

The KDM Dairy Report – July 3rd, 2014

What's Bullish:

- Dairy Products Report: American and Total cheese production in May was up, but less than analysts expected. American cheese output increased just 1% vs. 2013, and Total cheese output was only 2.2% higher than last year. Both WI and CA produced less American and Cheddar cheese in May '14 than they did in May '13. Butter production in May was just 0.5% higher than last year. Dry whey output during the month was 2% higher than in 2013, but manufacturers' ending stocks were 3.3% below year ago levels.
- Fluid Milk Northeast: Milk production declines in the Northeast and Mid-Atlantic

Futures Month	Class III 07/03	Class III 06/27	Change	Dry Whey 07/03	Dry Whey 06/27	Change	Cheese 07/03	Cheese 06/27	Change
Jul-14	\$21.38	\$21.34	\$0.04	66.500c	65.750c	0.75c	\$2.035	\$2.040	(\$0.005)
Aug-14	\$20.58	\$21.30	(\$0.72)	65.200c	64.250c	0.95c	\$1.966	\$2.044	(\$0.078)
Sep-14	\$20.32	\$21.26	(\$0.94)	60.750c	61.500c	(0.75c)	\$1.976	\$2.070	(\$0.094)
Oct-14	\$20.25	\$21.13	(\$0.88)	58.500c	59.100c	(0.60c)	\$1.988	\$2.072	(\$0.084)
Nov-14	\$19.81	\$20.65	(\$0.84)	57.000c	57.725c	(0.73c)	\$1.951	\$2.036	(\$0.085)
Dec-14	\$19.50	\$20.17	(\$0.67)	56.000c	56.375c	(0.38c)	\$1.928	\$1.997	(\$0.069)
Jan-15	\$18.84	\$19.45	(\$0.61)	54.000c	54.000c	0.00c	\$1.880	\$1.941	(\$0.061)
Feb-15	\$18.30	\$18.85	(\$0.55)	53.025c	53.500c	(0.48c)	\$1.837	\$1.900	(\$0.063)
Mar-15	\$18.13	\$18.62	(\$0.49)	52.000c	52.500c	(0.50c)	\$1.825	\$1.875	(\$0.050)
Apr-15	\$18.01	\$18.57	(\$0.56)	51.000c	52.250c	(1.25c)	\$1.818	\$1.866	(\$0.048)
May-15	\$18.00	\$18.37	(\$0.37)	52.000c	52.000c	0.00c	\$1.830	\$1.860	(\$0.030)
Jun-15	\$18.00	\$18.37	(\$0.37)	52.000c	52.000c	0.00c	\$1.814	\$1.860	(\$0.046)
12 Mo Avg	\$19.26	\$19.84	(\$0.58)	56.498c	56.746c	(0.25c)	\$1.904	\$1.963	(\$0.059)

