

The KDM Dairy Report – December 5th, 2014

What's Bullish:

- Fluid Milk Northeast: Northeast and Mid-Atlantic milk production is mostly steady. Bottling plants are pulling heavily on milk supplies, as they resume full schedules. Class I demand is ample, as stores restock and schools restart classes. Manufacturing milk intakes are lighter, although adequate for production needs.
- Fluid Milk Southeast: Milk production is flat in the region, while bottling orders are steady to increasing. Milk volumes clearing into manufacturing are marginal. Milk production in Florida is steady, but bottling orders have bounced back from Thanksgiving week volumes, helped by the

Futures Month	Class III 12/05	Class III 11/26	Change	Dry Whey 12/05	Dry Whey 11/26	Change	Cheese 12/05	Cheese 11/26	Change
Dec-14	\$17.80	\$18.00	(\$0.20)	59.750c	59.925c	(0.17c)	\$1.719	\$1.751	(\$0.032)
Jan-15	\$16.15	\$16.80	(\$0.65)	52.500c	53.075c	(0.58c)	\$1.608	\$1.678	(\$0.070)
Feb-15	\$15.78	\$16.49	(\$0.71)	46.750c	48.575c	(1.83c)	\$1.612	\$1.675	(\$0.063)
Mar-15	\$15.87	\$16.51	(\$0.64)	44.000c	45.600c	(1.60c)	\$1.640	\$1.695	(\$0.055)
Apr-15	\$15.91	\$16.52	(\$0.61)	44.000c	46.000c	(2.00c)	\$1.642	\$1.691	(\$0.049)
May-15	\$16.21	\$16.59	(\$0.38)	43.800c	45.250c	(1.45c)	\$1.672	\$1.705	(\$0.033)
Jun-15	\$16.45	\$16.74	(\$0.29)	44.575c	45.475c	(0.90c)	\$1.694	\$1.715	(\$0.021)
Jul-15	\$16.59	\$16.83	(\$0.24)	45.250c	45.750c	(0.50c)	\$1.704	\$1.724	(\$0.020)
Aug-15	\$16.90	\$17.10	(\$0.20)	45.775c	46.050c	(0.27c)	\$1.732	\$1.748	(\$0.016)
Sep-15	\$17.09	\$17.28	(\$0.19)	46.150c	46.750c	(0.60c)	\$1.752	\$1.763	(\$0.011)
Oct-15	\$17.08	\$17.18	(\$0.10)	47.000c	47.500c	(0.50c)	\$1.745	\$1.750	(\$0.005)
Nov-15	\$17.02	\$17.20	(\$0.18)	46.000c	47.250c	(1.25c)	\$1.742	\$1.754	(\$0.012)
12 Mo Avg	\$16.57	\$16.94	(\$0.37)	47.129c	48.100c	(0.97c)	\$1.689	\$1.721	(\$0.032)

- arrival of vacationers into the state. Cream availability is adequate; however, some buyers expect supplies to tighten as the week progresses. Cream demand is good, as end-users ramp up production following the Thanksgiving holiday break. Contacts note strong pulls from eggnog, cream cheese, and ice cream production.
- Butter: Churn operators are actively filling seasonally strong print orders. Some plants are running full schedules to keep up with demand. Most of the interest is domestic, as U.S. prices are not competitive in the global market. Cream supplies tightened and multiples firmed on the week.
- International: Western European farmgate milk prices are declining and for those producers who are over quota, there is serious consideration being given to reducing milk production soon.
- NDM West: Prices shifted lower and the market tone is weak. However, some Western manufacturers report their uncommitted inventories are light and they plan for limited engagement with the spot market. That may mean that spot loads available for sale at lower prices are restricted at this time.
- International: Oceania cheddar cheese production is very active. However, domestic demand in Australia is strong and keeping supplies tight for exports. Negotiations are ongoing with Japan for 2015 supplies. These negotiations are very competitive, involving a number of international cheddar suppliers.

