

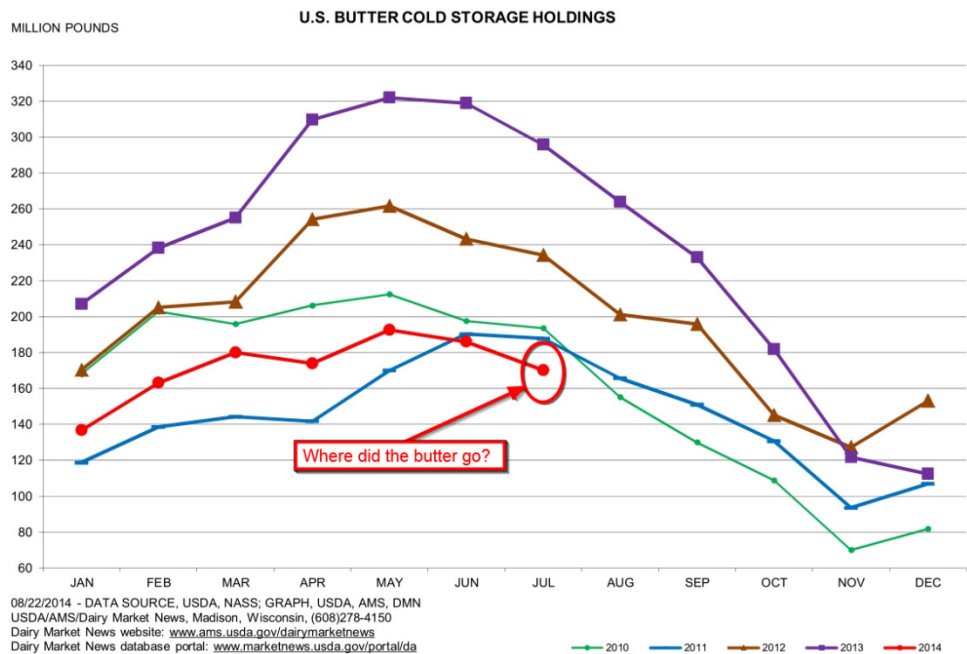
The KDM Dairy Report – August 22nd, 2014

What's Bullish:

- Spot Market: Blocks picked up 4¼¢ and barrels gained 5¢ for the week to settle at \$2.26¼/lb and \$2.26/lb, respectively. Bidders were unable to shake loose any barrels, but managed to buy 9 loads of blocks. Grade A NDM gave up 9¼¢ on just one trade to close at \$1.30/lb, but butter shot up another 16¼¢ on heavy trading of 39 loads, to close at \$2.82¼/lb.
- Cold Storage Report: Butter stocks at the end of July were down 42% vs. a year ago and down 9% from June, according to USDA (see graph). American cheese stocks were 6% less than a year ago, while total cheese stocks were down 8%.

Futures Month	Class III 08/22	Class III 08/15	Change	Dry Whey 08/22	Dry Whey 08/15	Change	Cheese 08/22	Cheese 08/15	Change
Aug-14	\$22.23	\$22.16	\$0.07	69.125¢	69.125¢	0.00¢	\$2.108	\$2.094	\$0.014
Sep-14	\$23.53	\$22.64	\$0.89	66.750¢	68.000¢	(1.25¢)	\$2.250	\$2.157	\$0.093
Oct-14	\$22.44	\$21.10	\$1.34	65.250¢	66.750¢	(1.50¢)	\$2.148	\$2.012	\$0.136
Nov-14	\$20.62	\$19.82	\$0.80	62.025¢	62.750¢	(0.73¢)	\$1.991	\$1.912	\$0.079
Dec-14	\$19.51	\$19.03	\$0.48	58.500¢	59.050¢	(0.55¢)	\$1.910	\$1.866	\$0.044
Jan-15	\$18.55	\$18.45	\$0.10	55.000¢	56.775¢	(1.78¢)	\$1.835	\$1.825	\$0.010
Feb-15	\$18.08	\$18.00	\$0.08	53.325¢	54.325¢	(1.00¢)	\$1.800	\$1.790	\$0.010
Mar-15	\$18.02	\$17.94	\$0.08	52.275¢	53.750¢	(1.48¢)	\$1.807	\$1.790	\$0.017
Apr-15	\$17.94	\$17.90	\$0.04	51.500¢	53.250¢	(1.75¢)	\$1.812	\$1.795	\$0.017
May-15	\$17.96	\$17.94	\$0.02	51.500¢	53.000¢	(1.50¢)	\$1.810	\$1.799	\$0.011
Jun-15	\$17.98	\$18.00	(\$0.02)	51.500¢	53.000¢	(1.50¢)	\$1.815	\$1.805	\$0.010
Jul-15	\$18.06	\$18.05	\$0.01	52.000¢	53.250¢	(1.25¢)	\$1.820	\$1.812	\$0.008
12 Mo Avg	\$19.58	\$19.25	\$0.32	57.396¢	58.585¢	(1.19¢)	\$1.926	\$1.888	\$0.037

