

The KDM Dairy Report – September 26th, 2014

What's Bullish:

- Cold Storage Report: Butter stocks at the end of August were down 37% vs. a year ago, according to USDA. American cheese stocks were down 1%, while total cheese stocks were 4% lower.
- Fluid Milk Southeast: Milk output is steady in the region, but strong Class I sales are pulling heavily on milk supplies. Consequently, loads are not clearing to manufacturing. Florida milk production declined following last week's tropical storm downpour, and as a result, spot imports of milk totaled 120 tankers this week, 28 more than last week. Some areas are under flood warnings after receiving as much as 10 inches of rain. The cream market remains strong. Supplies are intermittent. Cream cheese sales are steady to strong.
- Fluid Milk West: In CA, milk production is uneven. South/Central California daytime temperatures are lower than in the previous week, but dairy herds haven't recovered sufficiently to increase milk production on a week to week basis. Milk production in NM is unchanged to slightly improving volume-wise, but dairy producers in some areas indicate dry lot operators are struggling with excess rain and waterlogged holding pens. Sales to bottlers inched higher to fulfill demand across a wider territory. Farm milk pickups continued lower in AZ. Recent spells of heat and high daytime humidity put stress on dairy cows that could not be alleviated during cooler nighttime temperatures. Balancing plant operators report available cream volumes are lower and a few regular buyers are receiving fewer cream loads on a week to week basis to help spread usage among customers. In-state cream volumes are below demand. Seasonally lower cream sales to ice cream plants have been replaced by increasing demand from sour cream and cream cheese operations. Cream is moving east into the Central region for a few loads, but Western cream buyers report interest within the West is hungry for spot cream loads.
- Butter Central: Retail demand is entering the peak season with large orders anticipated in the coming weeks. Some manufacturers are being told retailers may not promote butter as much as in previous years due to the higher prices. Sales into food service accounts are mostly steady, while ingredients orders remain active as end users gear up for the upcoming holidays. U.S. butter prices are significantly higher than international markets, which is impeding new export orders. But domestic manufacturers' supplies are limited as some finished product is going directly from the production line onto the shipping truck.
- Butter West: Retail butter needs continue to fuel production schedules for churns in the West. Demand is good with contract buyers often asking for additional loads if available. Record butter prices are having less of a deterrence to purchases as buyers look to fill fall holiday demand. Butter stocks continue to lag well behind volumes available last year.
- Nonfat dry milk: Prices have stabilized as buyers become more convinced the bottom is in. Domestic interest is growing. Some market participants report that the large volume of sales over the past few weeks has resulted in manufacturer supplies declining.
- Cheese Northeast: As seasonal declines in milk production occur, some manufacturers have begun to adjust their weekly cheese production schedules. Some buyers are finding it difficult to obtain spot loads of mozzarella, as contract orders tend to clear the majority of current production. Cheese stocks are adequate for immediate needs.
- Cheese Midwest: Production in the Midwest is mixed. Some manufacturers are reporting full production schedules and are still behind on deliveries. Others are limiting production to meet orders and are tightly managing inventories. Cheese plants do not want to have excess unsold stocks at current price levels. Retail demand is fair to good as buyers look to fill holiday needs. Mozzarella sales are also active with increased pizza demand. Barrel cheese demand is good, but supplies are tight.
- Cheese West: Production in the region is steady to stronger. Some manufacturers are operating full schedules to fill fall orders and previously committed export sales. Others are reluctant to expand production without guarantees of buyers at current manufacturing costs. Barrel demand is very good, but supplies are tight.
- International: Oceania cheddar cheese prices are steady to firm. Production is steady to increasing as milk output expands, but current production is focused on filling existing orders. Good domestic demand is factoring into and restricting supplies available for export. Japan and Korea are the primary destinations for current export orders with some smaller volume sales for New Zealand going to Russia. Prices this week averaged a U.S.-equivalent \$1.81/lb.