What's Bearish:

- Spot Market: Blocks finished the week 10½c lower to settle at \$1.58/lb while barrels lost 9¼c to \$1.55/lb. 7 loads of blocks and 11 loads of barrels exchanged hands. Grade A NDM edged ½c lower to \$1.11/lb on 3 trades, while butter managed to gain 1¼c to \$1.98½/lb on 4 trades.
- Dairy Products Report: American cheese output in October was up 3.2% vs. a year ago and up 5.8% from Sep, according to USDA. Total cheese output increased 2.3% and 3.5% respectively. Manufacturers' stocks of NDM were up 75.7% vs. Oct '13.
- Dairy cow slaughter for the week ended 11/22 totaled 55,300 head, down 8,200 head (12.9%) vs. the same period in 2013. YTD the cull is down 290,400 cows (10.1%) vs. a year ago. That's a lot!
- Fluid Milk Central: Central milk production ranges from marginally decreasing to slightly higher rates on week with year on year numbers steadily above year ago levels. The increased over year ago levels are largely due to expanding herd sizes. Milk is moving intraregional with Wisconsin being the common destination. Spot loads of milk are abundant and range from Class to \$4.00 under. Condensed skim supplies are heavy and being further discounted in the spot market.
- Fluid Milk West: Milk production is steady in most areas of CA. With Thanksgiving in the rearview mirror, processors are turning their attention to managing milk surplus intakes over the December/January back to back holiday weeks. Some smaller processors expect to take some downtime during those weeks, sending even more milk loads toward larger processors. As the year draws to a close, recent reports indicate some dairy cooperatives are looking for ways to recoup recent losses in the commodity markets. Options reportedly include assessing cooperative members on the amount of milk produced in 2014. Milk handlers in AZ report milk production is steady to increasing as temperatures settle into a range comfortable for dairy cows. Processors report the portion of milk intakes clearing into powder are increasing. Alfalfa harvesting is ongoing, with excellent field conditions for baling. Milk production in NM is mostly steady. Cheese production is active as manufacturers respond to late orders for the holidays as well as regular week to week orders. Market participants noted there is a gloom and doom aspect to the market due to January futures predicting a sharp price decline. Some excess Western cream is clearing into Central region churning operations.
- Dry Whey Northeast: Prices moved lower at the bottom of the range due to declining f.o.b. spot prices. With cheese plants running at/near capacity, dry whey production levels are marginally higher than last week. Stocks are growing, as whey output increases while very few spot transactions pull from those volumes. Demand is light.
- Dry Whey Central: Prices moved mostly lower on declining spot sale prices and weaker contract basing points. Most sales going at or near the bottom of the range are going for export to compete with lower global markets. Demand is light domestically and internationally. Domestic end users have most needs covered for the remainder of the year and are mainly only looking for bargain opportunities. International buyers have many offers to choose from as competition is strong in the export market, in particular those coming from Europe.
- NDM Northeast: Prices dipped lower this week reflecting significant declines in indices and f.o.b. spot prices. In general, the market undertone for nonfat dry milk remains weak. Production of low/medium nonfat is higher while current inventory levels are collectively expanding regional volumes, as drying rates increase. Buyer interest is restrained and determined by immediate needs.

