

The KDM Dairy Report – July 18th, 2014

What's Bullish:

- Spot Market: Block cheese gained 5¼¢ to settle at \$2.02¼/lb while barrels picked up 8¼¢ to close at \$2.07/lb. Trading was active with 21 loads of blocks and 20 loads of barrels exchanging hands. Butter jumped 10¼¢ to settle at \$2.48/lb on 24 trades, but NDM gave up 4¢ on just 2 trades to close at \$1.69¼/lb.
- Weekly cold storage numbers indicate both cheese and butter stocks at USDA-selected storage centers are down 1% over the period 07/01 through 07/14.
- Fluid Milk East: Milk production in the Northeast and Mid-Atlantic regions is showing slight declines, although milk

Futures Month	Class III 07/18	Class III 07/11	Change	Dry Whey 07/18	Dry Whey 07/11	Change	Cheese 07/18	Cheese 07/11	Change
Jul-14	\$21.51	\$21.40	\$0.11	67.950¢	67.000¢	0.95¢	\$2.041	\$2.035	\$0.006
Aug-14	\$21.33	\$20.70	\$0.63	67.500¢	67.000¢	0.50¢	\$2.025	\$1.970	\$0.055
Sep-14	\$20.33	\$19.85	\$0.48	63.150¢	64.500¢	(1.35¢)	\$1.954	\$1.900	\$0.054
Oct-14	\$19.83	\$19.79	\$0.04	60.500¢	61.000¢	(0.50¢)	\$1.930	\$1.929	\$0.001
Nov-14	\$19.42	\$19.32	\$0.10	58.500¢	59.000¢	(0.50¢)	\$1.905	\$1.892	\$0.013
Dec-14	\$19.18	\$19.09	\$0.09	58.750¢	58.400¢	0.35¢	\$1.888	\$1.882	\$0.006
Jan-15	\$18.50	\$18.50	\$0.00	55.250¢	55.000¢	0.25¢	\$1.847	\$1.854	(\$0.007)
Feb-15	\$18.19	\$18.14	\$0.05	53.250¢	53.025¢	0.23¢	\$1.822	\$1.820	\$0.002
Mar-15	\$18.09	\$18.03	\$0.06	52.750¢	52.000¢	0.75¢	\$1.815	\$1.818	(\$0.003)
Apr-15	\$18.00	\$17.88	\$0.12	52.000¢	52.200¢	(0.20¢)	\$1.808	\$1.810	(\$0.002)
May-15	\$18.01	\$17.90	\$0.11	52.000¢	52.000¢	0.00¢	\$1.815	\$1.813	\$0.002
Jun-15	\$18.01	\$17.93	\$0.08	51.300¢	52.000¢	(0.70¢)	\$1.815	\$1.817	(\$0.002)
12 Mo Avg	\$19.20	\$19.04	\$0.16	57.742¢	57.760¢	(0.02¢)	\$1.889	\$1.878	\$0.010

