

The KDM Dairy Report – March 13th, 2015

What's Bullish:

- Spot Market: Block cheese gained 1¢ for the week to settle at \$1.57/lb while barrels were up 5¢ to close at \$1.54½/lb. 7 loads of blocks exchanged hands along with 5 loads of barrels.
- Cheese buyers are still buying. Stocks of cheese at USDA-selected storage centers fell 1% (1.2 million lbs) through the first nine days of March.
- Fluid Milk South: Milk production in Florida is mostly flat, as warmer conditions influence cow comfort. Temperatures hovering in the 80s are expected throughout the week. Cream supplies are less available causing multiples to firm, as

Futures Month	Class III 03/13	Class III 03/06	Change	Dry Whey 03/13	Dry Whey 03/06	Change	Cheese 03/13	Cheese 03/06	Change
Mar-15	\$15.50	\$15.42	\$0.08	48.000¢	46.750¢	1.25¢	\$1.570	\$1.567	\$0.003
Apr-15	\$15.40	\$15.50	(\$0.10)	44.450¢	43.500¢	0.95¢	\$1.583	\$1.592	(\$0.009)
May-15	\$15.10	\$15.50	(\$0.40)	43.375¢	41.500¢	1.88¢	\$1.560	\$1.608	(\$0.048)
Jun-15	\$15.61	\$16.15	(\$0.54)	42.750¢	41.000¢	1.75¢	\$1.618	\$1.676	(\$0.058)
Jul-15	\$16.32	\$16.68	(\$0.36)	41.250¢	40.500¢	0.75¢	\$1.694	\$1.735	(\$0.041)
Aug-15	\$16.95	\$17.15	(\$0.20)	42.150¢	40.125¢	2.03¢	\$1.750	\$1.775	(\$0.025)
Sep-15	\$17.25	\$17.28	(\$0.03)	41.725¢	39.000¢	2.73¢	\$1.790	\$1.795	(\$0.005)
Oct-15	\$17.40	\$17.32	\$0.08	41.250¢	40.700¢	0.55¢	\$1.801	\$1.799	\$0.002
Nov-15	\$17.39	\$17.26	\$0.13	41.100¢	39.050¢	2.05¢	\$1.800	\$1.794	\$0.006
Dec-15	\$17.15	\$17.00	\$0.15	41.000¢	40.000¢	1.00¢	\$1.780	\$1.769	\$0.011
Jan-16	\$16.80	\$16.69	\$0.11	41.550¢	42.000¢	(0.45¢)	\$1.735	\$1.735	\$0.000
Feb-16	\$16.71	\$16.60	\$0.11	41.525¢	40.750¢	0.77¢	\$1.730	\$1.730	\$0.000
12 Mo Avg	\$16.47	\$16.55	(\$0.08)	42.510¢	41.240¢	1.27¢	\$1.701	\$1.715	(\$0.014)

- buyer interest picks up. Pre-holiday butter orders are strong, combined with active cream cheese production and rising ice cream interest.
- Cream Central: Cream supplies firmed up as order volumes increased as many butter churn operators maintained or increased churn rates. Ice cream makers are slowly increasing production rates. Demand for ice cream is marginally improving as the temperatures increase.
- Fluid Milk West: CA milk volumes are about level with week ago volumes. Reports of increasing mastitis problems continue as an apparent result of showers moistening dry lot pens. Components are starting to taper off. Hard ice cream and soft mix manufacturers are running production lines and taking in condensed skim and cream loads.
- Butter: Production is strong in the West and Central regions, but declining in the Northeast. Inventories for print butter are mixed as print demand has increased due to the spring holidays approaching. The strength of the dollar has made export interest light, but cream availability is tight throughout the regions as needs for other cream products increase. Bulk butter demand has increased as supplies have tightened.
- Cheese Northeast: Milk supplies are enabling heavy seasonal production for most cheese operations in the region. However, orders from contracted customers remain good, as an early Easter holiday stimulates current interest. Inventories are not described as burdensome.
- Cheese Midwest: Buying interest for cheese in the region is strong, even stronger than recent weeks for some plants. This is leading to increased cheese production following weeks of already strong production schedules. Some cheese buyers calling this week are surprising sales managers with unsolicited and unexpected requests for cheese to be delivered as early as next week and through the end of April. This has led to purchasing spot milk to be able to increase production schedules. Some plants have thin cheese inventory levels because they have been selling almost all of what they have made, which is why buying more milk is necessary to meet last minute new orders for cheese. For the immediate future, continuing active cheese production is planned to keep up with buying demand. Some manufacturers would like to transition to holding somewhat more inventories to have a greater ability to respond to buyers aside from scrambling to produce more cheese in a short time frame.
- Cheese West: Demand for cheese purchased by commercial buyers is good as they seek cheese for aging as well as current needs. Steady demand from retail and food service customers is also noted. With memories of cheese prices reaching the \$2.40's a pound last year, many buyers are comfortable with increasing holdings in the \$1.50's as a physical hedge against potential higher prices or supply needs.
- CWT has accepted 20 requests for export assistance to sell 8.483 million pounds of Cheddar, Gouda, and Monterey Jack cheese and 176,370 pounds of butter to customers in Asia, the Middle East, North Africa, and the South Pacific. The product has been contracted for delivery in the period from March through September 2015.

