

The KDM Dairy Report – September 12th, 2014

What's Bullish:

- Spot Market: Blocks finished the week unchanged at \$2.35/lb while barrels gained ½¢ to settle at \$2.33½/lb. There were no trades all week. Nonfat dry milk increased ¼¢ to close at \$1.34/lb on just 4 trades. Butter was the star, leaping 15½¢ to reach \$3.00/lb on active sales of 17 loads.
- Fluid Milk Southeast: Producer milk volumes in the Southeast have somewhat steadied. The level of farm output and good Class I demand have significantly tightened milk supplies in the region. Manufacturing milk shipments are nominal this week. This week, Florida's farm-level milk production is showing signs of leveling off. Temperatures are still hot, with some afternoon showers. Class I sales ticked up slightly over last week. Cream supplies continue to tighten following the Labor Day holiday week. Cream cheese makers pull on cream supplies remains strong. Strong Class I pulls have significantly limited condensed skim milk supplies.
- Fluid Milk Central: Milk production in the region is generally above last year. However, milk handlers noted additional small herd operations selling out. Milk spot load availability tightened this week as prices ranged from \$0.50 to \$2.50 over Class. Interest from cream cheese, whipping cream, and half and half manufacturers is picking up, while high butter prices are causing some ice cream makers to cut back on production. Cream supplies tightened during the week in large part due to increased demand from cream cheese manufacturers.
- Butter: Current record prices haven't curbed domestic demand as some expected. Demand remains very good because buyers are often unable to fully secure desired volumes for upcoming holiday needs. Many butter manufacturers indicate most of current inventories are spoken for, leaving little to offer in the spot market. Domestic orders from food service and retail accounts are picking up. The trade indicates butter imports originating from New Zealand and Australia are in the process of coming to the U.S.
- Cheese West: Production continued at a strong pace this week. Milk supplies are mostly adequate for full production schedules for those plants looking to increase production. Cheese demand is good as buyers look to acquire supplies for upcoming holiday orders. Buyers are able to secure contracted volumes of cheese, but are being held back on additional orders as cheese stocks are tighter than desired. Wholesale prices for block and barrel cheeses are higher. Cheese plants are also managing their stocks to prevent building unsold inventory at current price levels.
- CWT has accepted 8 requests for export assistance to sell 1.210 million pounds of Cheddar and Gouda cheese and 11.255 million pounds of whole milk powder to customers in Asia, the Middle East, North Africa, and South America. The product will be delivered September 2014 through March 2015.

Futures Month	Class III 09/12	Class III 09/05	Change	Dry Whey 09/12	Dry Whey 09/05	Change	Cheese 09/12	Cheese 09/05	Change
Sep-14	\$24.52	\$24.28	\$0.24	67.000¢	66.750¢	0.25¢	\$2.333	\$2.316	\$0.017
Oct-14	\$23.35	\$22.67	\$0.68	64.000¢	62.250¢	1.75¢	\$2.241	\$2.186	\$0.055
Nov-14	\$20.67	\$20.49	\$0.18	60.000¢	59.000¢	1.00¢	\$2.009	\$1.990	\$0.019
Dec-14	\$19.45	\$19.47	(\$0.02)	56.000¢	57.500¢	(1.50¢)	\$1.915	\$1.900	\$0.015
Jan-15	\$18.13	\$18.45	(\$0.32)	51.950¢	54.000¢	(2.05¢)	\$1.822	\$1.838	(\$0.016)
Feb-15	\$17.71	\$18.01	(\$0.30)	49.000¢	52.300¢	(3.30¢)	\$1.797	\$1.808	(\$0.011)
Mar-15	\$17.51	\$17.89	(\$0.38)	48.000¢	51.000¢	(3.00¢)	\$1.779	\$1.802	(\$0.023)
Apr-15	\$17.52	\$17.84	(\$0.32)	48.000¢	50.000¢	(2.00¢)	\$1.784	\$1.803	(\$0.019)
May-15	\$17.54	\$17.85	(\$0.31)	48.000¢	51.000¢	(3.00¢)	\$1.781	\$1.802	(\$0.021)
Jun-15	\$17.57	\$17.87	(\$0.30)	48.000¢	50.250¢	(2.25¢)	\$1.790	\$1.812	(\$0.022)
Jul-15	\$17.75	\$18.00	(\$0.25)	49.000¢	50.625¢	(1.63¢)	\$1.808	\$1.816	(\$0.008)
Aug-15	\$17.74	\$18.00	(\$0.26)	49.000¢	51.750¢	(2.75¢)	\$1.807	\$1.815	(\$0.008)
12 Mo Avg	\$19.12	\$19.24	(\$0.11)	53.163¢	54.702¢	(1.54¢)	\$1.906	\$1.907	(\$0.002)