Futures Month	Class III 09/26	Class III 09/19	Change	Dry Whey 09/26	Dry Whey 09/19	Change	Cheese 09/26	Cheese 09/19	Change
Sep-14	\$24.58	\$24.54	\$0.04	67.350¢	67.000¢	0.35¢	\$2.345	\$2.340	\$0.005
Oct-14	\$24.29	\$24.70	(\$0.41)	64.500¢	62.500¢	2.00¢	\$2.330	\$2.385	(\$0.055)
Nov-14	\$22.03	\$22.63	(\$0.60)	58.500¢	59.975¢	(1.48¢)	\$2.150	\$2.203	(\$0.053)
Dec-14	\$20.61	\$21.06	(\$0.45)	56.000¢	56.750¢	(0.75¢)	\$2.036	\$2.075	(\$0.039)
Jan-15	\$18.75	\$18.96	(\$0.21)	51.275¢	51.500¢	(0.23¢)	\$1.885	\$1.898	(\$0.013)
Feb-15	\$17.95	\$17.95	\$0.00	48.500¢	48.550¢	(0.05¢)	\$1.825	\$1.825	\$0.000
Mar-15	\$17.76	\$17.54	\$0.22	47.000¢	47.225¢	(0.23¢)	\$1.810	\$1.791	\$0.019
Apr-15	\$17.60	\$17.47	\$0.13	46.500¢	47.000¢	(0.50¢)	\$1.800	\$1.782	\$0.018
May-15	\$17.51	\$17.45	\$0.06	46.750¢	46.725¢	0.02¢	\$1.797	\$1.782	\$0.015
Jun-15	\$17.50	\$17.52	(\$0.02)	46.025¢	47.000¢	(0.98¢)	\$1.800	\$1.787	\$0.013
Jul-15	\$17.78	\$17.78	\$0.00	47.000¢	48.250¢	(1.25¢)	\$1.815	\$1.805	\$0.010
Aug-15	\$17.90	\$17.85	\$0.05	47.750¢	48.325¢	(0.58¢)	\$1.820	\$1.809	\$0.011
12 Mo Avg	\$19.52	\$19.62	(\$0.10)	52.263¢	52.567¢	(0.30¢)	\$1.951	\$1.957	(\$0.006)

What's Bearish:

- Spot Market: Blocks fell 11¢ to settle at \$2.28/lb and barrels lost 13¢ to close at \$2.30/lb. 13 loads of blocks and 3 loads of barrels exchanged hands during the week. Butter was down a penny to settle at \$3.05/lb on 17 trades, but Grade A NDM gained 2¢ to \$1.39½/lb on 1 trade.
- Livestock Slaughter Report: Dairymen sent 37,500 fewer cows to slaughter in August vs. a year ago, a 14.1% decline. With the cost of replacements sky high, it's one way to grow the herd! YTD 232,400 fewer cows have exited the milking herd.
- Dairy cow slaughter continues to lag. Just 55,000 head were culled during the week of 09/13, compared to 65,900 head during the same period last year; a drop of 10,900 head, or -16.5%.
- Fluid Milk Northeast: Milk production is mostly steady in the Northeast. Manufacturing milk supplies are ample.