- intakes for most processing plants are moderate. The Southeast's milk production rates inched lower. Milk haulers schedules, in some instances, are changed from every day pickups due to the declines. The combined impact of marginal increases in bottling sales and lower milk production rates is lessening loads sent to manufacturing. Florida's farm-level production is hindered by hot, humid and wet weather, with daytime temperatures in the mid 90s and nights in the mid-70s. Pastures are not improving, with thunderstorms occurring daily and most of Florida experiencing 6 inches above normal rainfall for this time of year. Class I demand is up a tick this week. Spot shipments out of the area totaled 35, down from 48 last week.
- Fluid Milk Central: Central region milk production has seasonally declined from peak levels. Bottling sales are lower following seasonal trends. However, schools will resume in southern parts of the region in three weeks, beginning the process of filling school milk pipelines. Spot load milk is available at prices ranging from \$1.00 under to \$1.00 over Class in many parts of the region, but is hard to find in some areas. Ice cream sales are flat but ice cream production remains strong.
- Fluid Milk Southwest: Milk production in CA is trending lower. In the Central Valley area, dairy operators report several days with higher humidity than is customary for July, and this is making it more difficult to maintain cow comfort. NM milk haulers report loads are steady to trending seasonally lower. Milk intakes in AZ are trending lower as a long string of hot days takes a toll on cow comfort. Fluid accounts are ordering steady volumes for refilling grocery outlets. Cream sales are active into cream cheese/ice cream production. Western butter churn operators are foregoing some churning to complete spot cream sales and enhance returns on cream. With tightening cream supplies, cream prices are firm.
- Fluid Milk Pacific Northwest: Hot weather in the region is affecting milk production. Milk intakes are reported to be down by 5-10% as high temperatures in the triple digits affect cow comfort. Milk supplies are past seasonal peak amounts.
- Butter: The market is tight in most regions, with some frozen butter being reworked to meet current interest. Butter demand is steady into food service accounts as summer travel spurs vacation related fast food and eat-in dining. Sales into industrial accounts are steady. Butter production is mostly lower as cream volumes clear into ice cream/frozen novelties production. Some butter/powder plant operators report the current returns on spot cream sales are too good to pass up. However, those operators also note they will have to retain cream volumes in the coming weeks to start rebuilding salted and unsalted bulk and retail inventories before holiday demand arrives.
- Cheese Midwest: Cheese production is easing slightly lower seasonally. Milk production has passed the peak in the estimation of most cheese makers. Some plants are taking spot surplus milk at prices ranging from \$1.00 under to \$1.00 over to help production. Condensed skim is being added in some cheese plants to improve vat yields. Some plants have made slight reductions in production schedules to reflect milk availability. Mozzarella orders show some seasonal weakness due to slower pizza sales, but that aside, cheese buyers are taking orders and other buyers are looking for cheese. Cheese availability outside contract orders is tighter in the Midwest. Barrels are harder to find than blocks.
- Cheese West: Cheese production in the West continues to be busy, but milk volumes are decreasing as hot weather affects milk production. Manufacturers are filling previously arranged export orders in addition to regular contract sales to domestic customers. Domestic demand is steady as buyers look to refill their inventories on price breaks whenever possible.

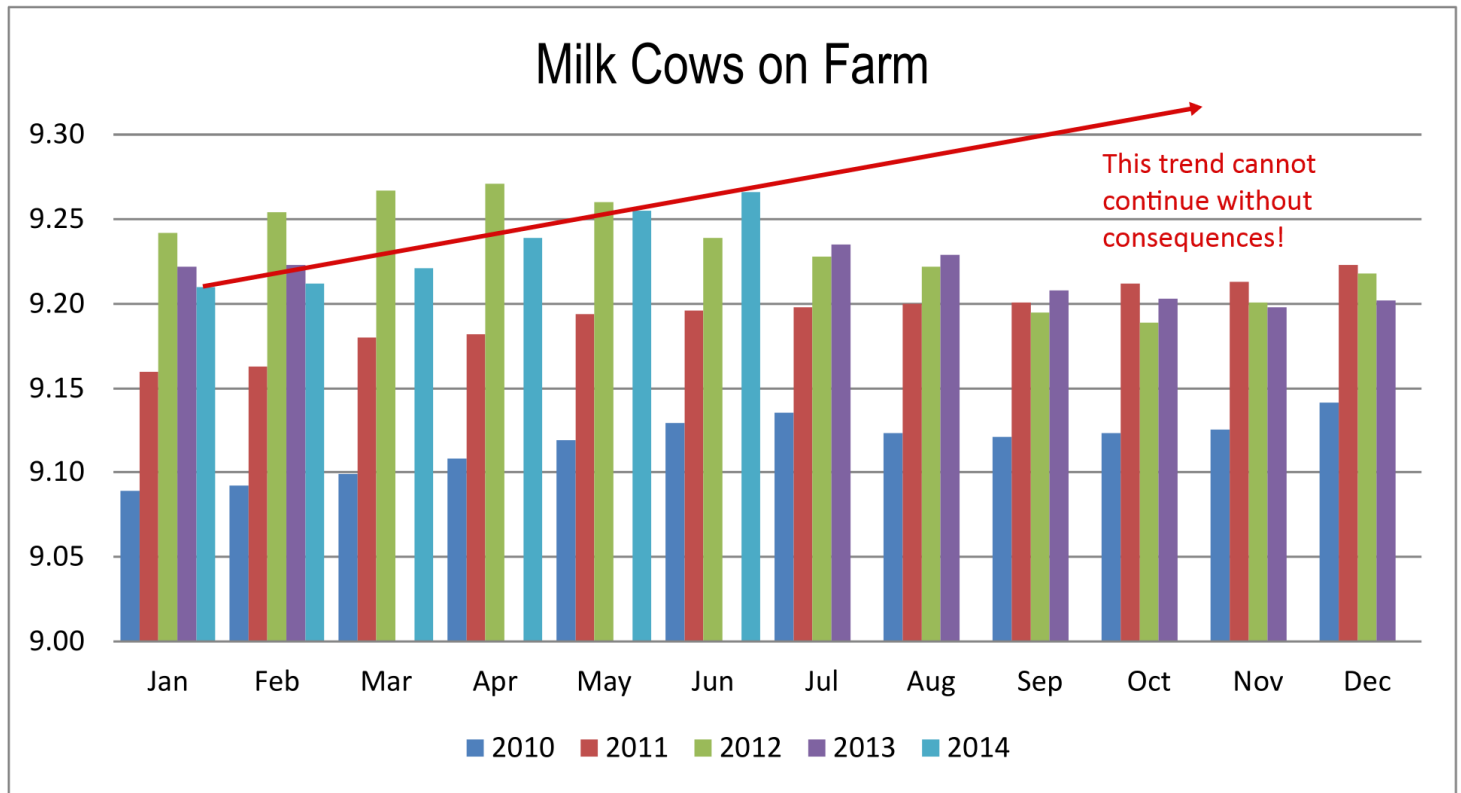
What's Bearish:

- Milk Production Report: U.S. milk production in June came in below expectations at 1.9% above a year ago, yet registered its largest year-over-year increase in 2014. Cow numbers grew 11,000 head from May, with 64,000 cows added since the beginning of the year (see graph below). Every state but one (Ohio) in the 23 largest milk producing states had an increase over last year.
- Dairy cow slaughter for the week ended 07/05 totaled just 41,600 head, the lowest weekly total since mid-2011.
- Dry Whey: Prices moved lower this week as some plants continue to operate on full schedules. Multiple spot purchases were available as inventories are steady to increasing.
- NDM: The market is weak. Market participants indicate the recent Global Dairy Trade auction results, which showed lower prices on skim milk powder, are pointing the way for the U.S. NDM market. Current U.S. prices are well above the world market. These prices are keeping buyers from making any commitments to sizeable NDM purchases in the near term. As buyers delay commitments, stocks are building steadily at resellers' locations.
- Cheese Northeast: Sufficient Class III milk volumes contributed to elevated cheddar production, as cheese plants work full schedules throughout the week. A few cheese makers are using condensed skim to increase vat yields, as component levels decline. Mozzarella sales have slowed, with some manufacturers expecting interests to surge around mid-August. Stocks are marginally expanding with increases in production.

- International: Western European milk production continues to be good with producers incentivized by good margins and favorable weather. Export market activity for most dairy commodities is light. Export prices are under pressure from other global markets. Domestic demand has also weakened, due to the onset of the European holiday season. Milk production in Eastern Europe remains strong with continued significant increases over year ago levels in Poland and the Baltic States. Increased levels of cheese, skim milk powder and butter are being produced, compared to last year.
- International: Beginning season milk prices for Australia are above levels of years past and producers are readying for a good start to the new season. Cows will begin calving over the next 4 weeks. Declines in the whole milk powder market have made cheese production more economical. Milk volumes going to cheese plants are anticipated to increase in the first half of the new season. Export spot sales activity has been fairly light for most dairy commodities. Trading is light with reports that China has mostly adequate supplies for the near term and Ramadan has lowered export interest from the Middle East.

Recommendation:

Buyers in this week's spot market continued to go after cheese as a combined 41 loads of blocks and barrels exchanged hands. This bodes well for August Class III which has just started its calculation. Aug finished the week up 63¢ at \$21.31 and is still trading about 40¢ discount to current spot prices, which work out to about \$21.70. It's really hard to say where prices will go after August, however. Today's Milk Production Report came in slightly under expectations in terms of output, but confirmed the growing size of the herd through reduced culling. As the graph points out, this trend can't go on indefinitely without consequences. It appears we could be in for some softening of prices at some point, depending on weather and demand. On the international side, exports seem to be slowing down, putting pressure on dairy end product prices. Australia and New Zealand still be opening their new milking season soon, having just had attractive margins. With weakening international powder prices, more Oceania milk could end up being turned into cheese this fall; cheese that our exports will need to compete with to find a home. Butter is the lone bright spot as we continue to experience tight cream supplies and extremely strong demand. In a victory for dairy promotion, more and more stories are hitting the newswires about Americans abandoning margarine and consuming more real butter. With so much unknown, we continue to recommend getting coverage with PUT options as far out as you can!



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