- NDM Central: Prices decreased significantly following lower priced spot trading and large declines in various index pricing. The undertone is softening as supplies are exceeding current demand. Milk supplies are heavy and pushing some NDM drying schedules to capacity. Most sales are limited to domestic use with marginal activity in the export market. Inventory levels range from moderate to heavy.
- Cheese Northeast: Cheese production is steady, though available milk supplies support full schedules at most cheese facilities. Retail sales are active as yearend consumer specialty needs accompany regular demand, but most production is designated for preexisting near-term contractual arrangements, and the market tone remains unsettled to weak.
- Cheese Midwest: Cheese production is mostly steady but ahead of current buyer interest. Surplus milk is being purchased by some cheesemakers near \$3 below Class. This is encouraging cheese production beyond current buyer interest, keeping production schedules active. Surplus milk near \$5 below Class is anticipated near the week of Christmas. Buying interest for retail sales is lower this week, but food service demand for cheese remains strong in terms of the normal seasonal pattern of food service sales. Wisconsin wholesale prices for 1,000 to 5,000 pound mixed lots of process cheese decreased 15¢.
- Cheese West: Cheese production is steady but the market is softening and inventories are uneven. Many manufacturers are meeting orders but remain wary about allowing inventory levels to increase. Lower price levels of foreign cheese concerns manufacturers but opportunities to export are still presenting themselves. Some manufacturers, who have been exporting cheese to Mexico, are increasingly being challenged on a price basis by cheese moving from other regions at prices that are very difficult for U.S. manufacturers to profitably meet.
- International: Manufacturing milk supplies in Western Europe are expected to increase over the yearend holiday period. The weaker Euro, compared to the U.S. Dollar, over the past number of weeks has made European dairy commodities more competitively priced and improved export interest. China in particular has shown and continues to show interest in purchasing increased volumes of various dairy commodities from Europe. Eastern European milk production is at or just beyond the seasonal low point. Cream and milk volumes continue to be shipped to Belarus from Eastern Europe. The European Commission has announced a 28 million Euro, approximately \$40 million U.S. Dollar, aid package for dairy farmers in Estonia, Latvia, and Lithuania. The financial aid will assist individual farmers who have encountered liquidity problems brought about by the Russian embargo.
- International: Australian milk production is beginning to trend downward, but remains above year ago levels. Persistent dry conditions in western Victoria and dry weather in Tasmania over the past fortnight may accelerate the downward trend in the coming weeks. The milk production forecast by some cooperatives remains around 2% above last year. Some badly needed rains covered some of the dairy producing areas of Victoria and the southern portions of New South Wales. The rains will help pasture and forage growth. Hay harvest activities are well underway in the dairy producing regions and yield assessments are variable, but generally below average. Demand is strong for 2015 hay supplies with current prices steady to firm.
- International: Milk production in New Zealand is moving lower with steeper declines noted on the South Island. However, milk production is above year ago levels and manufacturers are busy processing current milk volumes. October milk production as reported by DCANZ was 3.30 million MT, up 4.5% from October 2013 and 10.2% higher than the level two years ago. Farmgate prices are lower this season, compared to last with many producers forgoing supplemental feeding. This situation may lead to a shorter season as producers may dry off cows earlier in light of the marginal returns on extended production.
- International: According to GTIS, October cheese imports into China declined, compared to the previous, with the U.S. share declining 49%.

Recommendation:

Spot cheese prices put in fresh lows this week, falling to levels not seen since Mar '13. Meanwhile, the USD pushed in to new multi-year highs, increase the cost of our exports. More international data is coming in revealing just how much imports into China have fallen. Unless they begin to buy again soon (not likely), the U.S. is going to have a LOT of extra milk it will need to handle domestically. Futures reacted with a fairly vicious sell-off across Q1 and Q2 contracts. Milk below \$16 has now appeared on some contracts, while several analysts have revised 2015 prices much lower, with the possibility of some \$14 settlements. Cull rates remain very low as attractive margins encouraged producers to make as much milk as possible. But now the tables are turning and we all know it takes time for the milk spigots to begin to tighten. We're now experiencing the other side of a strong export market. When nearly 16-17% of our milk equivalent is leaving the country, it's great, but when demand suddenly declines, the domestic market is overwhelmed. Going forward it will be interesting to see just how low we go, while a strong beef price and poor dairy margins may entice some producers to generate some quick cash. Butter demand is still strong as last minute holiday orders are keeping supplies on the tighter side, but post holidays, we expect prices to fall in line with cheese and NDM. The Jan-Jun avg is now down to \$16.08, with July-Dec at \$16.95 and all of 2015 at \$16.51. Should you sell here? Hard to say. If you have no coverage and these prices are profitable, it would make sense to get something done. On the other hand, we usually advise against chasing a market lower, but to wait for a bounce. That said, we have not had that great a success with that method as orders we've placed just above the market have not hit and keep falling further away. But international prices may be finding a bottom, and that could eventually help establish a bottom for the U.S. as well. But we remain bearish for the short to medium term as U.S. prices are still not competitive. For those producers who have sales above this market, consider buying cheap call options to protect your upside risk.

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