

**The KDM Dairy Report – August 29<sup>th</sup>, 2014**

**What's Bullish:**

- Spot Market: Blocks gained 6¼¢ during the week to settle at \$2.33/lb while barrels picked up 8½¢ to close at \$2.34½/lb. Buyers were able to secure 17 loads of blocks, but no barrels. NDM found a bottom and rebounded up 2½¢ on 13 trades as buyers started to see value at current prices. Butter, however, lost 6¼¢ to settle at \$2.75½/lb on heavy volume of 29 trades.
- Fluid Milk Southeast: The region is seeing a steady decline in milk production. Load sizes to processors are falling off in some instances as hot temperatures affect cow comfort. Bottling sales moved slightly higher with area schools starting back up.

Futures Month	Class III 08/29	Class III 08/22	Change	Dry Whey 08/29	Dry Whey 08/22	Change	Cheese 08/29	Cheese 08/22	Change
Aug-14	\$22.24	\$22.23	\$0.01	68.700¢	69.125¢	(0.42¢)	\$2.109	\$2.108	\$0.001
Sep-14	\$23.95	\$23.53	\$0.42	65.875¢	66.750¢	(0.88¢)	\$2.298	\$2.250	\$0.048
Oct-14	\$22.87	\$22.44	\$0.43	62.500¢	65.250¢	(2.75¢)	\$2.202	\$2.148	\$0.054
Nov-14	\$21.00	\$20.62	\$0.38	60.000¢	62.025¢	(2.03¢)	\$2.040	\$1.991	\$0.049
Dec-14	\$19.80	\$19.51	\$0.29	57.500¢	58.500¢	(1.00¢)	\$1.948	\$1.910	\$0.038
Jan-15	\$18.60	\$18.55	\$0.05	54.500¢	55.000¢	(0.50¢)	\$1.856	\$1.835	\$0.021
Feb-15	\$18.21	\$18.08	\$0.13	52.250¢	53.325¢	(1.08¢)	\$1.822	\$1.800	\$0.022
Mar-15	\$18.10	\$18.02	\$0.08	51.800¢	52.275¢	(0.48¢)	\$1.813	\$1.807	\$0.006
Apr-15	\$18.04	\$17.94	\$0.10	51.000¢	51.500¢	(0.50¢)	\$1.812	\$1.812	\$0.000
May-15	\$18.00	\$17.96	\$0.04	51.000¢	51.500¢	(0.50¢)	\$1.816	\$1.810	\$0.006
Jun-15	\$18.05	\$17.98	\$0.07	50.250¢	51.500¢	(1.25¢)	\$1.825	\$1.815	\$0.010
Jul-15	\$18.04	\$18.06	(\$0.02)	52.000¢	52.000¢	0.00¢	\$1.830	\$1.820	\$0.010
<b>12 Mo Avg</b>	<b>\$19.74</b>	<b>\$19.58</b>	<b>\$0.16</b>	<b>56.448¢</b>	<b>57.396¢</b>	<b>(0.95¢)</b>	<b>\$1.948</b>	<b>\$1.926</b>	<b>\$0.022</b>

