

**The KDM Dairy Report – January 23<sup>rd</sup>, 2015**

**What's Bullish:**

- Spot Market: Blocks finished the week a penny higher to \$1.48/lb on just 3 trades. Barrels lost ½¢ to settle at \$1.44½/lb, but buyers supported that level, picking up 11 loads. Grade A NDM may have bottomed out. Buyers purchased 6 loads, moving the price up 3¼¢ along the way to \$0.98¼/lb. Butter was unchanged at \$1.55/lb on just one trade.
- Cold Storage Report: Butter stocks at the end of December were down 12% vs. the prior year, and down 2% from Nov, according to USDA.
- Dairy cow slaughter for the week ended 01/10 totaled 64,800 head, up 5,500 head

Futures Month	Class III 01/23	Class III 01/16	Change	Dry Whey 01/23	Dry Whey 01/16	Change	Cheese 01/23	Cheese 01/16	Change
Jan-15	\$16.08	\$16.01	<b>\$0.07</b>	57.425¢	56.000¢	<b>1.43¢</b>	\$1.583	\$1.578	<b>\$0.005</b>
Feb-15	\$14.98	\$14.43	<b>\$0.55</b>	50.075¢	44.925¢	<b>5.15¢</b>	\$1.512	\$1.488	<b>\$0.024</b>
Mar-15	\$14.64	\$14.02	<b>\$0.62</b>	43.000¢	36.925¢	<b>6.08¢</b>	\$1.510	\$1.492	<b>\$0.018</b>
Apr-15	\$14.59	\$13.90	<b>\$0.69</b>	38.500¢	33.600¢	<b>4.90¢</b>	\$1.528	\$1.496	<b>\$0.032</b>
May-15	\$14.65	\$14.18	<b>\$0.47</b>	36.175¢	33.000¢	<b>3.18¢</b>	\$1.550	\$1.536	<b>\$0.014</b>
Jun-15	\$14.99	\$14.80	<b>\$0.19</b>	36.800¢	33.500¢	<b>3.30¢</b>	\$1.587	\$1.591	<b>(\$0.004)</b>
Jul-15	\$15.51	\$15.51	<b>\$0.00</b>	37.750¢	35.075¢	<b>2.68¢</b>	\$1.629	\$1.656	<b>(\$0.027)</b>
Aug-15	\$15.88	\$15.84	<b>\$0.04</b>	38.500¢	35.000¢	<b>3.50¢</b>	\$1.665	\$1.693	<b>(\$0.028)</b>
Sep-15	\$16.10	\$16.06	<b>\$0.04</b>	38.450¢	34.000¢	<b>4.45¢</b>	\$1.692	\$1.712	<b>(\$0.020)</b>
Oct-15	\$16.25	\$16.20	<b>\$0.05</b>	38.500¢	35.600¢	<b>2.90¢</b>	\$1.717	\$1.722	<b>(\$0.005)</b>
Nov-15	\$16.19	\$16.10	<b>\$0.09</b>	39.500¢	36.575¢	<b>2.93¢</b>	\$1.705	\$1.710	<b>(\$0.005)</b>
Dec-15	\$16.13	\$16.01	<b>\$0.12</b>	39.000¢	36.250¢	<b>2.75¢</b>	\$1.697	\$1.700	<b>(\$0.003)</b>
<b>12 Mo Avg</b>	<b>\$15.50</b>	<b>\$15.26</b>	<b>\$0.24</b>	<b>41.140¢</b>	<b>37.538¢</b>	<b>3.60¢</b>	<b>\$1.615</b>	<b>\$1.615</b>	<b>\$0.000</b>

