

The KDM Dairy Report – October 10th, 2014

What's Bullish:

- Fluid Milk West: CA milk production is uneven. Northern California's mild weather continues, and milk production is steady. In Southern California, temperatures reached the triple digits during the last week. Milk production has been mixed, with some producers reporting steady to higher volumes and others working through lower volumes. Water shortages prevail throughout the state, with 58% of the California classified as D4, Exceptional Drought.
- Cheese Midwest: Evidence of continuing cheese inventory tightness for some buyers remains. Spot cheese sales were

Futures Month	Class III 10/10	Class III 10/03	Change	Dry Whey 10/10	Dry Whey 10/03	Change	Cheese 10/10	Cheese 10/03	Change
Oct-14	\$24.10	\$24.27	(\$0.17)	65.575¢	65.825¢	(0.25¢)	\$2.314	\$2.327	(\$0.013)
Nov-14	\$21.79	\$21.74	\$0.05	62.500¢	62.000¢	0.50¢	\$2.102	\$2.111	(\$0.009)
Dec-14	\$20.02	\$20.10	(\$0.08)	57.800¢	57.000¢	0.80¢	\$1.967	\$1.987	(\$0.020)
Jan-15	\$18.39	\$18.17	\$0.22	53.000¢	51.000¢	2.00¢	\$1.830	\$1.832	(\$0.002)
Feb-15	\$17.70	\$17.72	(\$0.02)	49.000¢	47.000¢	2.00¢	\$1.790	\$1.815	(\$0.025)
Mar-15	\$17.40	\$17.44	(\$0.04)	46.000¢	44.525¢	1.48¢	\$1.773	\$1.792	(\$0.019)
Apr-15	\$17.08	\$17.24	(\$0.16)	44.250¢	44.500¢	(0.25¢)	\$1.753	\$1.777	(\$0.024)
May-15	\$16.94	\$17.24	(\$0.30)	43.500¢	44.875¢	(1.38¢)	\$1.743	\$1.779	(\$0.036)
Jun-15	\$17.02	\$17.23	(\$0.21)	43.500¢	43.750¢	(0.25¢)	\$1.751	\$1.778	(\$0.027)
Jul-15	\$17.04	\$17.35	(\$0.31)	42.750¢	44.000¢	(1.25¢)	\$1.765	\$1.794	(\$0.029)
Aug-15	\$17.16	\$17.34	(\$0.18)	43.000¢	44.000¢	(1.00¢)	\$1.772	\$1.800	(\$0.028)
Sep-15	\$17.08	\$17.34	(\$0.26)	43.250¢	44.500¢	(1.25¢)	\$1.762	\$1.787	(\$0.025)
12 Mo Avg	\$18.48	\$18.60	(\$0.12)	49.510¢	49.415¢	0.10¢	\$1.860	\$1.882	(\$0.021)

made early this week to buyers who were willing to pay based on last week's averages, rather than wait a few days to obtain cheese at this week's averages. Cheese supplies in the Midwest remain tighter than might have been the case in recent years, due to current factors making it more expensive to supplement Midwest inventories with cheese manufactured in the West. Buyers have surprised some manufacturers by already seeking commitments to supply 2015 cheese orders. Quoted premium increases by manufacturers do not seem to be a significant deterrent to contracting. At an international dairy expo trade show in Wisconsin last week, a cheesemaker sold out a number of varieties before the show ended, even with supply levels having increased from levels sold a year ago.

- Exports: CWT has accepted 6 requests for export assistance to sell 546,747 lbs of Cheddar and Gouda cheese, 49,604 lbs of butter (82% milkfat) and 4.676 million lbs of whole milk powder to customers in Asia, Central America and the Middle East. The product will be delivered October 2014 through March 2015.
- International: Australian milk production is building towards the seasonal peak. The good early season weather conditions for milk production have given way to dry conditions in some areas. Irrigation has started in areas of Victoria, which is earlier than usual. Production through September has seen increases over year ago levels, but weather concerns have caused some cooperatives to lower their milk production estimates for this season.

What's Bearish:

