daytime temperatures in some areas are topping 100 degrees and lingering at that level for several hours. Class I orders picked up early this week, easing the amount of milk having to clear through butter/powder. Steady to increasing orders for condensed skim from ice cream and other Class II manufacturers are easing pressures on dryer schedules. Butterfat components are dropping seasonally, especially in areas where temperatures are reaching over 100 degrees during the day. Cream contract sales are seasonally active, and cutting into availability of spot cream volumes. Cream demand is active in the Southwest, with butter makers and frozen dessert/soft serve/ice cream manufacturers showing interest.
- Butter: Demand is good, especially bulk supplies, while a few manufacturers noted slower print sales in the Central region. Supplies are adequate for contractual obligations, but many manufacturers have not yet built up inventories like in years past.
- NDM West: Domestic interest is building after the recent decline in prices, and end users note some Q3 and beyond needs require fulfillment. A few Western manufacturers indicate that, although NDM production continues at a steady pace, uncommitted inventories are light.
- Cheese Northeast: Manufacturers are continuing full production schedules, but with marginal increases in orders, some cheese makers noted that maintaining rather than building inventories is the precedence. While domestic sales are slowing, export demand and trade is helping move product.
- Cheese Midwest: Cheese manufacturing is active, bolstered by strong milk intakes, but barrel interest is strong, with some Midwest manufacturers being challenged in meeting increased recent demand. The Midwest cheese market is widely viewed as firm with inventories are in good balance.
- CWT has accepted 11 requests for export assistance to sell 850,984 pounds of Cheddar and Gouda cheese and 434,311 pounds of whole milk powder to customers in Asia, Africa, Central America, the Middle East, and North Africa. The product will be delivered June through November 2014.
- Exports: U.S. dairy exports in April remained strong, coming in just below March's record levels, and up 8% vs. one year ago. Exports of NDM/SMP at 53,147 tons was just the third time ever above 53k tons, while cheese exports were the second highest ever at 33,759 tons (up 32% vs. 2013). Cheese sales to South Korea and Japan both topped Mexico for the first time. Butterfat exports were their lowest since last June, but double last April's level, while dry whey exports were up 9% from a year ago, and the third highest level ever. U.S. exports were equivalent to 16.9% of total milk solids produced in April.
- International: Australian milk production remains steady, but July-April production was 0.8% below the previous year. Timely autumn rains have prompted some good grass growth, however, high protein hay is less available than in previous years. Dairy cattle exports from Australia are running above last year, with China the main destination point. New Zealand milk production has entered the typical low production period for the year. Some producer cooperatives indicate that over half of the cows have been dried off and moved to winter pastures. Cheese prices moved higher on the upper end of the range. Product availability is limited with most manufacturers producing only what is needed to cover commitments. Oceania cheddar averaged a U.S. equivalent \$2.11/lb this week.
- International: This week's GDT auction recorded an overall 4.2% drop in the price index, but cheddar cheese was up 8% to a U.S. equivalent \$1.92/lb.
- International: The director of global brands and nutrition at Fonterra sees global demand for milk increasing. Jacqueline Chow was quoted in a news article this week saying demand for milk shows no sign of abating, especially in developing nations with a growing middle class. She expects the world to require another 100 billion liters of milk by 2020.
- International: Indonesia is still 60% reliant on milk imports to meet domestic demand, according to the Ag Ministry there, and they have so far been unable to catch up. Domestic milk demand is growing at a 7% annual rate, but milk production has only been able to increase 3.3% per year.

Indonesia is characterized by low per capita milk consumption, so the milk industry has ample room for growth in Southeast Asia's largest economy.

