

**The KDM Dairy Report – May 29<sup>th</sup>, 2015**

**What's Bullish:**

- Spot Market: Block cheese finished the week up 4½¢ on just 2 trades to settle at \$1.69½/lb. Barrels jumped 5¢ to \$1.67/lb on a massive 31 loads trading. Grade A NDM inched ¾¢ higher to close at 90¾¢/lb on just 2 trades, but butter ended the week up 11½¢ to closet at \$2.00½/lb with 17 loads exchanging hands.
- Ag Prices Report: The milk-feed ratio for April was announced at 1.95, down from 2.00 in Mar and 2.42 a year ago. It's the lowest milk-feed ration since a 1.88 was recorded in Sep 2013. Hmmm.
- Dairy cow slaughter for the week ended 05/16 totaled 51,600 head, up 7.1% vs. the same period a year ago.

Futures Month	Class III 05/29	Class III 05/22	Change	Dry Whey 05/29	Dry Whey 05/22	Change	Cheese 05/29	Cheese 05/22	Change
May-15	\$16.22	\$16.22	\$0.00	44.500¢	45.000¢	(0.50¢)	\$1.656	\$1.656	\$0.000
Jun-15	\$16.82	\$16.47	\$0.35	42.800¢	43.950¢	(1.15¢)	\$1.725	\$1.688	\$0.037
Jul-15	\$17.42	\$16.65	\$0.77	41.500¢	41.400¢	0.10¢	\$1.792	\$1.713	\$0.079
Aug-15	\$17.42	\$16.89	\$0.53	41.000¢	41.000¢	0.00¢	\$1.803	\$1.740	\$0.063
Sep-15	\$17.56	\$17.25	\$0.31	39.500¢	40.000¢	(0.50¢)	\$1.823	\$1.787	\$0.036
Oct-15	\$17.56	\$17.32	\$0.24	39.700¢	40.000¢	(0.30¢)	\$1.820	\$1.796	\$0.024
Nov-15	\$17.51	\$17.26	\$0.25	39.250¢	39.750¢	(0.50¢)	\$1.822	\$1.795	\$0.027
Dec-15	\$17.31	\$17.20	\$0.11	38.400¢	39.750¢	(1.35¢)	\$1.802	\$1.789	\$0.013
Jan-16	\$16.84	\$16.91	(\$0.07)	38.325¢	39.000¢	(0.67¢)	\$1.765	\$1.760	\$0.005
Feb-16	\$16.86	\$16.79	\$0.07	39.500¢	40.250¢	(0.75¢)	\$1.755	\$1.755	\$0.000
Mar-16	\$16.89	\$16.93	(\$0.04)	40.250¢	40.500¢	(0.25¢)	\$1.763	\$1.755	\$0.008
Apr-16	\$16.86	\$16.91	(\$0.05)	40.700¢	40.700¢	0.00¢	\$1.753	\$1.753	\$0.000
<b>12 Mo Avg</b>	<b>\$17.11</b>	<b>\$16.90</b>	<b>\$0.21</b>	<b>40.452¢</b>	<b>40.942¢</b>	<b>(0.49¢)</b>	<b>\$1.773</b>	<b>\$1.749</b>	<b>\$0.024</b>

- Cream Southeast: With developing seasonal temperatures, cow comfort is expected to decline, reducing milk volumes. Cream availability is adequate. While supplies were readily available during the holiday weekend, reports suggest cream is closer to even following the holiday.
- Fluid Milk West: Milk production in CA continues to step lower from week to week as daytime temperatures move higher. Daytime highs near 100 degrees are forecast for the San Joaquin Valley. The drought in California is negatively impacting farming operations as some producers report water costs are increasing. AZ milk production is decreasing due to the dry and warm weather. Sales of condensed skim into Class II operations are trending upward. NM milk intakes are stable. Class I demand is lower, but ice cream producers are ramping up production as they expect peak sales in July. Cream supplies and demand are balanced in the West. Most cream volumes are destined for ice cream and soft serve mix plants, as demand for stick/cup/cone and multi-serve packs is trending up. Butter manufacturers are also active in the market, continuing to build inventories ahead of summer.
- Butter Central: Domestic demand is still higher than expected which leaves some manufacturers concerned about inventory levels for Q3. There have been reports that exports may be picking up as other countries have a higher demand. Some manufacturers report that current sales levels are picking up with others being able to build inventories.
- NDM West: End users with unmet needs through the end of the year have yet to come forward to take positions on low/medium heat NDM. Low/medium heat nonfat dry milk production is steady to lower at most locations. Those plants with lower intakes are operating below full capacity.
- Cheese Midwest: The continuing strength of cheese production utilizing strong 2015 milk supplies is leading manufacturers to consider how long the somewhat surprising demand strength from cheese buyers will continue. Unexpectedly strong demand from domestic buyers has helped to keep cheese inventories at comfortable levels notwithstanding high production volumes. Both retail and foodservice buyers have helped keep cheese moving out of plants. Most cheesemakers do not suggest any reason why they question this trend continuing.
- International: Despite the ending of milk production quotas, milk production in Western Europe is beyond the seasonal peak with overall production below year ago levels. Farmgate prices for milk remain low and are not incentivizing producers to take steps to expand production. Weather and pasture conditions have been favorable for cow comfort and milk production. Estat - Newcronos reported EU-28 January-March 2015 milk deliveries down 1.3% compared to last year. Selected member states showed the following January-March percentage changes compared to the same period last year: Germany, -1.7%; France, -2.7%; UK, +0.6%; Belgium, -3.1%; Italy, -1.2%; and Ireland, -4.3%.
- International: Demand for bulk butter in Western Europe has improved as some buyers have made additional purchases to cover their short term needs. There are additional requests coming into manufacturers for longer term orders with some extending through Q4. March butter export volumes increased compared to the previous month with most of the increase attributable to purchases from Saudi Arabia. Good demand for sweet whey powder from infant formula manufacturers for eventual export has supported the market. Cheese production is below year ago levels, due to the continuing Russian ban, and continues to lower whey production.
- International: Australian milk production has marginally declined as weather conditions have been detrimental to cow comfort levels. Rain and cold weather over most of the major dairy producing areas have also contributed to an increase in hay prices. Milk production for the season in New Zealand is coming to a rapid close. A vast majority of the dairy herd will be on winter pastures by the end of May. Most commodity prices continue to move lower, but the rate of decline has lessened and may indicate that prices are near their low point. Oceania butter supplies are fairly tight, which would seem to contradict the general lower pricing trend. Demand has been fairly good with good interest coming from the US in recent weeks.