What's Bearish:

- Spot Market: While cheese moved higher, Grade A NDM lost 3¼¢ to settle at \$0.99¼/lb on 10 trades and butter fell 5½¢ to \$1.69¼/lb on 10 trades.
- Dairy cow slaughter for the week ending 02/28 totaled 58,400 head, down 4.6% vs. a year ago. After a promising start to 2015, cull rates have now been below 2014 levels two weeks in a row.
- Fluid Milk East: In the Northeast and Mid-Atlantic regions, weather conditions are milder as milk production increases along seasonal trends. Manufacturing milk supplies are sufficient. Milk production continues to rise in the Southeast. Contacts note that bottling distribution channels are full to capacity, as residual milk supplies clear to manufacturing plants.
- Fluid Milk Central: Warmer temperatures in the Central region improved milk production rates slightly. Additional milk supplies are becoming available with most milk spot load prices ranging from Class to \$3.00 under Class, with some reporting \$5.00 under. Bottling orders are mixed. Some educational institutions are on spring break resulting in reduced orders.
- Fluid Milk Southwest: AZ processors report milk production is creeping higher and nearing the expected peak for the year. Class I sales to bottlers are lower as various school districts close March 12 - 20 for parent/teacher conferences and spring break. Milk production in NM restarted its upswing after pausing last week. Weather conditions improved in the eastern half of the state, which is helping cow comfort. Class I and II orders shifted lower, eventually sending additional loads to Class IV. Manufacturing plants are also clearing additional loads from some out of state handlers.
- Fluid Milk Pacific Northwest: Western Oregon temperatures warmer than normal have advanced growth of fields for hay production. Pasture productivity is advancing and allowing more use of pastures. Milk production levels continue to rise. In Washington, a warmer than normal February has led to early growth of pastures. First cutting hay is underway. Milk production is up slightly from last week. In Utah, mild weather

has left alfalfa crops three weeks ahead of normal. This has benefitted dairy producers by reducing the need for supplemental feed. Utah and Idaho milk production is up on a weekly basis.

- Dry Whey Northeast: Prices continue to decline as indices trend lower in a weak market. Production is increasing somewhat with active trading of condensed skim for Class III use. Contract sales are prompting the bulk of dry whey movement, with extra offerings to customers. Buyers are taking a wait and see attitude, while looking for product at lower prices.
- Dry Whey Central: Prices are moving lower and inventories are high. Some sellers are offering discounts in order to decrease stocks. Production levels have increased as cheese orders have picked up. The strength of the dollar is bringing down export demand. The market tone is weakening as dry whey manufacturers have excess supplies to offer in the spot market.
- Dry Whey West: Supplies are plentiful in the region. Because many buyers either have an adequate inventory cushion, or sense lower pricing on the near horizon, they are resistant to paying above their price target, which in many instances, is lower than sellers will presently accept. Some manufacturers are slightly lowering recent asking prices in an attempt to reduce holdings, but not by enough to attract potential buyers. Manufacturers are also notifying contract buyers that additional loads are available if desired.
- NDM: The market is weak as prices are creeping lower and inventories increase. Some manufacturers are reporting inventory above year ago levels. Buyers are hesitant to commit to contracts in a falling market.
- Exports: U.S. Dairy exports slumped in January, continuing a steady decline since the middle of 2014. Total volume of dairy exports during the month fell 23% compared to a year ago. Butterfat took the biggest hit, down 75% vs. Jan '14, followed by MPC down 57% and cheese down 26%. Lagging demand from China and the effects of the West Coast port labor dispute were cited as factors. U.S. exports as a % of production fell from 14.5% a year ago, to just 11.2% in Jan '15.

Recommendation:

At the end of January, Fonterra announced that drought conditions in New Zealand would severely impact milk production in their country. The butter/powder markets shot higher on the news, taking Class III with it. My how times have changed! No one is talking about it anymore, and with the exception of very strong domestic demand for cheese (which we think is temporary), nearly every other bit of news is bearish. Milk production is on the upswing as the country warms, the US-dollar made a 12-year high vs. the euro, and January exports came in well below 2014 levels. As a result, dairy futures have gone through a classic, "buy the rumor, sell the fact" cycle. May Class III went from a low of \$13.84 on Jan 15th, to a high of \$16.45 on Feb 27th, a gain of \$2.61/cwt. But since then, it has given back \$1.35/cwt at today's settlement of \$15.10. The same type of price movement can be seen in butter, nonfat dry milk and Class IV futures. The Fonterra scare sent spot prices to a level where Class IV was higher than Class III. With Class IV leading both bull and bear markets for Class III as of late, it was another factor supporting gains in Class III. But using today's spot prices for blocks, barrels, butter and May dry whey futures, they now calculate to about \$15.25 Class III and just \$13.80 Class IV. In summary, the market has come back to reality about current fundamentals. We're also of the opinion that as soon as cheese demand is satisfied, we will make new lows for the year. Hedgers should continue to sell rallies May-Sep.

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