

**The KDM Dairy Report – July 11<sup>th</sup>, 2014**

**What's Bullish:**

- Spot Market: Both blocks and barrels came off mid-week lows to inch-out small gains. Both finished up ¼¢ to settle at \$1.97 and \$1.98½ respectively. Trading was heavy as buyers came on strong, picking up 29 loads of blocks and 15 loads of barrels.
- Fluid Milk Northeast: Milk volumes saw a drop as Hurricane Arthur brought significant rainfall, heat and humidity in areas of the region. Milk intake volumes are slightly down from last week at most balancing plants. Milk haulers in the Mid-Atlantic are either removing or consolidating routes as high temperatures continue to slow down milk production.

Futures Month	Class III 07/11	Class III 07/03	Change	Dry Whey 07/11	Dry Whey 07/03	Change	Cheese 07/11	Cheese 07/03	Change
Jul-14	\$21.40	\$21.38	\$0.02	67.000¢	66.500¢	0.50¢	\$2.035	\$2.035	\$0.000
Aug-14	\$20.70	\$20.58	\$0.12	67.000¢	65.200¢	1.80¢	\$1.970	\$1.966	\$0.004
Sep-14	\$19.85	\$20.32	(\$0.47)	64.500¢	60.750¢	3.75¢	\$1.900	\$1.976	(\$0.076)
Oct-14	\$19.79	\$20.25	(\$0.46)	61.000¢	58.500¢	2.50¢	\$1.929	\$1.988	(\$0.059)
Nov-14	\$19.32	\$19.81	(\$0.49)	59.000¢	57.000¢	2.00¢	\$1.892	\$1.951	(\$0.059)
Dec-14	\$19.09	\$19.50	(\$0.41)	58.400¢	56.000¢	2.40¢	\$1.882	\$1.928	(\$0.046)
Jan-15	\$18.50	\$18.84	(\$0.34)	55.000¢	54.000¢	1.00¢	\$1.854	\$1.880	(\$0.026)
Feb-15	\$18.14	\$18.30	(\$0.16)	53.025¢	53.025¢	0.00¢	\$1.820	\$1.837	(\$0.017)
Mar-15	\$18.03	\$18.13	(\$0.10)	52.000¢	52.000¢	0.00¢	\$1.818	\$1.825	(\$0.007)
Apr-15	\$17.88	\$18.01	(\$0.13)	52.200¢	51.000¢	1.20¢	\$1.810	\$1.818	(\$0.008)
May-15	\$17.90	\$18.00	(\$0.10)	52.000¢	52.000¢	0.00¢	\$1.813	\$1.830	(\$0.017)
Jun-15	\$17.93	\$18.00	(\$0.07)	52.000¢	52.000¢	0.00¢	\$1.817	\$1.814	\$0.003
<b>12 Mo Avg</b>	<b>\$19.04</b>	<b>\$19.26</b>	<b>(\$0.22)</b>	<b>57.760¢</b>	<b>56.498¢</b>	<b>1.26¢</b>	<b>\$1.878</b>	<b>\$1.904</b>	<b>(\$0.026)</b>