What's Bearish:

- Fluid Milk Northeast: Milk production is good in the Northeast and Mid-Atlantic regions. Manufacturing milk supplies for most producers are adequate for post-holiday orders in spite of strong Class I pulls. The milk supplies of some manufacturers in the Mid-Atlantic are clearing to Class III and IV at discounts because of maintenance projects taking place.
- Fluid Milk West: CA milk production is steady to increasing and continues to be well above year ago levels. Lower feed costs have helped to encourage dairies to increase production. NM milk production is steady. Scattered rains across the state this week helped to provide added comfort from the hot, dry conditions of late. Milk is available for processing plants wanting to increase production. Class I demand has flattened out for school needs. Milk is being moved out of state to fill demand outside the region. Daytime temperatures in AZ remained in the 90's to low 100's, but cooled at night. Fluid sales are flat as schools begin to normalize orders.
- Fluid Milk Pacific Northwest: Milk production in the region continues to taper off seasonally, but remains above year ago levels. Favorable cow comfort levels, combined with lower feed costs, are helping to increase overall milk production. Forage quality in parts of Utah is reported to be of superb quality with exceptional yields. Combined with lower grain costs, dairies are able to reduce overall feed cost estimates for winter rations.
- Dry Whey: Northeast dry whey prices are unchanged from the previous week, but the market tone is softening. Additional milk supplies assisted cheese and dry whey production, while buying interest for dry whey is light. Central dry whey offerings are exhibiting weaker prices as well. The market tone is softening as substitute dairy ingredient prices are lower. Many buyers are hesitant to take a position as the global whey prices are considerably lower than domestic. Western dry whey prices are mostly lower and the market tone is weaker. Whey production continues to be heavy as cheese plants are running busy schedules. Demand for whey is fair to good, but lower international prices are pressuring the market and manufacturers are lowering prices to remain competitive. Whey stocks are building and sellers are looking to keep inventories light as the market moves lower.
- NDM: Prices are weak in a softening market. Supplies exceed demand in many instances, as many buyers have ample supplies on hand.
- Cheese Northeast: Cheese output remains steady at high levels. Interest is solid, especially for mozzarella, as pizza sales increase with most schools back in session. However, the market undertone is disconcerted.

