

**The KDM Dairy Report – October 24<sup>th</sup>, 2014**

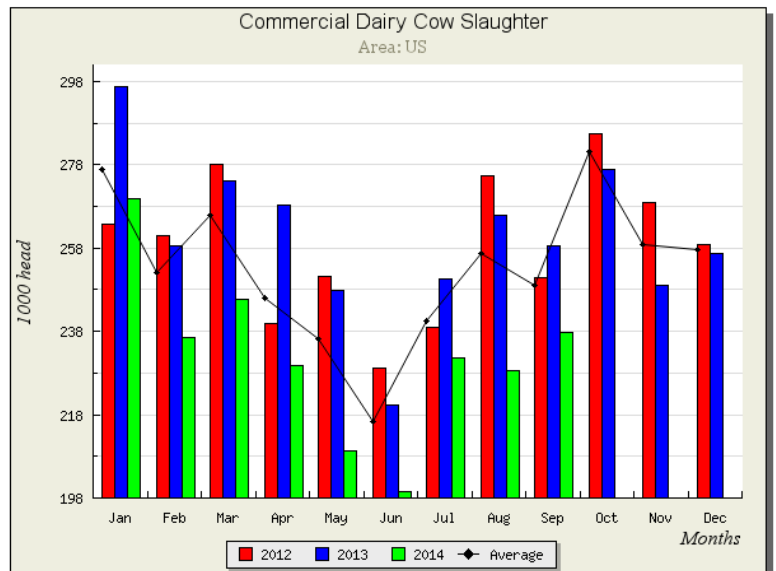
**What's Bullish:**

- Cold Storage Report: Butter stocks in cold storage at the end of September totaled 146.1 million lbs, down 37% vs. a year ago, and down 11% from August. American cheese stocks were down 5% and 3%, respectively.
- Butter stocks at USDA-selected storage centers have declined 15% (2.5 million lbs) over the period 10/01 through 10/20.
- Fluid Milk East: In the Northeast and Mid-Atlantic regions, milk production is mostly steady with movements along seasonal trends. Class I demand is steady with adequate orders. Florida imported 160 spot shipments of Grade A milk, matching last week's import loads. Milk production is mostly flat, as hot and rainy conditions continue. Contacts note that increasing Class I demand relates to the arrival of seasonal tourists, and eggnog availability. Southeast milk production is mostly steady to slightly higher. Bottling plants in the Southeast are actively processing milk loads, as orders are strong.
- Fluid Milk Pacific Northwest: Balancing plants in the region are using virtually all current production to fill orders and contracts for various dairy products. Milk production varies from state to state, but generally, volumes are in balance with demand.
- Butter Central: Holiday orders are picking up, spurred by recent declining wholesale butter prices. Production rates vary, but are generally higher as manufacturers look to fill seasonally increasing sales. Interest from both retail and food service accounts strengthened. U.S. prices are converging to competing global markets.
- Cheese Northeast: Cheese production is seasonally strong alongside increased milk production, but cheesemakers are noting good holiday sales, with steady orders. Wholesale transactions into foodservice are adequate. Buyers remain cautious, but current cheese inventories are not burdensome.
- Cheese Midwest: Some cheese manufacturers in the region believe cheese inventory levels are "decent" while others note inventory levels being worked lower. Opinions about sales are mixed, with some cheese plants being sold out for much of this year, some reporting good sales, while some note customers still purchasing hand to mouth while hoping for a price decline. Midwest demand for Italian cheese remains particularly strong and is expected to remain strong for a couple of more weeks. Halloween is regarded as one of the strongest food service days of the year for pizza sales, with frozen pizza sales also strong.
- Cheese West: Demand for cheese in the West mostly remains strong, with some buyers showing steady interest. There have been inquiries seeking additional cheese beyond contracted supplies received by some manufacturers. Some buyers who have not entered into purchase contracts, seeking last minute spot purchases this week, have been disappointed.
- CWT has accepted 9 requests for export assistance to sell 3.252 million pounds of butter (82% milkfat) and 55,116 pounds of Cheddar cheese to customers in Europe, the Middle East and North Africa. The product will be delivered December 2014 through April 2015.
- International: Temperatures in Australia are increasing with highs approaching 90 degrees. The increased temperatures are quickly drying out those areas that do not irrigate. The dry conditions have already significantly reduced anticipated crop harvests. Dairy Australia reports increased hay price volatility as overall hay yields are being downgraded, due to the lack of rain. Higher water costs and lower yields will continue to impact hay supplies in the major dairy producing regions.