- Florida's farm-level milk production continues to drop as hot seasonal temperatures stress the cows. Class I demand is good with some bottlers adding loads. Spot import shipments totaled 160 loads this week, up 40 truckloads from previous week.
- Fluid Milk Southwest: Milk production in NM continues to trend seasonally lower. Access to tankers and drivers for milk hauling continues to present some problems. Daytime temperatures in the triple digits are common in AZ and have increased stress on dairy cows. Some relief from both misting systems and cooler nights has helped, but milk production continues to be affected. Butter manufacturers continue to look for additional cream for churning as their fall production season kicks into gear. Securing drivers and tankers continues to be a problem in moving cream over any distance.
- Fluid Milk Pacific Northwest: Milk production in the region is dropping seasonally. Higher temperatures during the day have also negatively affected production. Milk continues to remain in the region as production capacity is adequate for current supplies. ID and UT also note that milk volumes are trending seasonally lower.
- Butter Northeast: The region's butter production has improved; however, declining milk supply levels and good cream prices are limiting churning rates in the Northeast. Domestic demand is active as the Labor Day holiday approaches. Buyers are looking to obtain butter for Q4 sales. The current bulk butter prices for domestic sales are reported 4-6 cents over the market of the CME Group.
- Butter West: Fall retail demand is ramping up and manufacturers are increasing print production to fill orders for later delivery. Buyer demand remains strong for spot offerings to the market. Some increased cream supplies are becoming available to butter manufacturers, but inventories remain tight.
- Cheese Northeast: Milk intakes at cheese plants are mostly steady with production around seasonal levels. Inventories are tight with good domestic demand, as active sale transactions occur at a premium, in the spot market. The market undertone is firm.
- Cheese Midwest: Most cheese manufacturers are operating plants at or near capacity and some manufacturers continue adding nonfat dry milk to vats to increase volume. Despite this, demand continues to outstrip supply. So far, most cheese manufacturers are not contemplating schedule adjustments for the holiday weekend because most plan to continue with almost full out schedules now in effect. Cheese orders from food service and institutional buyers have come earlier this year than last year. These orders are quite strong and are believed to be a factor contributing to upward cheese price pressure. Some food service buyers last year delayed ordering, seeking to wait for lower prices. Many were then left scrambling to fill orders without the benefit of lower prices hoped for. Some of these buyers are accelerating food service orders earlier this year than previously, due to determination not to be left looking for cheese, notwithstanding current prices. In the view of some sellers, the typical September-October peak in cheese prices has now moved earlier in the year in part due to large buyers determined to secure cheese. Retail sales also remain strong in this \$2.00 plus cheese world. Retail store buyers have not slowed purchases from cheese manufacturers. Provolone sales are particularly strong and slicers are quite busy. Cheese curd sales are very robust, up from levels a year ago. With profits from curd sales ahead of profits from barrel sales, some manufacturers are delaying delivery of barrel orders in favor of selling curds. Some curd operations are running 24x7 and could sell even more. Customers for barrels are being told that it will be closer to the end of the year before the situation resolves and even that is not certain.
- Cheese West: Production continues strong as cheese stocks are often below current demand. Some increased milk is being directed to cheese production to fill that need, but many plants are already at full production. Demand is good as buyers look to acquire product for fall orders. With September around the corner, buyers are increasingly anxious to guarantee their stocks. Wholesale prices are moving higher on the good demand.
- Weekly cold storage numbers indicate butter stocks at USDA selected storage centers fell 6% (1.3 million lbs) over the period 08/01 through 08/25. Cheese stocks were flat over the same period.
- International: New Zealand's milk production is showing weekly increases, but production volumes are only just above year ago levels. Weather conditions are cool and wet, making calving and producer operations marginally difficult. The lower milk prices to start the season have narrowed producer margins significantly and will cause producers to be much more cautious in their purchases of feed and seed. Butter and AMF prices showed strength on the prospects of increased buying from Russia.

**What's Bearish:**

- Dairy cow slaughter for the week ended 08/16 totaled 52,900 head, down 6,600 head (-11%) vs. the same period a year ago. YTD the cull is now more than 200,000 head behind 2013.