- Fluid Milk Central: Milk production in the region is mostly flat on the week. Some milk handlers noted cheese makers are reducing milk spot load purchases unless they have cheese sales to back the supplies. Bottling sales are trending lower due to the higher prices. Ice cream production rates are significantly reduced.
- Butter Northeast: Although butter makers realize a slight reduction in cream availability this week, butter output is mostly steady in the region. Sales to food service and bakeries remain active. As imported butter offerings are made available, butter producers are weighing the competitive threat on sale volumes. Some buyers are pondering the purchase of imported butter. Market participants note an unwillingness to carry inventory in excess, while speculating when butterfat prices will fall. Most inventories are sufficient for current needs, as the market adjusts toward equilibrium.
- Dry Whey Northeast: Prices are lower. Ample milk supplies to cheese manufacturing increased dry whey production this week. Producers' dry whey stocks are growing. The market continues to weaken.
- Dry Whey Central: Prices are steady to lower and the market tone is exhibiting weakness. Domestic interest is reduced as ice cream makers are scaling back whey ingredient orders. Many feed blenders have ample whey supplies to cover short to intermittent needs.
- Dry Whey West: Prices are steady to lower, with export prices significantly lower than domestic pricing. The market has a definite weaker undertone. Buyers are balancing the need to build supplies, yet are often holding out for more favorable prices.
- International: Milk production in Western Europe remains above year ago levels, but is declining seasonally. The relative strong production can be attributed to good milk prices, favorable weather, expanding dairy herds and more than adequate feed and forage supplies. European dairy commodities have become more competitive in recent weeks with the decline of the Euro, compared to the U.S. dollar. Some U.S. banks are forecasting further declines in the Euro in the coming weeks. Eastern European milk production shows fairly strong growth compared to year ago levels. Butter production in the first half of 2014 showed significant increases over previous year's levels.
- International: Australian milk production is off to a good start this season and on the rise. Early season-to-date figures show production up as much as 9% for some cooperatives, compared to last year. Temperatures are warming up nicely in major dairy producing areas and prompting increased forage growth. Dairy commodity export demand is active, but increased global supplies are offering buyers the opportunity to shop around for the best price. Trade activity with China is increasing, but without major spikes in purchasing. New Zealand milk production is in full swing with production levels quickly rising. Preliminary data shows August milk production near 5% above year ago levels. Recent rains have prompted good pasture growth on both islands. Supplies of most dairy commodities are readily available and being sourced from current production.

Recommendation:

We're glad our "bold print" recommendation from last week caused some of you to take action. For the first half of the week, it looked like horrible advice as Oct-Dec made new contract highs. But then on Thursday, two loads of barrels traded in the spot market in what was a foreshadowing of what was to come. Prior to Thursday, barrels hadn't traded since the week ending Sep 5th. Barrels finished with a bid so the market didn't completely fall apart, but during today's spot session, buyers disappeared and barrels dropped 19¢, with blocks finishing down 6¢. Record high cheese prices finally slowed sales down enough to shake loose some product. Another sell-off ensued. Nov Class III hit a high of \$23.34 on Thursday, but settled today \$1.31 lower; a rapid decline in only 2 days. More could be ahead. In what is usually a self-fulfilling prophecy, once prices start to decline, buyers typically stand on the sidelines waiting for a bottom. And who can blame them? Unless you absolutely need the product, why pay more than you have to? We're not going to gloat over our correct "call". Barrels are still on the tighter side so we could see some support surface at higher levels than many anticipate. With current spot prices working out to about \$23.75 (Nov), futures are already pricing in further declines. Next week could be wild up or down, depending on what happens. But, it was a classic example for hedgers to "sell into strength" and not try to pick a top. Should we see more dramatic declines in next week's spot market, it will be awfully hard to buy PUT options or sell; it's no fun chasing a market lower. Interestingly, the 2015 contracts finished higher overall, and we're hearing that despite some important bearish fundamentals and the prospect of a lot more milk next year, there is a surprising amount of buy-side interest. Perhaps it's long hedgers (end users of milk or cheese), or simply speculators seeing value at these prices, but it will be interesting to see if that persists despite the strong possibility of further dramatic declines in the front months. One thing to monitor; milk buyers in the EU and Oceania are dramatically slashing the prices they will pay producers in those regions, to the point that they are close to being below cost of production. If milk production in these regions drops off as producers cull more aggressively, it could act as a stabilizing force to U.S. milk prices. China could factor into the mix again if they decide to step up purchases with falling international prices. In the meantime, the obvious target for spot cheese prices is the \$1.95 to \$2.05 range they sat in most of the summer. Expect buyers to get more aggressive if we approach those levels. Our advice would be to sell rallies in Q4. Continue to look at getting at least some coverage, say up to 25% of your monthly production, in 2015.

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