- Spot Market: Blocks gained 4¼¢ for the week to settle at \$2.19¢/lb on just 1 trade, but barrels lost 7¢ on 5 trades to close at \$2.10/lb. Butter plunged another 9¢ on mainly offers, with just one trade during the week, settling at \$2.80½/lb. Grade A NDM declined 1½¢ to close at \$1.38/lb on just one trade.
- U.S. dairy exporters shipped 12% fewer dairy products out of the country this August than a year ago, and also saw a 7% decline in exports vs. July, according to the U.S. Dairy Export Council. Sales have fallen in four of the last five months as the U.S. faces price disadvantages from Oceania and the E.U.
- Weekly cold storage numbers indicate both butter and cheese stocks are starting to build in October. Butter holdings at USDA-selected storage centers increased 3% while cheese holdings increased 1% over the period 10/01 through 10/06.
- Producers are continuing to grow the herd from within. Dairy cow slaughter for the week ended 09/27 totaled 55,400 head, down 8,900 head (13.8%) vs. the same period a year ago.
- Fluid Milk East: Milk volumes in the Northeast and Mid-Atlantic are steady to higher. Class I demand is level. Balancing plant managers report that discounted milk volumes are heavy. Transportation issues are problematic, as some sellers are finding it hard to locate trucks. Southeast milk production volumes are heavier. Manufacturing plants across regions are receiving surplus supplies. Spot milk shipments into Florida this week totaled 130 loads, 10 less than last week. Ample milk production, increased Class I usage, and declines in ice cream production have helped advance cream volumes in the East. Condensed skim supplies are steady to higher. Spot sales are active. Some discounted transactions are below market.
- Fluid Milk Central: Mild weather and improved feed quality are contributing to generally increasing milk production rates along with improved butterfat and protein levels. Milk spot load availability is also increasing. Class II interest is mostly flat across the various products. Declining orders from ice cream makers and ample butterfat imports have dramatically reduced cream demand, leaving internal cream supplies readily available.
- Fluid Milk Southwest: Milk production in NM is steady, with pleasant temperatures aiding cow comfort. Rain is less of a problem this week, and holding pen surfaces are drier than in weeks past. This is giving cows some relief from walking through mud. Class I deliveries are down slightly. Dairy operators report milk production is unchanged to improving in AZ. Heat and humidity abated in recent days, allowing cows some time for recuperation. Handlers indicate sales to bottling plants are unchanged to lower as holiday schedules impact orders from educational institutions.
- Fluid Milk Pacific Northwest: Milk supplies are strong in the region, within the context of production declining seasonally. Milk production remains above levels a year ago in many areas. Temperatures rarely above the 70's, with lows in the 30's and 40's, prevailed. It was a good week for harvesting, with precipitation below average.
- Butter: Operators are churning at generally higher rates as cream is readily available. Manufacturers are working ingredient inventories lower and purchases of cream and bulk butter are largely linked to print butter orders. Interest for retail butter is active. However, some retailers are

waiting on anticipated lower prices before placing large holiday orders. Export interest is marginal as U.S. prices are not competitive against other global markets. Domestic supplies are marginally growing.

- Dry Whey Northeast: Prices fell on a weak market. Spot price offerings are generally lower, with discounts under the market. Competitive global whey markets are marginalizing exports. Domestic demand is mixed. Production of dry whey continues to rise, with heavy cheese manufacturing, as seasonal milk volumes increase. The market undertone is soft.
- Dry Whey Central: The market tone is weakening. Cheese production rates are increasing, causing additional drying of sweet whey. Domestic interest is declining as more end users report adequate supplies on hand. Competing international whey prices are limiting U.S. participation in the export markets.
- Dry Whey West: Current inventories of Western dry whey are sold out or sold down. However, buyers are not particularly motivated to secure purchases. Observations heard from varied quarters indicated alertness to the potential for pricing to decline in the future.
- Cheese Northeast: Vats are operating near capacity at some plants as heavy milk intakes as well as seasonally strong cheese demand prompt weeklong production schedules. Exports are slow.
- Cheese West: A recent development is cheddar supplies being increasingly considered to be long. Cheddar aging programs are thus expanding. Meanwhile, cheese export opportunities are fading. U.S. pricing makes exporting increasingly challenging. In fact, some cheese previously exported has returned to the U.S., after original buyers subsequently obtained lower priced cheese from other countries, then shipped the originally exported U.S. cheese back to the U.S.
- International: Western Europe milk production is declining, but remains above year ago levels. Weather conditions are favorable and cow comfort levels are good. Farmgate prices, have declined, but still hold a good return for producers. Additional price declines are expected in the future, prompting milk producers to make as much milk as possible while the prices are good. The decline in the Euro, compared to the U.S. dollar, supports European exports by making them more competitively priced. Milk production in Eastern Europe has declined, but remains ahead of last year's levels. Weather conditions are favorable for milk production and producer margins remain good.
- International: New Zealand milk production is robust and expanding towards the seasonal peak and above year ago levels. Some cooperatives have reduced farmgate prices. Some producers have responded by taking steps to increase production, via supplemental feeding, in order to sustain a comparable cash flow. Milk manufacturing is very active and supplies are building.

Recommendation:

The supply side of the equation continues to increase (low cull rates, strong output in Oceania and the E.U., cheap feed) while international demand continues to falter (note export data above). Domestic demand remains good for now, however, which is allowing for what looks like an orderly decline in prices going in to the end of the year. However, once that demand is satisfied, we believe we're in for some lower prices for a sustained amount of time. 2015 contracts continue to erode as producers are still able to lock in a profitable margin. Don't wait until you see \$16's and \$15's to hedge when you could have locked in \$17's. Sure, it's far less than this year's prices, but potentially losing up to \$2/cwt in margin could make the difference between being profitable, even just barely, or bleeding cash at a decent rate for an extended time. We continue to recommend getting coverage in 2015, and if you're worried about prices rallying after you pull the trigger, just spend the money and get some kind of upside protection in place, even if it's \$2 higher than where you sold. Better to be able to sleep at night than to fret over opportunity cost. The picture is looking increasingly bearish given the strength in the U.S. dollar, which makes our exports more expensive for international buyers. In addition, the U.S. stock market is showing signs of a possible major correction as the bull market it has experienced since early 2009 has been broken (see chart).



The stock market is an emotional animal. If we were to see a major correction, consumers watching their retirement portfolios invested in IRAs and 401k's declining in value can substantially lower consumer confidence and spending. Wallets and purses are tightened. Less going out to eat = less demand for dairy. It's just another factor to watch as we navigate the possibilities for 2015. Producers should be hedgers not necessarily trying to outguess the market. Trade accordingly!

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