

The KDM Dairy Report – February 6th, 2015

What's Bullish:

- Spot Market: Blocks finished the week up ¼¢ to \$1.53½/lb on no trades, while barrels fell 2¼¢ to close at \$1.48¼/lb on 10 trades. But the real excitement was in Grade A NDM which settled up 3¢ to \$1.10/lb on aggressive buying of 54 loads. Butter buyers picked up 18 loads but the price still fell 4¼¢ to \$1.79½/lb.
- Dairy cow slaughter for the week ending 01/24 totaled 65,500 head, up 5,000 head (8.3%) vs. the same period a year ago. Dairy cow slaughter has been ahead of 2014 for 2 of the last 3 weeks.
- Prices surged at this week's GDT auction, with the index jumping 9.4%. Most of the increase was due to a 19.2% spike in WMP and 6.7% rise in SMP, following Fonterra's announcement the prior week of much lower forecast milk receipts. Cheddar cheese, however, fell 11.1% to a U.S.-equivalent \$1.20/lb.
- NDM: Prices are advancing. The trade indicates world SMP pricing is lending support to the market increases. NDM supplies are tight to available.
- Cheese Midwest: Larger Midwest cheese manufacturers are feeling better about the prices they sell cheese for compared with prices they pay for milk, than in mid-January, when cheese prices declined rapidly. Some cheese manufacturers notice more recent interest from cheese brokers in acquiring inventories. This adds to purchasing by regular retail customers supplemented by food service buyers, who all seem to be stocking up on cheese. Exporting cheese is somewhat challenging. Nevertheless, exports still supplement profitability for some Midwest cheese plants in the form of current whey exports.
- Cheese West: Prices are trending higher, reflecting increased demand for current and future needs. Domestic cheese demand is fair to good and clearing product. Demand for Swiss types is holding up well with good cut and food service orders noted. The trade notes that sales of cheddar and natural varieties have been fair to good. Mozzarella interest has been good around the football holidays to pizza accounts. Cheese production is active with increasing milk supplies within the region. Some plants are running fuller than projected and milk is moving to find processing space.
- International: Western European milk production increases have slowed compared to year ago levels, primarily due to over quota producers reducing milk flows to reduce levee payments. Available supplies of butter, SMP and WMP are relatively tight.
- Butter: Prices are increasing rapidly which has led to a firmer market tone. Production is increasing due to the higher available milk and spot loads of cream are readily available, but demand is steady to higher as some buyers are purchasing for only current needs while the price increases have sparked additional demand with others.
- International: Australian milk production moved marginally lower, compared to the previous report. Australia experienced its third warmest year on record in 2014 with seasonally average rainfall. Many parts of the country are already experiencing dry conditions which will impact livestock and crops in 2015. Prices for most dairy commodities have seen some recovery as uncommitted supplies are running tighter than anticipated. The big news out of New Zealand has been the downgrade in this season's milk production forecast by various cooperatives. The combination of dry weather and low farmgate prices are bringing a quick end to milk production on both islands. The accelerated declines have prompted cooperatives to lower their seasonal forecasts with some cooperatives estimating this year's production falling 3% or more, compared to last year. Dairy product supplies are adequate to cover current commitments, but the declines in production will likely decrease volumes offered on future GDT auctions. The announcement of forecasts below year ago levels and the likelihood of reduced GDT volumes has sparked buyer interest for various dairy products, especially whole milk powder.
- International: Australian Cheddar supplies are fairly tight with some cheese makers holding firm on price for the domestic market. Cheddar returns are beginning to converge with other production streams, so there may be some decreases in production in the near term. A major cheese exporter in New Zealand missed the U.S. import licensing deadline and is actively seeking agreements with other cooperatives to fill its commitments in the U.S. According to GTIS, December cheese imports into China increased, compared to the previous month.

Futures Month	Class III 02/06	Class III 01/30	Change	Dry Whey 02/06	Dry Whey 01/30	Change	Cheese 02/06	Cheese 01/30	Change
Feb-15	\$15.88	\$16.00	(\$0.12)	54.750¢	53.000¢	1.75¢	\$1.563	\$1.586	(\$0.023)
Mar-15	\$16.00	\$15.66	\$0.34	48.500¢	45.000¢	3.50¢	\$1.612	\$1.593	\$0.019
Apr-15	\$15.91	\$15.50	\$0.41	45.750¢	40.475¢	5.28¢	\$1.619	\$1.614	\$0.005
May-15	\$15.93	\$15.62	\$0.31	42.000¢	38.200¢	3.80¢	\$1.633	\$1.638	(\$0.005)
Jun-15	\$16.25	\$15.93	\$0.32	40.000¢	38.750¢	1.25¢	\$1.677	\$1.669	\$0.008
Jul-15	\$16.75	\$16.40	\$0.35	40.750¢	38.000¢	2.75¢	\$1.725	\$1.720	\$0.005
Aug-15	\$17.10	\$16.70	\$0.40	41.500¢	38.000¢	3.50¢	\$1.760	\$1.746	\$0.014
Sep-15	\$17.16	\$16.80	\$0.36	41.425¢	37.175¢	4.25¢	\$1.780	\$1.760	\$0.020
Oct-15	\$17.28	\$17.00	\$0.28	40.025¢	37.525¢	2.50¢	\$1.793	\$1.769	\$0.024
Nov-15	\$17.07	\$16.75	\$0.32	40.500¢	38.275¢	2.23¢	\$1.756	\$1.742	\$0.014
Dec-15	\$16.79	\$16.55	\$0.24	40.750¢	38.500¢	2.25¢	\$1.730	\$1.722	\$0.008
Jan-16	\$16.64	\$16.50	\$0.14	40.525¢	39.500¢	1.03¢	\$1.730	\$1.720	\$0.010
12 Mo Avg	\$16.56	\$16.28	\$0.28	43.040¢	40.200¢	2.84¢	\$1.698	\$1.690	\$0.008

