

The KDM Dairy Report – August 15th, 2014

What's Bullish:

- Spot Market: Blocks finished the week up 12¢ to settle at \$2.22/lb, while barrels gained 8¼¢ to close at \$2.21/lb. Just 2 loads of barrels exchanged hands, while buyers picked up 15 loads of blocks. Butter trading was even heavier, with a total of 59 loads, as bidders pushed the price up 26¢ to \$2.66/lb. Grade A NDM gave up 14¼¢ to settle at \$1.39¼/lb on 5 trades.

| Futures Month | Class III 08/15 | Class III 08/08 | Change | Dry Whey 08/15 | Dry Whey 08/08 | Change | Cheese 08/15 | Cheese 08/08 | Change |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| Aug-14 | \$22.16 | \$21.77 | \$0.39 | 69.125¢ | 68.775¢ | 0.35¢ | \$2.094 | \$2.053 | \$0.041 |
| Sep-14 | \$22.64 | \$21.54 | \$1.10 | 68.000¢ | 68.500¢ | (0.50¢) | \$2.157 | \$2.049 | \$0.108 |
| Oct-14 | \$21.10 | \$20.65 | \$0.45 | 66.750¢ | 66.000¢ | 0.75¢ | \$2.012 | \$1.982 | \$0.030 |
| Nov-14 | \$19.82 | \$19.70 | \$0.12 | 62.750¢ | 62.000¢ | 0.75¢ | \$1.912 | \$1.919 | (\$0.007) |
| Dec-14 | \$19.03 | \$19.14 | (\$0.11) | 59.050¢ | 59.000¢ | 0.05¢ | \$1.866 | \$1.884 | (\$0.018) |
| Jan-15 | \$18.45 | \$18.51 | (\$0.06) | 56.775¢ | 57.000¢ | (0.23¢) | \$1.825 | \$1.828 | (\$0.003) |
| Feb-15 | \$18.00 | \$18.01 | (\$0.01) | 54.325¢ | 54.500¢ | (0.17¢) | \$1.790 | \$1.795 | (\$0.005) |
| Mar-15 | \$17.94 | \$17.95 | (\$0.01) | 53.750¢ | 53.750¢ | 0.00¢ | \$1.790 | \$1.799 | (\$0.009) |
| Apr-15 | \$17.90 | \$17.95 | (\$0.05) | 53.250¢ | 52.775¢ | 0.48¢ | \$1.795 | \$1.801 | (\$0.006) |
| May-15 | \$17.94 | \$17.95 | (\$0.01) | 53.000¢ | 53.250¢ | (0.25¢) | \$1.799 | \$1.797 | \$0.002 |
| Jun-15 | \$18.00 | \$18.00 | \$0.00 | 53.000¢ | 52.000¢ | 1.00¢ | \$1.805 | \$1.815 | (\$0.010) |
| Jul-15 | \$18.05 | \$18.02 | \$0.03 | 53.250¢ | 52.000¢ | 1.25¢ | \$1.812 | \$1.818 | (\$0.006) |
| 12 Mo Avg | \$19.25 | \$19.10 | \$0.15 | 58.585¢ | 58.296¢ | 0.29¢ | \$1.888 | \$1.878 | \$0.010 |