- regions are more prominent this week due to hotter weather conditions. Milk components levels are also taking a hit due to the temperatures. Manufacturing milk supplies are still heavy, however, as plants took on additional loads leading up to the 4th of July holiday. The rising temperatures in the Southeast continue to slow farm-level milk production, as producers incorporate cooling tactics to encourage cow comfort. This week, Florida is seeing extremely warm conditions, which has influenced milk production. Cream supplies remain tight. Strong demand from cream cheese manufacturing continues to pull heavily on cream supplies in the Northeast.
- Fluid Milk Southwest: Milk production in CA is steady through midweek, but milk handlers report the recent heat wave will likely result in tankers picking up lower volumes by the weekend. Class I sales were slightly higher at the beginning of the week as grocery and convenience stores restocked ahead of the upcoming weekend/holiday. Concerns about water availability persist related to irrigation for row and field crops. Farm milk production in NM continues to trend lower from week to week, but processors indicate the decline is manageable and being partially offset by lower volumes heading into sales to bottlers. Sales into Class II operations remain active. Milk volumes arriving for processing are declining in AZ, along with component levels. Dairy producers note the long stretch of high daytime temperatures is taking a toll on cow comfort, and milk production is dropping. Cream sales are very active within the state, but transporting cream loads long distances in hot weather is raising some concerns about temperature rejections upon arrival. Cream demand is steady to firm in the Western region. Some butter manufacturers are still purchasing cream loads to meet upcoming butter orders. Other processors are clearing cream readily into the ice cream/soft serve/frozen novelties markets. Cream cheese production is also taking increasing cream volumes. With tightening cream supplies, cream multiples are firm.
- Butter: Prices are strong. The market tone remains firm as many manufacturers are behind on seasonal inventory levels. Production rates are mostly steady to lower as cream supplies are tight. Bulk butter spot offerings are limited. Domestic demand is mixed, however interest is greater than last year at this time due to the tightness in supplies.
- Cheese Northeast: Cheese production remains active, but an unanticipated upsurge in orders this week has swamped some cheese makers. Most cheese inventories are adequate to increasing.
- Cheese Midwest: Surplus milk availability and pricing has been tightening further north in Wisconsin, so an unexpected influx of additional surplus milk from IL was welcome. Some of the milk production decline was seasonal and expected, but some resulted from producers who recently elected to sell some cattle at current beef prices, reduce herd sizes, and expand crop production. Cheese manufacturers describe upper Midwest milk production overall as stable to slightly decreasing.
- Is India the next China? Union Minister for Agriculture, Radha Mohan Singh said in a news article this week that in order to meet growing milk demand, India's milk output has to grow by six million tons every year for the next 10 years. Failing to achieve this, the world's largest milk producer may have to resort to imports.
- CWT has accepted 20 requests for export assistance to sell 7,839 million pounds of Cheddar cheese, 110,231 pounds of butter (82% butterfat) and 972,239 pounds of whole milk powder to customers in Asia, the Middle East, North Africa, South America and Oceania. The product will be delivered July through December 2014.
- International: Western European milk production continues its seasonal downward trend, accelerated in some areas by periods of hot weather. Current milk production is viewed as strong and continues to exceed year ago levels. However, dairy producer margins are beginning to narrow as heavy commodity production has lowered commodity prices and caused decreases in farmgate prices. The 2014/15 quota levels have not expanded and with the likelihood of lower margins, producers will be more cautious not to exceed quota levels this year.
- International: Australian producers are no longer trying to extend milk production and chasing the higher milk prices with the onset of lower farmgate prices for the new season. Weather has changed from mild conditions to a more normal pattern with colder, wetter weather covering the major dairy producing regions in southeastern Australia. Dairy commodity stocks are being worked lower with a few extra spot sales occurring.

What's Bearish:

- Spot Market: Blocks fell 5¼c for the week to settle at \$1.96¼/lb while barrels gave up 2¼c to close at \$1.98¼/lb. Trading was heavy in the blocks with 26 loads exchanging hands in a holiday-shortened trading week. There were just 3 barrel trades. Butter gained 11c on Monday to hit a high of \$2.50/lb, only to give it all back to finish the week unchanged at \$2.39/lb on 19 trades. NDM lost 3¼c on 4 trades, settling at \$1.77¼/lb.
- Grains: Monday's Acreage and Grain Stocks reports were a bearish shock to the grain markets, as corn stocks were 39% higher than a year ago and soybean acres were up 11%, 2 million acres above most analyst expectations. Both corn and beans sold off hard on the news, putting in multi-month lows for each.