- Fluid Milk East: Northeast and Mid-Atlantic milk production is trailing off seasonally. Class I demand is strong as schools re-open, though manufacturing milk volumes are sufficient. Southeast farm-level milk production moved lower as temperatures in the 90s hampered cow comfort. Bottling sales have increased, with add-ons noted. Florida milk production has seasonally declined. The weather has been hot, with 10 straight days of heat index of 100 to 105, and nighttime temperatures in low 80s. The area's Class I demand continues to draw on milk supplies as loads to manufacturing see relative reductions. Spot import shipments totaled 120 loads this week, up from 80 loads last week.
- Fluid Milk Central: Milk production is steady to slightly higher as producers are not culling as many cows, but spot loads of milk are still selling at a premium to Class. Bottling sales are mostly improved, while some ice cream makers noted better sales.

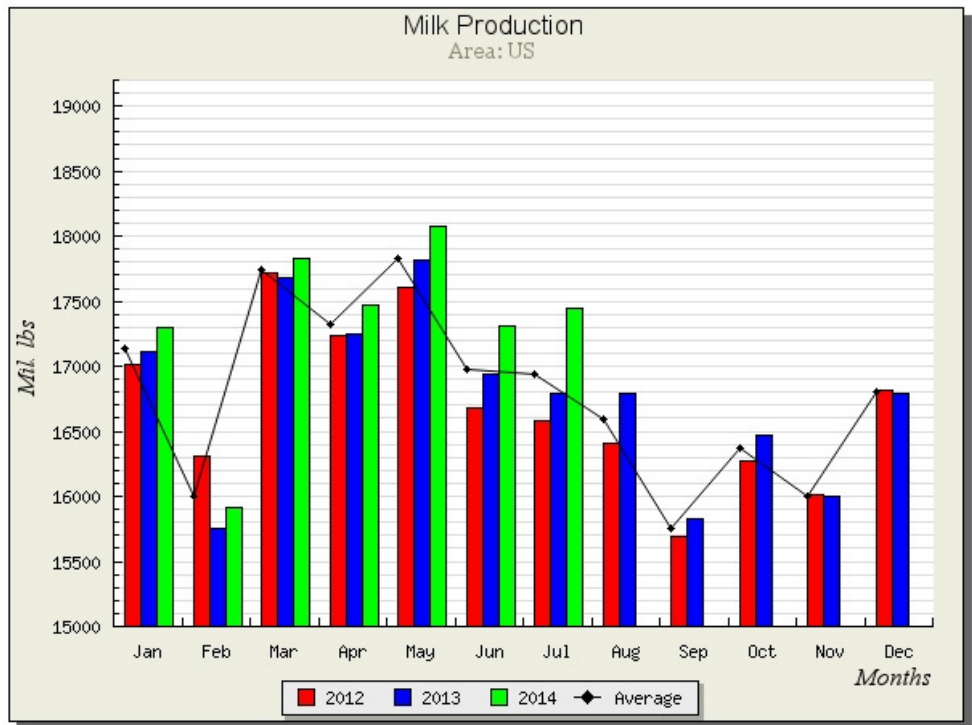


- Demand for cultured products is picking up as schools resume. Cream supplies were not as available this week.
- Fluid Milk Southwest: NM milk production is trending lower as the season advances. Milk processing both in and out of state is challenging as a shortage of truck drivers is slowing delivery of milk loads to manufacturing facilities. Orders clearing into bottled milk are increasing incrementally.
- Butter Northeast: Ongoing maintenance activities at some plants in the region has prevented some churning. Several butter manufacturers are primarily selling cream volumes into contract and spot sales. Inventories levels are unclear; however, some contacts advise they are lower than normal. Domestic butter demand is good with heightened interest expected into the fall season.
- Butter Central: Demand is keeping pace with near-record butter prices as sales continue to be higher than last year for most producers. The market tone is firm. Cream spot load availability tightened with a few butter operators still selling excess supplies. Butter churn rates are steady to slightly lower.
- Butter West: Production in the West is mostly steady, and some increased cream is available from bottlers supplying newly reopened schools. But butter demand continues to outweigh current inventories, even as cream supplies are increasingly being held for churning. Butter manufacturers are increasing print butter production in anticipation of fall holiday orders, but are constantly pressured to take advantage of high butter prices. Inventories are tight and buyers who elected to wait to procure stocks are finding it difficult to find available supplies. Bulk demand is very good. Prices are nearing the previous weekly average record price of \$2.81 from the first week of September in 1998.
- Cheese Northeast: Slightly heavy milk supplies are benefitting from strong food service orders, as some plants initiate 6-7 day production schedules to meet the demand. Still, milk supply levels are experiencing some falloffs with the re-openings of schools. Cheese stocks are primarily adequate. Most manufacturers are comfortable with inventory on hand.
- Cheese Midwest: Recent price strength has led some manufacturers to dip more deeply into cheese inventories to complete sales, leaving holdings very tight in some plants. A typical concern when prices increase quickly is that buyers might pull back, but that is not much reported as a current factor. Cheese sales are strong, both retail and food service/institutional.

