

The KDM Dairy Report – January 30th, 2015

What's Bullish:

- Spot Market: Blocks gained 5¼¢ to settle at \$1.53¼/lb on no trades, while barrels increased 6¢ to \$1.50½/lb on just 5 trades. Grade A NDM jumped 8¼¢ to settle at \$1.07/lb on a massive 34 trades, while butter shot up 19½¢ to \$1.75/lb on 18 trades.
- Fluid Milk Northeast: Milk distribution experienced a range of logistical problems up to immobilization and the cancelling of loads as traffic bans were in place for the blizzard. Some manufacturers braced for the storm beforehand, accepting milk ahead of usual scheduling. Although loads were pulled for bottling, Class I demand outpaced available supplies in most retail channels.

Futures Month	Class III 01/30	Class III 01/23	Change	Dry Whey 01/30	Dry Whey 01/23	Change	Cheese 01/30	Cheese 01/23	Change
Jan-15	\$16.14	\$16.08	\$0.06	58.000c	57.425c	0.58c	\$1.584	\$1.583	\$0.001
Feb-15	\$16.00	\$14.98	\$1.02	53.000c	50.075c	2.93c	\$1.586	\$1.512	\$0.074
Mar-15	\$15.66	\$14.64	\$1.02	45.000c	43.000c	2.00c	\$1.593	\$1.510	\$0.083
Apr-15	\$15.50	\$14.59	\$0.91	40.475c	38.500c	1.98c	\$1.614	\$1.528	\$0.086
May-15	\$15.62	\$14.65	\$0.97	38.200c	36.175c	2.03c	\$1.638	\$1.550	\$0.088
Jun-15	\$15.93	\$14.99	\$0.94	38.750c	36.800c	1.95c	\$1.669	\$1.587	\$0.082
Jul-15	\$16.40	\$15.51	\$0.89	38.000c	37.750c	0.25c	\$1.720	\$1.629	\$0.091
Aug-15	\$16.70	\$15.88	\$0.82	38.000c	38.500c	(0.50c)	\$1.746	\$1.665	\$0.081
Sep-15	\$16.80	\$16.10	\$0.70	37.175c	38.450c	(1.28c)	\$1.760	\$1.692	\$0.068
Oct-15	\$17.00	\$16.25	\$0.75	37.525c	38.500c	(0.98c)	\$1.769	\$1.717	\$0.052
Nov-15	\$16.75	\$16.19	\$0.56	38.275c	39.500c	(1.23c)	\$1.742	\$1.705	\$0.037
Dec-15	\$16.55	\$16.13	\$0.42	38.500c	39.000c	(0.50c)	\$1.722	\$1.697	\$0.025
12 Mo Avg	\$16.25	\$15.50	\$0.75	41.742c	41.140c	0.60c	\$1.679	\$1.615	\$0.064

- Milk production in the Mid-Atlantic region is steady. Manufacturing milk supply is adequate, although a few loads were re-distributed to bottlers.
- Butter: Northeast and Central regions are reporting print sales down, but retail demand has increased in the West. Production rates are increasing due to upward trends for intakes in milk supply. Cream is readily available and active. Export interest is improving as U.S. prices narrow towards global prices.
- CWT has accepted 4 requests for export assistance to sell 405,651 pounds of Cheddar and Gouda cheese and 440,925 pounds of 82% butter to customers in Asia, the Middle East and Central America. The product will be delivered in February through July 2015.
- International: Fonterra cut its forecast on the amount of milk it will get from its suppliers as the drought in New Zealand began to cut in to dairy operations' production. The company said it would collect 1.532 billion kilograms of milk solids in the year to May, 3.3 percent less than last season's record production, as a lack of rain had left pastures dry. As a result, Fonterra has slashed the volume of product that it plans to offer on GDT over the next six months, cutting almost 25,000 tons of whole milk powder (WMP).