Futures Month	Class III 10/24	Class III 10/17	Change	Dry Whey 10/24	Dry Whey 10/17	Change	Cheese 10/24	Cheese 10/17	Change
Oct-14	\$23.88	\$23.96	(\$0.08)	65.175¢	65.500¢	(0.33¢)	\$2.295	\$2.302	(\$0.007)
Nov-14	\$20.79	\$21.57	(\$0.78)	61.500¢	62.050¢	(0.55¢)	\$2.025	\$2.097	(\$0.072)
Dec-14	\$18.63	\$19.42	(\$0.79)	59.500¢	61.275¢	(1.78¢)	\$1.818	\$1.892	(\$0.074)
Jan-15	\$17.83	\$18.25	(\$0.42)	53.000¢	55.775¢	(2.78¢)	\$1.780	\$1.815	(\$0.035)
Feb-15	\$17.00	\$17.47	(\$0.47)	48.525¢	49.250¢	(0.73¢)	\$1.725	\$1.772	(\$0.047)
Mar-15	\$17.06	\$17.25	(\$0.19)	45.525¢	46.000¢	(0.48¢)	\$1.749	\$1.770	(\$0.021)
Apr-15	\$16.92	\$16.93	(\$0.01)	45.500¢	44.000¢	1.50¢	\$1.737	\$1.746	(\$0.009)
May-15	\$16.85	\$16.85	\$0.00	44.500¢	43.200¢	1.30¢	\$1.738	\$1.746	(\$0.008)
Jun-15	\$16.95	\$16.95	\$0.00	45.000¢	43.000¢	2.00¢	\$1.748	\$1.760	(\$0.012)
Jul-15	\$17.02	\$17.00	\$0.02	45.000¢	43.500¢	1.50¢	\$1.752	\$1.760	(\$0.008)
Aug-15	\$17.15	\$17.10	\$0.05	45.000¢	43.450¢	1.55¢	\$1.763	\$1.767	(\$0.004)
Sep-15	\$17.22	\$17.13	\$0.09	45.000¢	42.975¢	2.03¢	\$1.771	\$1.775	(\$0.004)
<b>12 Mo Avg</b>	<b>\$18.11</b>	<b>\$18.32</b>	<b>(\$0.21)</b>	<b>50.269¢</b>	<b>49.998¢</b>	<b>0.27¢</b>	<b>\$1.825</b>	<b>\$1.850</b>	<b>(\$0.025)</b>

**What's Bearish:**

- Spot Market: Blocks and barrels both lost 14¾¢ for the week to settle at \$2.14/lb and \$1.92¼/lb, respectively. There were just 2 blocks trades, but 15 loads of barrels exchanged hands. NDM gave up 13¾¢ to close at \$1.24¼/lb on 5 trades, while butter plunged another 19¢ to settle at \$1.82/lb on heavy sales of 40 loads.
- Livestock Slaughter Report: Commercial dairy cow slaughter in Sep totaled 237,700 head, down 8.1% (20,900 head) vs. Sep '13.
- Dairy cow slaughter for the week ended 10/11 totaled 55,300 head, down 8.3% vs. the same period last year. YTD, the cull is now more than 250,000 head behind 2013.
- Cream Northeast: Cream demand is slow and supplies are abundant. Cream multiples for all Classes are lower due to heavy supplies. A majority of the cream is clearing to butter makers. Cream cheese, sour cream, and yogurt production is slow to moderate. Condensed skim supplies are significant. Class IV production is active to handle increased supply levels.
- Fluid Milk Central: Milk production in the region remains strong with a few areas experiencing slight declines. Contacts note increased cattle transfers in the form of growing herds and farm



sellouts, as well as many farm expansions to accommodate more cows. Milk supplies continue to grow as a few plants are nearing capacity levels. Bottling sales are generally declining.