- Cheese West: Cheese production in the region is mostly steady, but milk volumes are slowing seasonally, forcing cheese manufacturers to increase yields with milk solids from NDM and condensed skim where available. Most cheese plants are filling previous orders on a timely basis, but additional orders are meeting tighter inventories. Demand is outstripping supply in many cases as buffer supplies of cheese are not as readily available.

What's Bearish:

- Milk Production Report: July milk output in the U.S. was up an unexpectedly strong 3.9% vs. a year ago, while cow numbers increased 5,000 head from June. Milk per cow jumped 64 lbs vs. last July as well, powering the increase. Gains were led by AZ up 8.9%, MI up 8.2% and CO up 7.6%. CA recorded a 4.4% increase with WI coming in up 3.4%.
- Livestock Slaughter Report: Dairy cow slaughter in July totaled just 231,600 head, down 19,100 head (-7.6%) from a year ago and the lowest July total since 2011. Through July, the dairy cull is down 194,800 head (-10.7%).
- Dairy cow slaughter for the week ended 08/09 totaled 53,300 head, down 5,500 head (-9.4%) vs. the same period in 2013.
- Fluid Milk West: Milk production in CA is steady to lower, but generally higher than year ago. Dairy producers are feeding dairy cows well, and have yet to notice any sharp declines in milk prices. Processing capacity in the state is adequate to handle all milk production, but some milk loads continue to fill supply gaps in other areas.



- Fluid Milk Pacific Northwest: Cooler weather and light precipitation in the region has helped to increase cow comfort levels. While milk production is trending seasonally lower, increased retention of cows and some herd building is helping to keep milk supplies near or above year ago levels. UT and ID milk supplies are above year ago levels with increased herd size the most significant factor adding to the growth. Higher production per cow compared to a year ago also is contributing to increased milk supplies.

Recommendation:

Even as powder prices continue to decline and in the face of a bearish Milk Production report, Class III futures raced to new contract highs in Sep and Oct this week. Commercial buyers continue to feel the pinch of delaying orders and are now looking at the calendar. There does seem to be a certain amount of panic involved as strong domestic demand continues to keep the cheese and butter shelves bare. Spot butter prices pushed to within 7c of new record highs (we incorrectly stated last week was a record high), while today's Cold Storage report put butter stocks at the end of July at a 4-year low. In addition, July saw more than double the normal butter drawdown during the month. Cheese stocks came in under some analyst expectations, so this report will be seen as friendly to the market. That's balanced, however, by a bearish Milk Production Report, which has more longer-term risk than up front. The milk is coming and cow numbers continue to grow as producers slow down culling. We don't know when this short-term demand will end; maybe within 30 days. With global butter and cheese prices far below the U.S., it will encourage imports. But we're also hearing China may be back as a powder buyer come Nov/Dec. That caused quite a stir last year, though we doubt they will buy at the same frenzied level. With grain prices continuing to falter, these are amazing times for producers. We would look to continue to cover Q4 with sales or PUT options. Go after the Oct 21.00 PUT at 25c, the Nov 19.25 PUT for 25c and the Dec 19.00 PUT for 35c. We still think it's ok to get some coverage for 2015 based on last week's recommendation, but we would limit it to no more than 20-25% of your monthly production. In testament to the tight cheese market, buyers were unable to purchase any barrels and only collected 9 loads of blocks. We expect buyers to be back next week as they continue to buy cheese hand-to-mouth. Spot prices work out to just under \$24/cwt Class III, so Sep and Oct could see more substantial upside. With NDM plummeting, Class IV sits at about \$21.15/cwt. If butter ever comes down, we could see that spread grow substantially. Producers should be factoring in the possibility of a negative PPD in the months ahead. Ultimately, a weak Class IV will also pressure Class III as milk is diverted from butter/powder, into the more lucrative and profitable vat! Get some protection on!

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