- (9.3%) vs. the same week a year ago. This is the first time in 51 weeks that the weekly cull has exceeded the prior year.
- Livestock Slaughter Report: 256,800 dairy cows exited the herd in Dec, up just 100 head from the prior year, but the first time the cull was higher than the prior year since Sep '13.
- Fluid Milk Southeast: Milk production in the region is steady, while sales are increasing with active Class I demand. In Florida, increases in milk production are showing signs of leveling off. Class I demand remains strong. Milk spot shipments into the state have dropped slightly this week, but still totaled 125 loads.
- Butter: Buyers are generally looking to fill near-term needs at this time and are waiting for opportunities to purchase ahead. Production rates are mostly steady to higher. Export interest is improving as U.S. prices are now below the Global Dairy Trading market.
- CWT has accepted 13 requests for export assistance to sell 815,270 lbs of Cheddar cheese and 1.797 million lbs of 82% butter to customers in Asia, Europe, the Middle East and Central America. The product will be delivered in January through July 2015.
- International: Western European milk production has slowed over the past number of weeks. Milk producers, who are over quota and face significant levees, have restricted production by various means to lower or avoid quota levee payments. Dairy cows are being culled at increasing rates in those areas producing over quota. Preliminary data for some of the over quota countries shows current milk intakes below year ago levels.
- International: Australian milk production continues on its typical seasonal decline. Dry conditions were alleviated, to some degree for some dairy producers, as significant rains covered much of the dairy region in Victoria. Hay supplies for the coming season are anticipated to be below normal. Dairy commodity supplies for some manufacturers are committed for the near term. Butter offerings for export have declined as manufacturers are balancing lower production levels with existing sales and not wanting to be over committed. Export and domestic demand are good. Australian domestic demand is strong and restricting volumes available for export and in some cases requiring a premium for export consideration. Domestic demand for Cheddar cheese is good and exports are performing well. November cheese imports into China increased, compared to the previous month.
- International: New Zealand's milk production is declining at an accelerated pace. Dry conditions over both islands are beginning to prompt discussions about drought with some comparisons being made to the Q1 2013 decline in milk production. Conditions are more severe on the South Island where some irrigation systems are being shut down, due to low river levels. New Zealand cooperatives have lowered their seasonal forecasts with seasonal production now estimated to be ranging from flat to 1.5% above last year's production. Rains are forecast in the coming week, but the impact of these rains on milk production will be marginal at best as farmgate prices remain low and are a disincentive for producers to extend the milk production season.

**What's Bearish:**

- Milk Production Report: Milk output in Dec was up 3.1% vs. the prior year while cow numbers were up 100,000 head. The herd size increased 18,000 head from Nov to Dec. Milk per cow increased 37 lbs to 1,862 lbs. States with the largest percentage gains were: TX up 9.7%, UT up 8.8%, MI up 7.8%, CO up 6.6% and SD and KS both up 6.4%. CA was down 0.1% while WI was 3.1% higher.
- Cold Storage Report: While butter stocks saw a drop, American cheese stocks were up 1% vs. Dec '13, while total cheese stocks were nearly unchanged.
- Livestock Slaughter Report: The 2.815 million head of dairy cows that were culled in 2014 was down more than 309,000 head from 2013 and the lowest annual total since 2010.
- This week's GDT auction saw the dairy price index increase 1%, led by WMP. However, cheddar cheese fell 4.3% to a U.S. equivalent \$1.34/lb.
- Fluid Milk Northeast: Milk production remains significantly above previous year's levels in the region. Most schools and universities are back in session, prompting stronger Class I demand, but there is still plenty of manufacturing milk available.
- Fluid Milk Central: Milk production is mostly steady, however, output is noted to be considerably higher than year ago levels due to the mild winter, adequate high quality feed, and producers taking advantages of current milk prices. Milk supplies are heavier than desired for some processors. Milk spot loads are ranging from \$2 under Class to Class. Bottlers note fluid sales are not picking up as anticipated. Cream supplies are readily available.
- Fluid Milk Southwest: Milk output in CA is mostly characterized as holding flat to making slight gains from a week ago. Milk is being handled well by processors with minimal downtimes noted. AZ milk production is moving higher on a week to week basis and trending several percentage

points higher from a year ago. Plant capacity is becoming snuggier and processors are limiting the milk supplies from other sources. Demand for Class I milk has leveled off. NM milk supplies are being handled well and processors are getting the volumes needed for various products. Bottling demand has slowed following higher interest shown through last week. The cream market is stable, but there are adequate supplies to service accounts in the region.

