

The KDM Dairy Report – November 7th, 2014

What's Bullish:

- Spot Market: Blocks gained 6¢ to settle at \$2.20/lb and barrels were up a penny to \$2.12/lb. Only bids and offers moved the market as there were no trades. Grade A NDM fell 8¼¢ on 8 trades to settle at \$1.16/lb, but butter jumped 11¼¢ to \$2.00¼/lb on 5 trades.
- Cream East: Demand is strong, while supplies are tight. Buyers short on supplies are finding it difficult to locate enough cream to fulfill current contracts. As a result, delays in shipments are occurring, as well as bids to redeem loads from previous spot transactions. Tight supplies have pushed multiples higher. Cream cheese orders are strong, with a considerable amount of last minute orders.

Futures Month	Class III 11/07	Class III 10/31	Change	Dry Whey 11/07	Dry Whey 10/31	Change	Cheese 11/07	Cheese 10/31	Change
Nov-14	\$21.86	\$21.25	\$0.61	59.750¢	59.500¢	0.25¢	\$2.149	\$2.092	\$0.057
Dec-14	\$19.18	\$18.99	\$0.19	54.875¢	57.000¢	(2.13¢)	\$1.905	\$1.865	\$0.040
Jan-15	\$17.57	\$17.85	(\$0.28)	49.750¢	53.000¢	(3.25¢)	\$1.770	\$1.781	(\$0.011)
Feb-15	\$16.90	\$17.41	(\$0.51)	47.250¢	50.000¢	(2.75¢)	\$1.722	\$1.757	(\$0.035)
Mar-15	\$16.69	\$17.06	(\$0.37)	44.000¢	46.500¢	(2.50¢)	\$1.720	\$1.747	(\$0.027)
Apr-15	\$16.74	\$16.90	(\$0.16)	43.900¢	46.000¢	(2.10¢)	\$1.725	\$1.727	(\$0.002)
May-15	\$16.73	\$16.91	(\$0.18)	43.900¢	46.500¢	(2.60¢)	\$1.725	\$1.732	(\$0.007)
Jun-15	\$16.75	\$17.01	(\$0.26)	44.225¢	46.500¢	(2.28¢)	\$1.727	\$1.740	(\$0.013)
Jul-15	\$16.90	\$17.10	(\$0.20)	45.000¢	46.025¢	(1.03¢)	\$1.736	\$1.743	(\$0.007)
Aug-15	\$17.29	\$17.29	\$0.00	46.000¢	47.725¢	(1.73¢)	\$1.770	\$1.761	\$0.009
Sep-15	\$17.39	\$17.33	\$0.06	46.250¢	48.000¢	(1.75¢)	\$1.780	\$1.768	\$0.012
Oct-15	\$17.41	\$17.42	(\$0.01)	46.775¢	48.000¢	(1.23¢)	\$1.775	\$1.775	\$0.000
12 Mo Avg	\$17.62	\$17.71	(\$0.09)	47.640¢	49.563¢	(1.92¢)	\$1.792	\$1.791	\$0.001

- Butter: The market is firming as sales into retail and food service accounts grow seasonally. Production decisions for churn operators vary largely on incoming orders. Butter makers are putting increased emphasis on managing inventories closely to ensure that minimal stock building occurs over the last two months of 2014. Export orders are lackluster, given higher U.S. butter prices compared to competing global markets, but domestic buyer interest is strong for retail and food service segments, while being at moderate levels for ingredient butter.
- International: Concerns are growing in Australia regarding the dry conditions, especially in southwest Victoria. The dry conditions will reduce grazing and force producers to start supplemental feeding if rains do not come soon.
- International: Australian cheese stocks remain fairly tight and are under good domestic demand. Australian mozzarella production has increased, due to good Asian demand, and is reducing cheddar production. Cheddar cheese averaged a U.S.-equivalent \$1.75/lb.

What's Bearish:

- U.S. dairy exports fell to their lowest level in 19 months, according to the U.S. Dairy Export Council. September exports of dairy products were down 16% from a year ago and down 11% from August. Significant milk supply increases in both Oceania and Europe have put the U.S. at a competitive disadvantage, while Chinese buying has slowed. Cheese exports fell below 30,000 lbs for the first time this year, while butterfat shipments plummeted 79% from a year ago.
- Dairy Products Report: Cheddar cheese output in September was a strong 5.9% higher than a year ago, according to USDA. Total cheese output jumped 4.7%, respectively.
- Broken record..... Dairy cow slaughter for the week ended 10/25 totaled 56,100 head, down 7.4% (4,500 head) vs. the same period a year ago.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic regions is steady. Bottling orders are steady to increasing, due to holiday demand. Class II sales vary. Manufacturing milk supplies are heavy in some instances, as designated pools of Thanksgiving milk clear to area balancing plants.
- Fluid Milk Southeast: Florida is experiencing an uptick in milk production. Spot shipments of Grade A milk into the state totaled 58 loads, 112 fewer than last week. Class I demand is seasonally declining, although sales are expected to increase from short-term retail buying as Thanksgiving draw nearer.
- Fluid Milk Central: Milk supplies are growing and curtailing prices on extra loads. Milk spot loads ranged from \$2.50 under Class to \$0.50 over. Bottling sales are mostly flat. Class II manufacturers are ramping up production in light of holiday orders.
- Fluid Milk West: Milk production in CA is inching upward, and remains ahead of last year's production. Milk sales to bottlers are unchanged to slightly lower as some educational institutions will not serve meals during next week's holiday.
- Fluid Milk Southwest: AZ dairy operators report the uptick in milk production is more noticeable and the new milk production season is underway. Processors report the volumes of milk clearing to manufacturing is rising as fluid milk demand is unchanged. Condensed skim sales into Class II are steady to lower overall, but orders moving toward production of some holiday cultured, whipped, and aerated products is creeping higher. In NM, handlers indicate tankers are leaving dairy farms with more milk volumes on board. Interstate milk loads are also clearing through New Mexico facilities. Sales into fluid accounts moved lower, but some milk is stair-stepping eastward to fill fluid demand across the Southeast.
- Fluid Milk Pacific Northwest: Cool but seasonal weather has been good for maintaining milk production. Milk demand has been steady and milk supplies are adequate for manufacturing needs. Much of the fall harvesting is near completion and dairies are assessing feed quantities and making decisions concerning herd size adjustments.
- Dry Whey: In the Northeast, inventories are growing and the market undertone continues to weaken. The market tone is weakening in the Central region as supply offerings are increasing, while discounts are becoming deeper. The export markets as well as cheaper alternative proteins are causing some suppliers to adjust prices lower to remain competitive. Production levels are generally steady to higher with ample milk supplies going into cheese production. Domestic interest is light. Export orders are declining. Western whey prices are weaker with few spot loads. Cheese production is strong, with some manufacturers moving milk through cheese plants to capacity levels in preference to other manufacturing options. Manufacturers are very conscious of U.S. prices being higher than foreign whey prices and thereby limiting export potential. This leaves a weaker undertone to whey markets going forward.
- NDM: Northeast prices are lower and the market continues to soften. Production is flat, yet inventories are growing. Rising milk supplies in the Central region are pushing nonfat dry milk production schedules to generally higher rates, with a few nearing capacity levels. Prices moved lower