What's Bearish:

- Dairy Products Report: Cheddar cheese output in Dec was up 2.7% from Dec '13 and up 8.7% from Nov, according to USDA. Butter output increased 3.3% and 17.4%, respectively. Total cheese output also saw gains, with Dec output 2.5% higher than the prior year and 5.5% higher than Nov.
- Fluid Milk Northeast: Despite being blistered by a second snow storm in as many weeks, milk production is still strong in the region. Milk supplies in the Mid-Atlantic region are heavy. A few truck loads were delayed by wintery conditions, but Class I sales are slightly down from last week, shifting loads to manufacturing.
- Fluid Milk Southeast: Milk production in the region is steady to increasing, while milk into manufacturing is close to 50% capacity. Class I sales are seeing some decline and are below expectations. Florida's farm level milk production is showing an uptick. Class I demand is sluggish. Condensed skim is readily available. Milk production rates are fueling supply levels at most manufacturing plants. Volumes are being cleared to dryers as plants balance heavy condensed skim milk supplies.

- Fluid Milk Central: Sources indicate milk production is at 2 to 3% above year ago levels. Fluid milk is selling for \$2.00 under class to class and is readily available. Class II sales are strong. Some contacts indicate extra supplies are being made into sweetened condensed milk. Cream supplies are heavy, as Eastern cream is making its way into the Midwest. Cream multiples moved lower this week, ranging from 1.14 to 1.25.
- Fluid Milk Southwest: Farm milk production in CA is steady to incrementally higher than last week. Alfalfa harvest is underway in the Imperial Valley, giving dairy producers fresh forage to include in rations. December 2014 Pool Receipts totaled 3.36 billion pounds, 0.4% higher compared to December last year. AZ milk production is steady to increasing incrementally. Weather conditions are conducive to cow comfort. NM milk production is modestly higher and feed inputs are readily available. With generally higher milk intakes throughout the West region, cream availability is steady to improving. In addition, cream pricing in some states has decreased.
- Fluid Milk Pacific Northwest: Milk output is trending slightly higher across most of WA and OR. Intake levels at processing plants are increasing with some plants being kept full to make products of greatest needs. Current weather conditions remain good for milk cows. Feed pricing and availability are generally favorable. Declines in milk prices are noted to be worked into the planning process, but farmers are slow to cull cows. Milk production in UT and ID continues to build at levels above a year ago. Processing plants are finding milk intakes are increasing and above projections. Milk is being moved around to find homes, and there are buyers for offered milk. There are concerns about handling the milk volumes during the flush. Several handlers were expressing the impact of the growing milk volumes and the ability to process the upcoming supplies.
- Dry Whey Northeast: Prices moved marginally lower this week. Production remains seasonally heavy, proportional to cheese processing rates for the region. Manufacturing inventories are heavy. Demand is moderate. The market is weak.
- Dry Whey Central: Prices are steady to weaker. Manufacturers are filling supply contracts but spot demand is light. Most buyers are only buying for current needs as they take a wait-and-see approach on pricing. Manufacturers indicated they are running into pricing pressure from the resale market.
- Dry Whey West: The market undertone remains weak with some segments slow to reactivate buying. Demand is uneven. Some buyers are taking needs under supply contracts, but are not willing to take extra whey at the present time. The spot market is showing limited interest with buyers also poking the resale market to find the best bargain.
- Cheese Northeast: Steady to slightly higher milk intakes are facilitating at/near capacity cheese production. Spot interest is light to fair. As post Super Bowl demand declines, manufacturers are keeping an eye on inventory growth.

Recommendation:

Most first-half contracts have tacked on +/- \$1.00/cwt since Fonterra's announcement last week. It also appears decent domestic demand is helping the cause, with buyers and end-users snapping up cheese, butter and powder at prices much less than 12 months ago. They may be some more upside left, but above \$1.60/lb cheese-equivalent, we'd expect more product to be offered. Despite this increased demand, we are still going to have to deal with very high milk production this spring, which we believe will ultimately push prices back down. This has been a great opportunity for those producers lacking coverage in the first half, to get some on. Buy PUT options to at least get a floor price in place. Technically, many first-half contracts are sitting on about a 50% retracement from their most recent high to low. For example, May Class III made a high June 25th of \$18.75, and a low of \$13.90 on Jan 20th. A 50% retracement from that low gets you to \$16.32. While we settled at \$16.00 today, the high was \$16.19, which is getting very close. Producers should consider doing this same exercise Apr-Jun and enter sell targets near or above that 50% retracement. Oftentimes, markets will then head back down after reaching those levels, so it's a good target.

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