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The KDM Dairy Report – October 31st, 2014

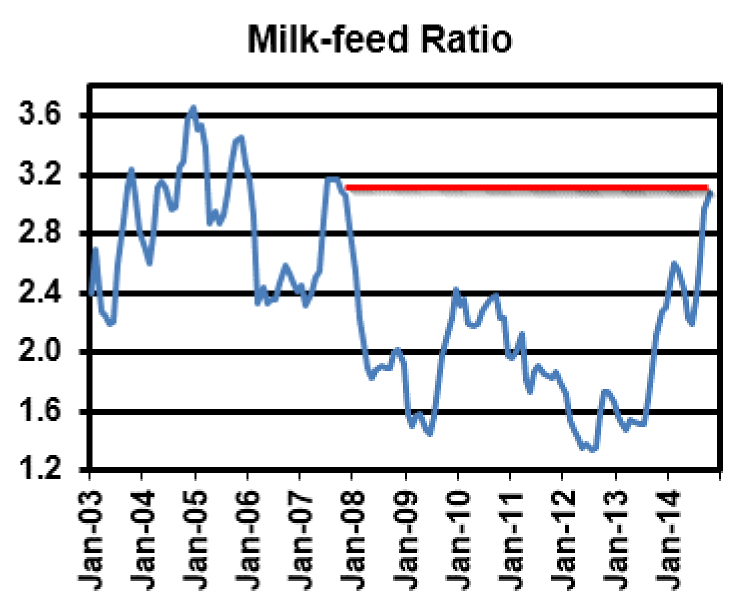
What's Bullish:

Futures Month	Class III 10/31	Class III 10/24	Change	Dry Whey 10/31	Dry Whey 10/24	Change	Cheese 10/31	Cheese 10/24	Change
Oct-14	$23.79	$23.88	($0.09)	65.075¢	65.175¢	(0.10¢)	$2.290	$2.295	($0.005)
Nov-14	$21.25	$20.79	$0.46	59.500¢	61.500¢	(2.00¢)	$2.092	$2.025	$0.067
Dec-14	$18.99	$18.63	$0.36	57.000¢	59.500¢	(2.50¢)	$1.865	$1.818	$0.047
Jan-15	$17.85	$17.83	$0.02	53.000¢	53.000¢	0.00¢	$1.781	$1.780	$0.001
Feb-15	$17.41	$17.00	$0.41	50.000¢	48.525¢	1.48¢	$1.757	$1.725	$0.032
Mar-15	$17.06	$17.06	$0.00	46.500¢	45.525¢	0.98¢	$1.747	$1.749	($0.002)
Apr-15	$16.90	$16.92	($0.02)	46.000¢	45.500¢	0.50¢	$1.727	$1.737	($0.010)
May-15	$16.91	$16.85	$0.06	46.500¢	44.500¢	2.00¢	$1.732	$1.738	($0.006)
Jun-15	$17.01	$16.95	$0.06	46.500¢	45.000¢	1.50¢	$1.740	$1.748	($0.008)
Jul-15	$17.10	$17.02	$0.08	46.025¢	45.000¢	1.03¢	$1.743	$1.752	($0.009)
Aug-15	$17.29	$17.15	$0.14	47.725¢	45.000¢	2.73¢	$1.761	$1.763	($0.002)
Sep-15	$17.33	$17.22	$0.11	48.000¢	45.000¢	3.00¢	$1.768	$1.771	($0.003)
12 Mo Avg	**$18.24**	**$18.11**	**$0.13**	**50.985¢**	**50.269¢**	**0.72¢**	**$1.834**	**$1.825**	**$0.008**