- Fluid Milk East: Northeast and Mid-Atlantic milk production is holding steady, but sales to bottlers are improving with solid demand from educational institutions. Southeast milk production increased slightly in some areas, as cooler temperatures prevailed. Sales are increasing in parts of the region due to schools starting back up. Florida has seen up to 6 inches of rain over the past three days leaving farm pastures soaked and muddy, as the heat index ranges over 100. The milk production level continues to fall given those conditions. Class I demand has strengthened with steady ordering expected as classes resume. The situation of increased demand and lackluster milk production sparked 80 imported loads of spot milk.
- Fluid Milk Central: Milk production is holding mostly steady, but spot load availability of milk is mixed as prices range from \$0.50 to \$2.00 over Class. Some powder producers are looking to sell milk supplies, while cheese makers tend to be looking for additional milk. Milk handlers noted shifting of milk from Class IV into Class III. However, the process has been slow for some due to Order provisions. Bottlers are filling more school pipelines, particularly in the southern portion of the region.
- Fluid Milk Southwest: CA milk production is stepping seasonally lower. Daytime temperatures continue to wear down cow comfort. Processing capacity within the state exceeds the supply. Class I demand is ongoing as suppliers to school districts set up weekly ordering plans. Overall farm milk production in NM is trending lower. Daytime temperatures regularly reach near 90 degrees, with modest cool down cycles during the night. Class I and II orders regained some volumes as educational institutes start meal programs. AZ milk production is declining as cow comfort sags beneath daily high temperatures. Class I orders increased slightly at the end of last week and the beginning of this week to account for demand from school districts. Heavy rains brought flashfloods to some operations surrounding the Phoenix area. As butterfat contents decline seasonally in milk intakes, a few balancing plants are running short on cream to fill contracts.
- Fluid Milk Pacific Northwest: Milk supplies in the region continue to move seasonally lower. Hot weather is reducing milk volumes as cows experience heat stress during daytime hours with limited relief at night. Milk is being processed locally whenever possible to reduce transportation costs. Most processing plants are working at below capacity and are taking the opportunity to schedule short term maintenance projects where needed. The reopening of schools in the region is pulling additional volumes of fluid milk for bottling.
- Butter: Prices strengthened this week in a firm market. Production levels vary as churn operators' decisions are mixed on handling cream supplies. Manufacturers realize inventory levels are not where they need to be to fill upcoming demand. However, a few are hesitant to overstock with the potential of stored supplies depreciating. Domestic retail demand remains active.
- Dry Whey: Northeast dry whey prices moved higher due to purchases based on indices. Dry whey production is slightly higher as cheese makers accommodate an increase in school orders. Demand is good from baking manufacturers as fall approaches. Western dry whey prices are steady to firm. Recent price reductions in various other dairy protein sources are putting downward pressure on spot whey markets. But tight whey stocks are countering this trend as spot market sales are limited. Export demand is steady with much of the demand coming from previous commitments.
- Cheese Northeast: Overall cheese production levels are experiencing marginal declines in the region. The impact of increasing fluid milk orders and fall-off in milk production are lessening milk intakes for cheesemakers. A surge in mozzarella sales is reducing stocks as school orders increase.
- Cheese Midwest: Milk tightness is constricting cheese production in the Midwest. Some scheduled and expected milk deliveries to plants have been reduced in volume this week. Cheese plant managers have received calls from other cheese producers looking for extra milk, to no avail. This has led some contracted buyers of barrels to be told that expected order delivery will have to be reduced. Barrels are already in tight supply, so future reduced contract deliveries with further tighten the situation. Relief to the milk tightness is not expected in the immediate future.
- International: China is seeing massive growth in its yogurt market due to new demand for healthier drinks on the go. According to a report released by Canadean, yogurt will become the third most consumed dairy drink in China by 2016 as it overtakes grain, nut, rice and seed alternatives to milk drinks.

What's Bearish:

- Weekly Cold Storage numbers indicate cheese stocks at USDA selected storage centers have increased 2%, or 1.9 million lbs, over the period 08/01 through 08/11. Butter stocks over the same period declined 1%, or 111,000 lbs.
- Dairy cow slaughter for the week ended 08/02 totaled just 50,200 head, down 10,500 head (-17.3%) vs. the same period last year. YTD producers have culled 192,700 fewer cows than in 2013.