#### What's Bearish:

- Dairy Products Report: Cheddar cheese output in April was up 1% vs. a year ago and up 1.5% from March. Total cheese output increased 2.2% over last April, but declined 1.4% from March.
- Dairy cow slaughter for the week ended 05/24 totaled just 48,400 head, down 14.8% vs. the same period last year.
- High milk prices have sent retail sales of fluid milk, cheese and yogurt lower, according to data released by Dairy Management, Inc. Milk volumes sales through May 18<sup>th</sup> were down 5.5% vs. last year. The average household buys 35 gallons of milk/year, down from 39 gallons in 2011. Cheese sales were down 4.7% YTD, while Yogurt sales fell 4.8% in May.
- Fluid Milk East: Northeast manufacturing milk supplies are heavy, with volumes managed to prevent milk from hitting the ground. Farm-level milk production is maintaining at near peak volumes. Southeast milk production is slowing as hot weather decreases cow comfort levels, but milk supplies remain heavy, with most secondary manufacturing plants employed to handle the increases. Milk haulers are experiencing backups at a number of plants, with reports of 24 hours wait times. Class I demand continues to feel the impact of school closing. Florida's milk production is declining as the weather continues to heat up, but bottling sales are down, causing exports to jump to 240 loads for this week, an increase of 90 loads from last week. Dryers are running at capacity at most manufacturing plants to manage heavy supplies.
- Fluid Milk Central: Milk production in the region is steady to higher. Many schools are letting out this week, further slowing bottling orders for many milk handlers. With extra milk available, spot loads of milk ranged from \$5.00 under to Class. Discounts for condensed skim continue to deepen.
- Fluid Milk West: Various plant operators in CA report milk loads are still readily available on the spot market, and some loads are clearing among plants to keep operations at capacity. April 2014 pool receipts of milk in CA total 3.58 billion pounds, 3.0% higher compared to April last year. YTD through April 2014 receipts are 5.3% higher than in 2013.
- Fluid Milk Pacific Northwest: Milk production in the region is steady with recent volumes. Production has leveled off following recent increases. This is allowing processors a break in handling milk volumes for any needed maintenance. Temperatures have been favorable for dairy cows to maximize production. Conditions for harvesting of first crop alfalfa have been good. UT and ID milk production is mostly steady. Some increased volumes have been credited to dairies keeping cows in the milking herd longer, rather than actively culling. Milk from within the region is satisfying most processors' demand.
- NDM East: Prices for low/medium heat nonfat dry milk were steady to lower this week. Dryers continue to run at capacity levels, leading to building inventories.
- NDM Central: Milk production is picking up in the region thus many milk processors are drying at generally higher rates. Inventories of low/medium heat NDM are growing.
- Cheese West: Cheese production in the West is active with sufficient milk available to meet buyers' demand. Some plants are turning milk away rather than building surplus stocks. Cheese producers are reporting good retail demand, despite higher than year ago prices, but export demand is moderating with much of the export shipments coming from previous sales. Export sales for Q3 are being negotiated with current prices meeting some resistance.
- International: EU milk production is lower with weekly declines being noted, but producer margins are good, and with the outlook for lower milk prices in the future, are incentivized to produce as much milk as possible in order to reap the current good returns. Weather conditions are favorable for milk production. Skim milk powder drying facilities are operating at near capacity. Eastern Europe milk production remains at/or near seasonal peak levels. Cheese producers and drying facilities are operating at near capacity levels.

#### Recommendation:

July Class III continued to feel the brunt of volatility this week in a choppy market. Most contracts were limited to single-digit gains or losses, but July finished the week down 24¢ at \$20.38. July will begin its calculation in a week, with current spot prices working out at just north of \$21/cwt. Barrel buyers were aggressive at times and passive at times. Big picture, export numbers look good, but those were for April and we're pretty sure there has been some softening since then. Longer term (3-5 years), the future looks bright for dairy, though we are continuing to feel some concern over 2015. Should prices stay above or near \$20 the balance of this year, higher cow numbers, falling grain prices and increasing production out of the EU could put a bump in the larger bull run. The first half of 2015 currently averages \$18.25 while all of 2015 is at \$18.18. If you have a good margin there with your component pay, we would consider selling up to 25% of your production. We know that's a long way out, but it wouldn't take much to pressure those prices lower, should global milk output increase. We exported nearly 17% of our raw milk production in April; therefore we are dependent on continued or increased exports to maintain current prices. Any blip in export demand and prices will fall. Up front, the market just feels like it wants to correct lower. We would aggressively get July PUTs bought. See if you can get a 1957 or 2000 PUT bought for 25-30¢, or just sell it. Go after the Aug 1925 PUT for 25-30¢.

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.  
© Copyright 2014 - KDM Trading, Inc. All Rights Reserved – www.kdmtrading.com