- Spot Market: Blocks were unchanged for the week, settling at $2.14/lb, but barrels jumped 19¾¢ to close at $2.11/lb and butter gained 8¢ to $1.84/lb. Grade A NDM was down ¼¢ to $1.24¼/lb. 6 loads of blocks, no barrels, 1 load of NDM and 20 loads of butter exchanged hands.
- Butter holdings at USDA-selected storage centers are down 16% (2.7 million lbs) over the period 10/01 through 10/27, according to weekly data.
- Fluid Milk Southwest: Production is even at the farm level in Florida, but strong Class I demand resulted in the import of 170 loads of Grade A milk into Florida, 10 more than last week. Milk distributed to bottling facilities is rising as orders increase. Milk supplies clearing to manufacturing are marginal. Fluid sales are good. Demand from all milk Classes is active. Contacts state buyers are seeking loads, as some cream users look to catch up following limited production, while butterfat prices moved lower. Sales of cream into cream cheese, sour cream and dips are steady to higher.
- Fluid Milk Pacific Northwest: Milk production in the region is mixed. Overall milk production is generally above last year's totals, but week to week intakes are declining toward the seasonal low point. Processing plant operators indicate they are selectively filling some plants and keeping others below capacity, depending on the product mix needed.
- Cheese Northeast: In general, strong holiday orders are pressuring plants to operate on 6-7 day production schedules. Domestic demand is active as holiday trade progresses. A variety of cheeses are experiencing seasonally strong sales. As the expectation that prices will fall looms, some cheese manufacturers note the challenge in maintaining tight inventories and the ability to accommodate seasonal demand.
- Cheese Midwest: Orders for cheese leading into the holiday season are increasing, but more ordering is still anticipated. Blocks are in balance in much of the Midwest, with barrels slightly tighter. Two factors are expected to increase cheese ordering in the near future. The timing of holidays ahead with the need to replenish/increase store inventory levels is one factor. A more immediate factor may be that a number of cheese converters who typically pay for cheese based on the monthly price average of the previous month, are believed to be awaiting November (next week) to increase ordering.

What's Bearish:

- Ag Prices Report: The October milk-to-feed ratio came out to 3.07, up from 2.97 in Sep and the first time we've been above 3.0 since Nov 2007; that's nearly seven years folks (see chart). A ratio above 3.0 has historically indicated a signal for expansion, which we have certainly seen.



- Dairy cow slaughter for the week ended 10/18 totaled 55,700 head, down 8.1% (4,900 head) vs. the same period a year ago.
- Fluid Milk Northeast: Milk production in the region is steady, as is Class I demand. Manufacturing milk supplies are sufficient for most production, although it's noted that seasonal milk increases above last year are hampering the level of specialty powder production in some channels. Mid-Atlantic farm level production is steady and above last year's numbers at this time. Manufacturing supplies are adequate.
- Fluid Milk Central: Milk production in the Central region continues to exceed levels of last year at this time. The extra milk supplies are starting to outpace demand as premiums for spot loads of milk are fewer and farther in-between. Milk spot loads ranged from $2.50 under Class to just $0.50 over. Many processors are strategizing holiday milk arrangements. Bottling sales are lackluster with noted marginal declines in sales.
- Fluid Milk Southwest: Milk production in CA is steady to higher as cooler temperatures support cow comfort in the region. However, on the feed side of milk production, availability of supreme quality dairy cow alfalfa is tight. September 2014 pool receipts of milk in CA totaled 3.18 billion lbs, 3.3% higher compared to September last year. NM milk production is working toward reversing the summer downward trend. Pickup volumes moved higher at several locations. Sales into Class I shifted lower, as some out-of-state buyers pushed back loads. Milk producers in AZ report production is higher throughout the state. In addition to increasing in-state milk volumes, some processors are also handling out-of-state surplus loads. Ice cream manufacturers are taking decreased volumes as that season retreats. Buyers and sellers report spot cream loads are readily available in many parts of the West.