- Cheese West: Hot weather and seasonally lower production levels have slowed milk intakes, but additional milk is available to meet demand. Increased supplies of nonfat dry milk at lower prices are also helping to add to milk solids to be used to fortify cheese vats. Wholesale cheese prices moved higher and have tempered some of the demand for additional loads above contracted needs. Those companies with various outlets for their milk supply are often prioritizing cheese production above alternative products. Export demand for cheese is showing some increased interest, but buyers are price conscious and often waiting for price breaks to make purchases.
- International: The Russian ban on many food imports from the West is likely to pressure an already weak international dairy market, according to Rabobank analysts. Russia is the world's second largest dairy importer, so products from the EU in particular will need to find another outlet. That could be the U.S.
- NDM: Prices of low/medium NDM are mixed on a weakening market. Trades in the spot market are limited but at significantly reduced pricing. European and Oceania markets moved lower, putting downward pressure on U.S. prices. Some manufacturers with the capabilities are looking to divert milk supplies from NDM into higher returning cheese production. Inventories of low/medium NDM are mostly growing.
- International: Western European dairy markets were dealt a blow this past week, when Russia blocked EU dairy exports from coming into the country. In 2013 Russia accounted for 33% of EU cheese exports, 25% of EU butter exports, and 27% of EU AMF exports. Lower dairy commodity prices are anticipated by many market participants as, once Russia bound, dairy products attempt to find new buyers. Milk production is declining along the seasonal trend, but above year ago levels. Weather conditions are mostly favorable across most regions of Europe with plentiful feed and forage supplies. According to ZMB estimates, June milk deliveries in the EU were 4.3% higher than a year ago.
- International: Eastern Europe milk production is declining, but volumes remain over year ago levels. Cow comfort levels are good and producers are receiving good returns and attempting to maximize milk production. Manufacturing schedules for butter, skim milk powder and whey continue to be active. Some market participants feel the Russian export ban will severely affect Eastern European countries.
- International: Australian milk production is beginning to increase with more cows coming on line. Weather conditions are cool and wet in the major dairy producing states. Manufacturing plants are ready for increased milk volumes. New Zealand's milk production is showing modest increases as cows are calving and coming on line. Weather conditions on the North Island have been very wet and may hamper grazing pastures if they're not allowed to dry off sufficiently. Conditions on the South Island are very good, especially in the Canterbury region, where forages are plentiful and temperatures have been seasonably mild. Milk production is expected to make sizable increases week to week leading up to the seasonal peak, which usually occurs in October.

Recommendation:

In the face of weakening international fundamentals, U.S. cheese and butter prices saw renewed strength this week. The average block/barrel price rose to its highest level since April, while spot butter made a new all-time high. The reopening of schools and milk production problems in the Midwest, combined with strong domestic demand are allowing the U.S. to be the price leader, at least for now. The big question on everyone's mind is how long we can maintain these prices. With the fall nearly upon us, commercial buyers appear almost desperate to build inventory for their anticipated needs. Meanwhile, near \$2 cheese all summer kept cheese plants from over-producing over the fear of sitting on historically expensive inventory. Now everybody wants butter and cheese now, and can't get it. Barrels in particular are tight, with U.S. barrel manufacturing facilities having less flexibility to ramp production up or down than is true for blocks. With both spot cheese and butter aggressively bid higher this week, Sep Class III futures rallied over \$1 to close the gap between cash prices, which currently work out to about \$23.40/hwt. The Sep contract begins its calculation next week, so even with its \$22.64 settlement on Friday, it is still trading at a significant discount. A few loads of cheese were shaken loose as spot prices rose above \$2.20/lb, but even so, the current tight situation is likely to result in continued support in the spot market. This should pull the Sep contract even higher. Oct on out though saw far less of a rally, while the first half of 2015 was mostly lower. With U.S. cheese and butter prices at a significant premium to the rest of the world and a Russian import ban in place, it is very likely that the U.S. will begin importing EU cheese and butter in higher numbers. That won't happen overnight, but it justifies the lack of strong support for Class III futures beyond October. In addition, producers continue to cull fewer cows to produce as much milk as they can. We realize many producers hedged 2014 at prices much lower than where we are now, making it hard to pull the trigger again. But we would seriously consider getting Q4 coverage and even look at selling the first half of 2015, which settled at an avg \$18.04 today. Including component pay, that puts many in the Midwest and Northeast federal orders near or above \$20/cwt mailbox. All of 2015 also, coincidentally, settled at an \$18.04 avg, for those that want to work further out. We can't but help to feel that eventually supply is going to catch up to demand, we just don't know when.

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