- Loads moving into bottling plants picked back up this week following several plants closing for the July 4<sup>th</sup> holiday.
- Fluid Milk Southeast: Milk production is down, compared to last week, as area temperatures moved higher. With most fluid milk going to bottling, sales are good. Florida's farm-level milk output is experiencing rapid decline, due to daily high temperatures and continuous thunderstorms affecting cow comfort. A contact noted the closing of an ultrafiltration plant due to a lack in surplus milk volumes. Spot milk shipments totaled 48 export loads compared to 130 last week. Ice cream production picked back up this week following a short July 4th holiday break. Some producers are still comfortable with curbing their butter production, as cream supplies clear to other cream based operations.
- Fluid Milk Central: Milk production is beyond peak, trending generally lower. Spot loads of milk ranged from \$2.00 under to \$1.00 over Class. Supplies are obtainable as a few distressed loads were offered. However, availability has tightened compared to previous weeks. Some cheese makers are looking to secure additional spot loads of milk. Bottling interest is light, but a few milk handlers noted improved sales. Soft serve ice cream orders are good. Cultured product demand is very good.
- Fluid Milk Southwest: Milk production in CA has seen declines from week to week in some areas, but handlers also report short term gains under changeable weather patterns. Bottlers placed restocking orders after the long holiday week. Ice cream/frozen dessert manufacturers are taking steady numbers of milk loads and condensed skim. NM milk production regained some volumes with the arrival of cooler temperatures and rain showers late last week, but haulers indicate those gains were short in duration. By the middle of this week, milk production was once again heading seasonally lower. Milk production in AZ continues to decline under pressure from high daytime temperatures. Cream demand is steady into ice cream/frozen desserts and cream cheese. Butter manufacturers are waiting for Class II demand to weaken, to allow more cream to move toward butter production.
- Fluid Milk Pacific Northwest: Milk production is steady for the week, but a trend toward higher daytime temperatures has alerted handlers that milk production may be declining within the next 7 - 10 days. Additional milk loads from other Western states are filling supply gaps on a weekly basis. Cream sales are active.
- Butter: Demand from ice cream and cream cheese accounts for cream supplies continues to restrict butter churn activity. Some butter manufacturers are supplementing production rates by microfixing additional volumes of bulk supplies to fill immediate needs. Domestic buyer interest is active. International demand is light. Inventories are steady to generally lower.
- Dry Whey West: Manufacturing milk supplies into some Western plants have moved lower. Dry whey production is steady to lower. Inventories are variable, with some indicating their holdings are below what is needed to fulfill contracts.
- Cheese Midwest: This post-holiday week some Wisconsin cheese manufacturers seeking extra milk were unsuccessful in finding it. Some manufacturers who have not been buying surplus milk in recent weeks but are now seeking a bit more milk to compensate for milk production declines, as well as manufacturers who have regularly been buying surplus milk during recent weeks, are not finding surplus milk this week. This tighter milk supply situation has kept cheese production at less than desired levels. Condensed skim is being used in some cheese plants to extend vat yields. Sales of cheese overall are strong, with some manufacturers struggling to fill contracted orders. Barrels are being purchased in Wisconsin this week at a premium to CME Group pricing due to some supply tightness.
- Cheese West: Domestic buyers continue to take contract cheese loads as agreed. Buyers are watching prices and limiting many buying agreements to near-by timeframes. In the Southwest, milk clearing into cheese production is variable as daytime temperatures have had some impact on manufacturing milk volumes.
- Exports: The U.S. Dairy Export Council published May export numbers, which were mostly positive. NDM/SMP exports hit a record high, up 8% from last year and the most ever in a single month. Cheese exports were the lowest of the year, but still 15% higher than a year ago. Exports of all dairy products in May were up 3% vs. 2013.

**What's Bearish:**

- Dry Whey Northeast: Prices were steady to lower this week. Active production from cheese makers has led to increases in dry whey stocks. Domestic demand is moderate, while export demand has slowed.
- Dry Whey Central: The market tone is showing signals of weakening as buyers report improved spot load availability. Production rates are mostly steady. Domestic dry whey buyer interest is diminishing and export orders are light.

- Cheese Northeast: Cheese production continues at a steady to higher rate, with additional milk supplies made available, as some dairy plants closed over the July 4th holiday period. Most cheese vats operate on a 6-7 day week. Interest from some wholesale customers eased slightly prompted by seasonal catering drop-offs, school closings, and consumers vacationing.
- Grains: More bearish news was released this week in the WASDE and Crop Production reports, confirming a huge new crop and moderate demand. Grains markets sold off after the news with Dec corn and Nov beans putting in new contract lows. Margins are increasing for dairies as feed costs fall.

**Recommendation:**

With peak production in the U.S. behind us and fall needs in the backs of their minds, cheese buyers appeared to be on a mission this week. The market continues its range-bound behavior, with buyers getting more aggressive when cheese approaches \$1.95/lb, while cooling off near \$2.10/lb. Cream is tight and butter inventories are less than desirable for this time of year, but butter manufacturers are facing stiff competition for cream from both ice cream and Class II manufacturers. Overall the market seems very uncertain as far as direction. It looks like we could see a little rally here in the near term, but we're getting more concerned over talk of herd expansions and barn building longer term. Producers have had good margins now for quite some time and many have rebuilt some lost equity. With feed costs continuing to fall, margins are getting even better. In order for prices to remain as high as they are, demand will need to increase too. Who knows? Not us! We're starting to see some producers take light positions out in 2015 in the face of these facts. It takes discipline to sell at prices that are lower than the front months, but at an annual average of \$18.07 for 2015, it makes good sense to start at least some hedging here. Each operation and risk tolerance is different, so you need to do what's right for you. For the balance of 2014, we still like cheap PUT options. Consider the following: Aug 20.00 PUT at 13¢, Sep 18.25 PUT at 14¢, Oct 17.75 PUT at 16¢. Enter target orders for the Nov and Dec 17.00 PUTs at 12¢. In uncertain times, at least you will have a floor under the price of your milk!

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