- Ag Prices Report: Predictably, with the sharp downturn in grain prices and rising milk prices, the August Milk-Feed ratio is estimated at 2.55, up from 2.36 in July and the highest level since March. Expect Sep to be even higher.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic region marginally increased as cooler than normal temperatures and favorable feed costs encourage an ideal environment for production. Class I demand is good as school contracts enhance sales. Milk volumes going into manufacturing are ample.
- Fluid Milk Central: Midwestern milk production rates vary as production per cow is seasonally declining. However, more dairy cows are noted as farm herd expansions are reported. Milk handlers are pushing more milk into Class I to fill the last of the school pipelines that are starting classes next week. Bottling sales are up in the short-term, with expectations of declines in the coming weeks. Class II demand is flat. Additional cream was available as bottling increased. Cream demand is starting to weaken as some ice cream manufacturers slow cream orders.
- Fluid Milk West: CA milk production is above year ago levels. Temperatures were moderate this week, although late week temperatures returned to triple digit levels in some of the dairy areas. With most schools back in session across the state next week, some increased Class I usage was noted. July 2014 pool receipts totaled 3.42 billion lbs, 5.9% higher compared to July last year.
- Butter Central: Production in the region is steady to slightly higher as cream supply availability improved. The undertone is marginally softening as various domestic and global markets moved lower. A few butter makers noted reduced sales into the retail and food service segments. Bulk butter interest remains strong as supply offerings in the spot market are limited.
- Dry Whey: Production is steady to increasing in the Northeast as vat schedules in most channels ramp up to accommodate growing cheese orders with the restart of school. Most buyers are in a wait-and-see mode while making purchases as needed. Prices of dry whey in the Central region are steady to slightly lower. The market tone is unsettled. Some manufacturers are drying greater volumes with improved cheese production. Buyer interest domestically is flat, export orders are limited and E.U. whey prices are falling. A few buyers/end users noted looking into potentially importing dry whey. Supplies are steady to higher. Dry whey prices moved lower this week in the West. The market is showing some downward pressure as other protein product prices have weakened. Domestic demand for whey is steady, but export demand is unsettled as increased offerings at lower prices from outside the U.S. are pressuring prices lower.
- NDM: Increased offerings at lower prices from both manufacturers and brokers are clearing at discounted prices. Lower priced sales from manufacturers are moving the market more in line with international prices and helping to clear inventories. Some buyers are taking advantage of the sharply lower prices to increase their holdings and build stocks at more favorable prices, though others are delaying commitments in order to search for lower priced nonfat dry milk. The market undertone is weak.
- Fluid Milk Sales: During June, 3.8 billion lbs of packaged fluid milk products are estimated to have been sold in the United States. This was 2.2% lower than June 2013. Estimated sales of total conventional fluid milk products decreased 2.9% from June 2013.
- International: European dairy markets moved lower as the Russian ban on European imports, weighed on markets. The embargo was implemented for one year and will have the greatest impact on cheese exports. The decline in cheese exports to Russia will most likely lead to increased production of butter and skim milk powder and expanded volumes available for export. The Russian ban on EU cheese imports has been felt especially hard in the Eastern European countries of Poland, Finland and Lithuania. Some countries have requested various measures of relief from the European Commission, but getting measures agreeable to all will be difficult. Milk production continues to be active with good weather and more than adequate feed and forage supplies.
- International: Australian milk production is continuing to build with some manufacturers showing intake volumes just above year ago levels. Temperatures are increasing and will improve pasture grass growth in the major dairy producing states. Dairy markets and manufacturers are still adjusting to the impact of the Russian embargo on Australian imports. Manufacturers are still making butter and skim milk powder in lieu of whole milk powder, due to the better returns, but the marginal advantage is declining. The Russian ban has raised concerns with producers that farmgate prices could be at risk.
- International: The European Commission this week announced emergency measures to help support the milk sector in light of Russian restrictions on imports. The support will focus on milk powder, butter and certain cheeses.

#### Recommendation:

Class III futures were very reluctant to rally this week, with several days of increasing spot cheese prices followed by sell-offs. There is a real disbelief, with increasing milk production, a weak powder market and much lower international prices, that this market can sustain itself at these levels. We get that, and agree in the long term. However, Class III milk is tied to our spot cheese market, which is a “cheddar only” contract, aged 30-days or less. In talking to folks this week and listening to chatter this week, the real story appears to be about the lack of barrel cheese. We wrote a couple weeks ago about the U.S.’s limited ability to add barrel production capacity. In fact, it appears there is plenty of milk everywhere and that cheese plants are running full out. They’re adding NDM to improve yields; anything to make more cheese, but for now demand is still outpacing supply. In short, we are currently “processor constrained”. It really doesn’t matter how much milk is out there, for the moment anyway. Consider also the strong domestic demand as large commercial buyers pick up need fall suppliers. \$2 cheese is no longer a demand killer. And Dairy Market News’ comment this week about demand for cheese curds possibly limiting the barrel supply in 2015 is downright shocking. 2014 has been a wild and crazy year, as no “expert” can really predict what is going to happen with all this going on, and we haven’t even mentioned the Russian ban yet. We expect cheese prices to remain supported in the near term, but for volatility to increase as uncertainty increases. Producers should buy PUT options to protect Q4. Determine a monthly “insurance” budget and buy the highest level of protection you can afford. It’s still hard to say what to do with 2015, but conservative hedgers should possibly get a start on the first half. Two or three more consecutive Milk Production reports like the last one will begin to make an impact on 2015. Get ahead of the curve before the writing is on the wall.

**Note:** We will be closed Monday in observance of Labor Day. Have a safe weekend!

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