- Fluid Milk Pacific Northwest: Milk production in the region is increasing along seasonally expected lines. Manufacturers are anxious about any increased production as most are running at nearly full capacity. Temperatures in the region are favorable for increased milk production. UT and ID milk production is increasing as mild winter weather has had little adverse effects on dairies. Milk production levels in the region are nearing current processing capacity. Milk production is still up 3 to 4% in the region. Production per cow is also increasing. Due to the increase in milk price during last year, the number of cows increased.
- Dry Whey Northeast: Prices declined in a weak market. Spot sales are moving prices lower as supplies outpace demand. Cheese manufacturers' milk intakes are heavy and encouraging dry whey production rates. Output is increasing most of the producers' inventories, as dry whey competes with comparative priced protein streams.
- Dry Whey Central: End users note increasing offers at flat or below market. The undertone is softening as some buyers are bearish on whey moving forward and feel whey is currently overvalued. Buyer interest domestically is light and many end users are working off inventories on hand. Export orders picked up this week, but are noted below year ago levels. Supplies are steady to growing.
- NDM Northeast: Prices continued to trend lower this week. Production remains active although an increase in Class I sales has somewhat eased low/medium nonfat schedules at drying facilities. With the recent reports of Mexico's demand for nonfat dry milk, some contacts suggest annual export volumes will be comparably lower. Low/medium heat nonfat inventories are building overall. The market undertone is soft.
- NDM Central: Reduced prices were seen this week as manufacturers looked to lower on-hand inventories. The market tone is weak. Export orders are marginal and noted to be below a year ago. Production of low/medium heat NDM remains strong as milk supplies are heavy. Supplies range from moderate to heavy.
- NDM West: Prices moved lower as both spot pricing and index based sales moved downwards. The market undertone remains weak. Production of low heat is moderate to heavy as processors work through seasonally heavy milk supplies. Buyer interest is light to moderate.
- Cheese Northeast: Sufficient milk intakes are furthering seasonally active cheese production rates. Plants are operating near capacity in some instances. Orders for mozzarella are active, prompted by food service and retail demand as schools reopen and the Super Bowl looms. Inventories are mixed but growing marginally. The market is unsettled.
- Cheese Midwest: Inventory is building at some Midwest cheese plants. Contributing factors include active cheese production, with some manufacturers using their cheese plants to balance the volume of milk intakes, as well as some potential buyers pulling back during a falling price market. Once prices began to fall significantly last week, some buyers slowed orders in an opportunistic buying strategy. Higher cheese production is helping boost cheddar manufacturing as well as mozzarella.
- Cheese West: Prices were lower this week. Some manufacturers are running at full production. Demand is steady. There has been some more spot availability due to export demand decreasing. Inventories are building slightly but manufacturers are cautious as not to have too much.
- International: USDA has forecasted Chinese imports of WMP to decrease 12% in 2015, due to slower economic growth in GDP. In addition, a relaxation of the one-child policy has yet to result in any significant baby boom. As a result, USDA expects dairy prices to remain under pressure this year.
- International: Eastern European milk production is increasing along the typical seasonal trend. Reports of milk and cream loads going into Belarus have declined in recent weeks.

#### Recommendation:

If you were an end user who got burned last year paying high prices for dairy end products, today's averages for 2015 look a whole lot better for your bottom line. We think it's that type of thinking, in addition to decent domestic demand leading into Super Bowl weekend that brought the buyers out this week. Sellers brought cheese to the spot market, but there was no way we were going to break \$1.40 as buyers came in to snap up product. We would call this week's decent retracement a bounce in a larger bear market. Further gains next week would cause us to want to add new short hedges for producers. Initial targets would be Mar at \$14.75, Apr at \$14.70 and May at \$14.90 Class III. Those would represent a 50% retracement from the recent high to low on a daily basis. This week's major USDA reports were mainly bearish the market, but we are starting to see a pick up in cow slaughter numbers. It remains to be established if this is a trend or not. There are also some positives coming out of the international front, with some early drought in Oceania and herd liquidation in the EU. International buyers are also seeing much lower global prices and may be deciding to begin buying. The export market appears to be picking up a little steam. That said, we would continue to recommend getting call options purchased for previous sales made either through your coop, cheese plant or directly using futures. Last week we recommended buying the Mar 16.00 call at 7¢. Today it settled at 12¢! The Apr 16.00 call went from 8¢ to 17¢! Producers can still get their upside insurance purchased for reasonable amounts, but it would make sense to get started. For those of you who are more aggressive, you may want to think about exiting some 2<sup>nd</sup> half futures which are sitting on a healthy profit. Resell it on a decent rally.

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