What's Bearish:

- Dairy cow slaughter for the week ended 01/17 totaled 65,200 head, down 4,200 head (6.05%) vs. the same period a year ago. YTD the cull is now 5,000 head behind 2014.
- Cattle Report: USDA's bi-annual Cattle Report indicates the number of milk cows on farms on Jan 1 was up 1% at 9.3 million head, vs. last Jan. In addition, the number of replacement heifers, at 4.6 million head, also increased 1%.
- Weekly cold storage numbers put cheese stocks at USDA-selected storage centers up 5% (5.14 million lbs) during the period 01/01 through 01/26. Butter stocks over the same period are up 93% (2.79 million lbs).
- Fluid Milk Southeast: Milk production in the Southeast is steady to tapering. However, bottling plants are full and cancelling loads as sales weaken. Primary manufacturing channel outlets are unable to handle the additional loads while one plant performs maintenance work. As a result, heavy milk volumes are clearing to secondary intake sources. In Florida, temperatures range from 30 degrees for night time lows to 83 degrees for day time highs. Milk shipments are balanced this week with no imports or exports. Cream supplies are sufficient for manufacturing needs.
- Fluid Milk Central: Milk receipts are still 3 to 4% above year ago levels. Class I demand is steady. Fluid milk is still readily available in most parts of the Central region and there are spot loads available.
- Fluid Milk Southwest: Milk production in CA is showing steady week to week growth. Dairy producers indicate this upswing is later than usual, but the upward trend seems to be firmly established now. December 2014 Poll Receipts of milk totaled 3.36 billion pounds, 0.4% higher compared to December last year. Year-to-date through December 2014 receipts are 3.6% higher from the comparable months in 2013. Plant operators report milk intakes into manufacturing plants are stepping higher weekly in AZ. Weather conditions are conducive to cow comfort, and dairy producers report feed is readily available. Milk production in NM is building from week to week. There have been some days with colder weather, but dairy cows are taking the changes in temperature in stride. A few fluid accounts have pushed back milk loads due to lower consumer demand and milk is stair-stepping east to west to find processing room.
- Fluid Milk Pacific Northwest: Milk production in WA and OR are steady to making slight weekly gains. Weather conditions are favorable for milk cows. Processing capacity in the region is adequate to handle available milk supplies. Cheese plants are tending to be kept in milk. Declining milk prices are working through as dairy producers are beginning to see lower checks. UT and ID milk production is trending seasonally higher and at levels above a year ago. Processing plants are running on normal schedules to handle incoming milk supplies. Conditions remain fair to good for milk output gains.
- Dry Whey: Farm milk output and manufacturing milk supplies are increasing dry whey production at cheese plants. Supplies are moving through contracts, however spot and resale activity is sluggish. The market tone is weak as there are many suppliers. Manufacturers are building inventories due to the abundant supply of milk.
- Cheese: Strong cheese production is being driven by the volumes of milk being received by cheese plants. Sales are lagging production in some plants, leading to increasing inventory levels.
- International: An article this week in an Aussie news site declares Russia's ongoing trade embargo is contributing to sluggish global prices for dairy products. Analysts say there's no real sign of a resolution any time soon, as diplomatic tensions between Russia and western nations continue to simmer. Russia banned food imports from western nations, including the European Union (EU) and Australia, last August, in

retaliation against sanctions imposed by those countries on Russia. Russia is the world's second largest dairy importer behind China, and 80 per cent of that comes from the EU, mostly in the form of butter and cheese. The withdrawal of Russia from the market has added downward pressure to prices.

Recommendation:

On Thursday (during our overnight trading Wed night), Fonterra announced that they were decreasing their milk production forecast for the current milking season, while at the same time slashing the amount of WMP that would be available in GDT auctions for the next six months. My how a headline can impact the markets! Suddenly end users wanted Class IV products, snatching up 34 loads of Grade A NDM in the spot market, as well as 18 loads of butter. Several dairy futures contracts (Class III, butter, cheese) were at or finished the day limit up on Thursday, followed by a gap open higher to open the evening session. By Friday morning, come Class III contracts were trading an additional 60¢+ higher on the day, and an even more impressive \$1.20+ higher than the previous day's lows. However, after a spot session on Friday that saw sellers bring product to market, Class III futures finished well off their highs, and even down for the day in the case of May-Sep. While the news in Oceania will likely mean a higher floor for prices here in the U.S., we will still need to deal with bearish short-term fundamentals coming in to spring. Milk flow is already high and cheese inventories are building. As cows freshen around the country, the problem will only get worse, unless we see a pickup in demand. Make no mistake though, we look to be supported here for a bit. Those April 16.00 Call options we recommended two weeks ago have gone from 8¢ to 45¢ settlement today. It's hard to say which way this market will go now as contrasting bear and bullish fundamentals battle it out. We would, however, continue to look for opportunities to get existing hedges covered. Profitable futures positions July-Dec should be bought back, in our opinion. Those who "waited too long" to get coverage at all are likely going to get a second chance. On further rallies, we would purchase PUT options Mar-Jun. Get some coverage and hang on to your seats next week!

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