as sellers moved large quantities at discounts in light of growing inventories. Buyer interest is light, while export orders are limited as U.S. prices are not competitive with competing global markets.

- Cheese Northeast: Plants are maintaining busy schedules as milk intakes continue to encourage production volumes. Manufacturing stocks are sufficient. Buyers who are careful of year-end inventory are holding back from additional purchases.
- Cheese Midwest: Cheese orders leading into the end of year holiday season are being filled by manufacturers. Orders this week are slightly increased. Production is steady but not at capacity in some plants because manufacturers, being uneasy about cheese prices in coming months, are scheduling production to avoid getting too far ahead of orders. Some plants are drawing on inventories to fill current orders. Milk going into cheese is primarily patronage milk although, spot loads are available if needed.
- Cheese West: Cheese orders are increasing from retail buyers to build inventories in advance of year-end holidays. Many manufacturers are meeting orders but remain wary about allowing inventory levels to increase much above what keeping the flow of orders moving requires. Lower price levels of foreign cheese concerns manufacturers and deters inventory building. Some manufacturers, who have been exporting cheese to Mexico, are increasingly being challenged on a price basis by cheese moving in from other regions at prices that are very difficult for U.S. manufacturers to profitably meet.
- International: This week's GDT auction saw the price index drop 0.3%. The biggest loser was Cheddar cheese, down 9.2% to a downright scary U.S.-equivalent \$1.24/lb.
- International: Robabank Dairy analysts don't expect the Chinese dairy market to strengthen until Q3 2015, according to a news article this week. Large existing stocks and strong global milk production are expected to dampen Chinese demand.
- International: Western European milk production has declined to its lowest levels of the season and demand for fresh milk products is good. However, milk prices are still at profitable levels and encourage milk production. Production in most countries is above year ago levels. Milk production in Eastern Europe continues to decline, but remains significantly above year ago levels.
- International: Australian milk production has peaked in most states with intakes above year ago levels. Domestic dairy commodity stocks are rebuilding with additional supplies available for the export market. The dairy markets have a bearish undertone with some analysts are not seeing a rebound in the current trends until mid-2015.
- International: New Zealand milk production is very strong with volumes above year ago levels. The seasonal peak in production will be reached this week in some areas with volumes at or exceeding historic highs. Weather conditions are favorable and pastures and feed supplies are in good condition. Processors are attempting to clear the heavy milk volumes as quickly as possible.

Recommendation:

Short-term, seasonal demand allowed spot cheese and butter to move higher for the week, but they finished off their mid-week highs, leaving a bearish overall feeling to markets. Nothing has changed since our last report except bearish fundamentals getting more bearish. On the international side it looks ugly. With September exports down so much, we'd expect October numbers to be similar when USDEC finally gets the data out. Our high milk prices the past year were dependent on strong and growing exports, but that is over until Q3, according to analysts. They are probably right. Dry whey futures got pounded this week as the surplus milk situation has resulted in heavy cheese production, combined with lackluster export sales. 2015 Class III contracts were also hit as producers scrambled to get covered. Class IV led the way lower again this week with current spot working out to about \$16.55. With spot cheese still north of \$2/lb, Class III comes in around \$21.85, more than \$5/cwt higher than Class IV. That gap will close, and you can guess which way we think it's headed. The Jan-Jun avg fell 29¢ from last week, to \$16.90. We've been harping on people to get covered but very few have. Getting burnt by contracting in 2014 has kept producers on the sidelines, but the pain of missing out on the upside of record prices this year, will feel a lot less painful than the lower prices that look to be heading our way. If you can still sell your milk at a profit, do it. In addition, having a "buy PUT option" strategy works great during times of high prices, but if you can't get anything done with that in 2015, you need to start looking at flat out sales before it's too late. The 2015 average lost 18¢ from last Friday and now sits at \$17.07. The 2nd half months will likely fall in sympathy with the 1st half, as producers start grabbing anything out there with a \$17 in front of it. Don't be last. Think long and hard about what your plan is for 2015. We think this thing is going to get pretty brutal. Enough said.

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