- Fluid Milk West: CA milk production is mostly steady with recent weeks at levels slightly above a year ago. Weather conditions are favorable for milk cows across the Central Valley. Milk production in NM is holding mostly steady with recent weeks, while Class I orders were lower. Milk production in AZ is steady to slightly higher. Processors are stepping up plant operations to handle additional milk supplies. Class I orders slowed this week with retail orders lower.
- NDM: Production rates are pushing higher as milk supplies are growing. Buyer interest is light unless discounts are present. Domestic demand is weak, while export orders are slow. Inventories are building.
- International: Western Europe milk production continues to decline and is nearing the seasonal low point. Farmgate prices have declined, but are not to a level to prompt producers to lower milk production or reduce herd sizes. Increases in global milk production and dairy product manufacturing have pressured prices lower for most dairy product markets and contributes to the weak undertone. Milk production in Eastern Europe continues to decline along the typical seasonal track. However, weather conditions, feed supplies and producer margins are favorable for milk production.
- International: Australian milk production is near the seasonal peak. Milk flows going into manufacturing facilities are heavy with most plants operating at near capacity. Supplies for all dairy commodities are building. Cheddar cheese output has increased significantly with the high milk volumes. Supplies, which were fairly light, are now building with the increased production. Cheddar prices have declined since the last reporting period, and now average a U.S.-equivalent \$1.79/lb.
- International: Dairy Australia reported this week that September milk production was 4.2% higher than a year ago. YTD (July-Sep) output is up 2.8%.
- International: New Zealand milk production is nearing its seasonal peak. Weather conditions are favorable for milk production with year to date preliminary estimates showing production 5% above year ago levels. Rainfall is more than adequate and warmer temperatures are prompting good forage growth. Manufacturers are operating at or near maximum capacity in order to clear the incoming milk supply.

#### **Recommendation:**

The week started out on a promising note as bidders for cheese and butter moved prices higher in the spot market. However, the formerly tight barrels traded 12 times on Tuesday while declining 7¼¢. Both blocks and barrels were higher again during Wednesday's spot session, leading to a positive start early Thursday. The Nov Class III contract put in a high of \$21.99 due to its perceived discount to current cheese prices, until the floor dropped out and blocks fell 21¼¢ in one spot session. Nov traded limit down 75¢ for a time, while further spot weakness on Friday pushed the contract even lower. Today's settlement at \$20.79 is \$1.20 off the previous day's high. Ouch. Dec Class III felt the pain as well, putting in a high of \$19.46 on Thursday, before settling at \$18.63 today. With the drop in the front months, the last half of 2015 actually posted a modest gain. However, the 2015 avg closed at \$17.13, down 6¢ from last Friday. It's hard to say where we go from here. Despite big milk production, cheese stocks are not heavy, while holiday demand is still good. We appear to remain processor-constrained on cheese as plants are mostly running full-out, yet many are sold out for the year. However, we can't ignore the action in this week's spot market. The fact a total of 17 loads of cheese traded this week indicates there is a willingness to sell, and might have something to do with imports finally arriving on our shores. Consider butter, whose cold storage stocks are down 37% vs. last year, yet saw prices plunge. Indeed, our dairy product prices are finally converging with international prices. We believe the market will continue to be volatile in the near term, as hand-to-mouth demand for the holidays meets inconsistent supplies. But we maintain a bearish outlook longer term and think any rallies should be sold. We've managed to cull 250,000 fewer cows which is increasing the herd size. Milk supplies are already strong; come spring we will have an amazing amount of fresh milk on hand. We would continue to aggressively sell Q1 and Q2, with less aggressive selling in Q3 and Q4. Time may be running out before prices make the next move lower.

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