- Cheese Midwest: Sales remain good, but increasing nervousness among buyers about the staying power of current high cheese prices is noted. Cheese price increases during recent weeks have slowed. Most plants have maintained strong cheese production levels but some plants have recently reduced schedules slightly to match production to sales, especially plants with higher inventory than desired.
- International: Milk production across much of Western Europe continues to decline seasonally, but is maintaining a margin over year ago levels. Pay prices for milk are good and farmers are responding. Lower prices are noted for Western European dairy products. Weaker trends and prices in the Oceania region are influencing the market more than higher U.S. dairy product pricing. World buyers are often taking longer times in negotiations and are very cautious in securing needs in the current unsettled and weak market environment. The Russian ban on importing dairy products continues to cast a large shadow over the dairy markets, directly impacting the listed countries and indirectly affecting those countries not on the list. The E.U. Agriculture Commission has announced emergency market support systems, including the utilization of the PSA - Private Storage Aid - for butter, SMP, and certain cheeses, to assist processors. Milk production is also showing modest gains versus year ago levels in Eastern Europe. Weather conditions remain fair to good for both cows and crops. Milk prices are being adjusted lower in several countries, the result of lower dairy product pricing. The Russian ban on dairy product imports is affecting the broad scope of countries and former trading partners.
- International: Milk production in Australia is trending higher seasonally and is reflecting improving weather, feed, and input conditions. Weather has been favorable for cow comfort, calving, and pasture growth. Feed costs have been relatively stable. Analysts are forecasting higher milk output for the milk season that began July 1. Initial, official forecasts were for a 2% increase over the previous season. New Zealand milk production trends continue to build. Early indications are nearly 10% higher than year ago levels for the first two months of the new season. More cows are calving, adding to the milk output. Weather is favorable on the South Island. Calving is just beginning to build and the milk flow is slowly increasing. Declining prices are noted across dairy product categories. Buyers are more cautious in making purchases of dairy products with the weaker trends enveloping the local and global dairy markets. Demand from major buying countries remains light. Processing plants are running well as the milk flow builds. Cheese prices are steady to slightly lower. Cheese offerings from the region remain seasonally light, yet the market pricing is being impacted by more cheese offerings and lower pricing trends from the E.U. As the E.U. loses market access to Russia, more cheese is backing up and pricing under pressure. Cheddar cheese averaged a U.S. equivalent \$1.79/lb this week.

Recommendation:

In our opinion, the writing is on the wall folks. We are in the last gasps of an amazing bull market that is about to come tumbling down. While over the very long term (5-10 years) we still believe we're in a bull market, U.S. prices have reached a level disproportionate to the rest of the world, necessitating a correction. To make matters worse, the U.S. dollar has been strengthening vs. the Euro and Oceania currencies, which is great if you're planning a trip (your dollar goes further), but bad if you are trying to export already high-priced dairy products (cost for our products increases). Even now, we are hearing that the ships are headed our way, as cheaper imports have become more attractive. Production is strong in Oceania, while the Russian dairy embargo has flooded the EU with dairy products that need to find a new home. Cheese and butter are still tight in the U.S., so guess where it's headed.... Last week we predicted a correction in the next 10-60 days and we still stand by that, though we're leaning more to the shorter side of that range. Yes, butter and cheese are still tight while holiday demand is strong, but eventually that demand will be met. This week's spot market illustrated just how desperate buyers are to own product as we pushed butter to a new all-time high of \$3.00/lb. When butter turns down, however, it will have a long way to fall! Consider also that the spot cheese market was essentially quiet, with just a half-cent increase for barrels on no trades. Blocks have not seen a bid or offer since Sep 2nd, with the last trade being Aug 29th. Barrels haven't traded since Sep 4th. The market is very nervous. So nervous, in fact, that despite an unchanged spot market on Tuesday, Oct and Nov futures spent much of the day limit down simply because there wasn't a bid. With spot prices working out to just north of \$24.50 Class III, Oct futures finally rallied today to close the gap with spot to about \$1, as this contract begins pricing next week. We think further strength in Q4 next week should be sold, however. If you don't want to sell, but PUT options. Oct 22.25 PUT options settled at 30¢ today. Enter orders to buy them at 20-25¢. Selling has also been active in the 2015 contracts, with good volume in all contract months. The average settled as high as \$18.08 on Tuesday, but finished the week down 39¢ from the high, to \$17.69. Producers are getting covered and selling. We would look at putting some coverage on at \$17.90 or higher. That's a massive discount to current prices, but with beans falling below \$10/bu and corn in the low \$3 range, feed costs will be lower next year. Producers who have a positive basis to Class III can still be very profitable at these numbers. The first half of 2015 is probably more important to protect as an impending wall of milk will take some time to work through. Sorry for being so negative this week, but we call it like we see it. And we might be wrong!

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