- Butter: Some buyers are actively placing holiday print orders, while others are <u>shopping around</u> and are optimistic <u>prices could fall further</u>. Export orders remain at <u>light levels</u>. Contacts indicate butterfat <u>imports continue to make their way</u> to the U.S. Butter manufacturers are linking production strongly with orders, and disinclined to build stocks. However, some regions are <u>facing growing milk and cream supplies</u>, resulting in gradually <u>increasing warehouse inventories</u>.
- Dry Whey Northeast: Prices are unchanged to <u>lower</u>, in a <u>softening market</u>. Production is steady. Inventories are moderate. Buyers of dry whey are <u>careful to control purchases</u>. Dry whey domestic <u>demand is fair</u> from bakeries and confectionary accounts.
- Dry Whey Central: Prices <u>declined</u> this week as index prices are <u>weakening</u>. The undertone is <u>soft</u>. Buyers noted <u>additional offerings</u> and discounts in the spot market. A few manufacturers are looking to clean out inventories before year's end. Production rates are <u>strong</u>, mirroring cheese vat schedules. Export orders are <u>slow</u> as U.S. prices continue to <u>exceed</u> competing global markets.
- Dry Whey West: Market participants report the market has a <u>weaker undertone</u> developing as U.S. prices, which are higher than world prices, are <u>limiting</u> export opportunities. Production is <u>active</u> as Western region milk production is either regaining some volumes, or manufacturers are choosing cheese over powder production. Dry whey inventories are mixed, with some manufacturers reporting <u>higher stocks on hand</u>.
- NDF Northeast: Prices for nonfat dry milk are mixed, as the market undertone <u>weakens</u>. As the market continues to <u>trend downward</u>, domestic demand is somewhat <u>lethargic</u> as potential buyers <u>delay purchases</u> outside of current needs.
- NDM Central: The undertone is <u>softening</u> behind nervousness of <u>cheaper international pricing</u> and <u>growing milk supplies</u>. Production rates continue to be <u>strong</u>. Domestic sales are moderate, while <u>export orders are slowing</u>. Supplier inventories of low/medium heat NDM are generally <u>increasing</u>.
- NDM West: Prices moved <u>lower</u> this week as a few manufacturers took opportunities to lighten inventories built earlier in the year. Nonfat dry milk production is <u>active</u>, especially in areas where milk production is <u>trending upward</u>.
- Cheese West: Demand from Western buyers is steady, but <u>buyers are aware</u> of the recent shifts in market tone. Buyers are watching in-house inventories closely, and tying spot purchasing activities to near term needs. In the Pacific Northwest, milk intakes are hovering near the seasonal low point, but some plant operators are <u>keeping cheese plants running at capacity</u>. Those cheese volumes are reportedly fully contracted to clear before the end of the year to both domestic and internationally buyers.
- Cheese: Foreign cheese is <u>increasingly competing</u> with domestic production on a price basis. World dairy product prices lower than U.S. prices, coupled with a <u>strengthening dollar</u>, make imported cheese <u>more competitive</u> in the U.S. It is said that "lots of cheese" is now <u>on boats</u> heading toward the U.S.
- International: Total cheese production in Australia was <u>up 9.6%</u> in Aug vs. last year, according to Dairy Australia. Cheddar output <u>jumped 22.6%</u> over the same period. Yikes!

Recommendation:

Class IV led the rally last year and looks to lead the way lower going forward. With the exception of holiday demand still supporting cheese and other dairy items, it's a bearish picture out there. Sure, a lot of cheese output is contracted through the end of the year, and we may see some Super Bowl demand after that, but we wouldn't be surprised to see milk prices take a further tumble before then. Consider the fundamentals. Cow numbers are up, milk production is up, international demand is tapering, international prices are much lower, boats are headed our way. Current spot prices work out to about $21.60 Class III and $16.75 Class IV. With the market bearish dry whey, butter and NDM/powder, Class IV is likely to head lower still. How long can Class III hold out? We put out our first big SELL! recommendation on 09/16. At that time, the Jan-Jun average was $17.79 and the Jan-Dec average was $17.85. Today, we're sitting at Jan-Jun $17.19 and Jan-Dec $17.25. These prices are not great, but for many of you, with component pay, still profitable. We continue to recommend getting aggressively sold Q1 and Q2, with less aggressive selling in Q3 and Q4. It appears the writing is on the wall, and short of a geopolitical event or an act of God, the future points lower.