- Weekly cold storage numbers indicate cheese stocks at USDA-selected centers increased 3.13 million lbs (4%) during June. Butter stocks fell 3% over the same period.
- Another week; same story. Dairy cow slaughter rates continue to lag last year's levels by significant margins. Just 48,700 head were culled during the week ended 06/21, a decline of 9.3% (5,000 head) vs. the same period in 2013.
- Fluid Milk Central: Farm production rates remain strong, with only a few instances of slight declines in milk bulk tank levels. Spot loads of milk are readily available, ranging from \$3.00 under to \$1.00 over Class.
- Fluid Milk Pacific Northwest: Milk production in the region is steady. Favorable temperatures with cooling at night are creating ideal conditions for dairy cows. Additional manufacturing milk is expected over the long holiday weekend.
- Dry whey: Strong cheese production throughout the U.S. is increasing whey production. The increased whey stocks are meeting moderate demand. Whey prices have a weak undertone. Domestic buyers are looking for additional stocks, but are becoming increasingly price conscious. Export sales have slowed as some buyers are willing to wait for more favorable pricing.
- NDM: Milk processors continue strong NDM drying rates as milk supplies remain heavy. Domestic demand is mixed. Export orders are light. Supplies of low/medium heat NDM are generally heavy. Inventories continue to build as most drying facilities run at capacity.
- International: New Zealand's April milk production as reported by DCANZ was 1.29 million tons, up 32.8% from April 2013, but 13.0% lower than two years ago. Current milk production is low with a majority of cows on winter pastures. Recent rains have promoted good pasture growth and producers are looking forward to a good start of the 2014/15 season. New season farmgate prices have been announced and, though lower than prices paid at the close of last season, are relatively high. Current cheese inventories are tight, but production is expected to increase in the coming weeks as cheese is providing a higher return than whole milk powder.
- Cheese West: Cheese production is heavy as milk supplies are at strong levels in much of the West. Some drop-offs are occurring in the southwestern states as high temperatures affect production, but northwest milk production remains sufficient to keep cheese plants in the area supplied with all the milk they desire. Cheese stocks are adequate for current demand. Domestic demand is steady with good retail movement at current prices. Buyers look to build inventories on price breaks, but are mostly in a comfortable supply position. Export demand is slower.
- International: After a brief uptick two weeks ago, this week's Global Dairy Trade auction saw the resumption of lower prices as the dairy index fell 4.9% vs. the previous event. The decline was led by butter, which plummeted 13.6% to a U.S. equivalent \$1.44/lb. Cheddar cheese declined 2.9% to a U.S. equivalent \$1.92/lb.

Recommendation:

The week started out rather promising, with butter being bid aggressively higher on Monday to a new high for the year at \$2.50/lb. But extremely bearish grain reports followed by weakness in the GDT auction on Tuesday took the wind out of the dairy markets. Butter finished the week unchanged while spot cheese was pressured by willing sellers, leaving red across much of the dairy complex by week's end (see prices above). Fundamentals definitely appear to be tilting more bearish, yet there was a real battle going on during the spot sessions as increased cheese availability by sellers met fairly strong demand by buyers. How long this will last we don't know, but if demand is ever satisfied, we could quickly take cheese into the 1.80's, which would make us more competitive in the global market. Heat is finally taking a toll on milk output in southern tiers of the country and cream remains tight. Butter has corrected but is unlikely to collapse. Stocks are still low and buyers need to build inventory for the fall. With very strong cheese output, dry whey prices look like they've peaked for now and could head somewhat lower. This is something to watch as every penny move in dry whey, changes Class III by 6¢. Current spot prices work out to about \$20.85 Class III. August futures are trading at a small discount, so are pricing in a further drop in cheese prices. The rest of the Class III futures curve is also predicting lower prices as well. The international picture is somewhat cloudy, but keep an eye on India as a potential new outlet for U.S. dairy exports. We also think China will be back as a buyer later this year. In summary then, the market looks slightly bearish short to medium term, but longer term bullish. In light of this week's large move lower in grains, producers should consider scale-in buying of their protein needs. K-mart, blue-light specials only come every so often! On the milk side, operations should get more aggressive in buying PUT options up front to protect against near-term weakness. Consider the Aug 20.00 PUT at 32¢ and the Sep 19.50 PUT at 41¢. A lot of revenue can be protected at very profitable prices!

Note: Our offices will be closed on Friday, July 4th, in observance of Independence Day. Thank you veterans and current military personnel for the freedoms we enjoy and take for granted!

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