**What's Bearish:**

- Weekly cold storage numbers indicate butter stocks at USDA-selected storage centers have grown 44% (5.9 million lbs) over the period 05/01 through 05/25. Cheese stocks over the same period showed a small increase of 357,000 lbs.
- Fluid Milk East: Class I demand is declining throughout the region as school wrap up next week. Northeast milk production continues to climb slowly to the peak. Bottling orders are still being cut. Milk output in the Mid-Atlantic continues at high rates, with volumes not expected to decline anytime soon. Some manufacturers are playing catch-up due to heavy weekend milk intakes. Additional storage was required in some instances, aside from usual facilities. Southeast milk production is steady. Manufacturing is operating at/near capacity. Milk volumes were burdensome at some facilities, limiting the processors' effectiveness.

- Fluid Milk Central: The spring flush and favorable weather conditions are making for available milk. Some processors in the Upper Midwest report milk intakes are 2-3% over year ago levels. Spot loads are at \$5 to \$7 under Class, with some reports showing as much as \$10 under. Some manufacturers are choosing to buy excess milk in order to make and store cheese. Bottling interest has slowed. Cream supplies are plentiful as most ice cream manufacturers took the weekend off. Demand was stronger at the beginning of the week and has now started to taper. Ice cream and butter producers are reporting to have ample supplies.
- Fluid Milk Pacific Northwest: Milk is readily available in the region. The recent holiday weekend and end of school terms have reduced milk bottling and made that milk available for manufacturing. Cream is also available with a few loads being sold outside the Northwest. Industry contacts report feed prices for farmers have remained reasonable. ID and UT milk production is strong. Many manufacturers report they are running at capacity and a few are reporting they cannot take on new milk. Cream is readily available.
- Butter Northeast: Churning activity remains seasonally strong although cream supplies may not be as heavy as over the past few weeks. Stock levels are building as churning continues to exceed demand. Retail orders have declined.
- Butter West: Industry contacts report milk and cream are generally available. The recent holiday weekend helped ease the short supply of cream in Parts of the West where it had been tight. Some manufacturers continue to sell excess cream for use in ice cream or other products. Marketers are suggesting there is plenty of butter available on the market and inventories have increased significantly over the last few months. Without increased export opportunities and reports of some imports, there is little upward pressure for butter prices in the near future.
- Dry Whey Northeast: Production is steady to higher due to excess milk supplies into cheese manufacturing over the Memorial Day Holiday. The undertone remains weak.
- Dry Whey Central: Some spot loads were selling at lower prices as manufacturers were clearing inventories. Production is steady to higher as cheese production continues to be strong and some manufacturers are choosing to make whey instead of other higher protein products.
- Dry Whey West: Industry contacts report plenty of inventory on hand with limited buyer interest. In some locations, edible dry whey supplies may be a little tighter but are still generally available to meet the immediate needs of buyers. Few spot sales have been made. Some off spec whey continues to enter the market. Off grade dry whey may be long in a few locations.
- NDM East: Prices for low/medium nonfat dry milk are steady to lower as the market continues to soften. Production is active following the holiday. Heavy drying is expected to continue as excess milk volumes from the flush, along with schools closing, swamp processing plants. Regional inventories continue to grow. Spot interest is light due to the shorter work week.
- NDM Central: Prices are steady to lower. Production is steady to increasing as the spring flush has milk volumes up. Some additional drying took place over the holiday weekend in order to clear out additional volumes of milk. Sources indicate stocks on hand are building.
- Cheese Northeast: Post-holiday cheese production in the region is moderate to heavy. Milk supplies over the Memorial Day weekend were heavy, as some cheese makers added surplus loads to production at prices well below class. Key cheese manufacturers are running 7 day schedules. Retail sales are fair. The market undertone is unsettled.
- Cheese West: Cheese makers report a firm contract market for American style cheeses. However, they also report few export sales, and industry contacts anticipate cheese inventories to be a little long in the weeks to come and prices to soften.
- International: Oceania cheddar prices moved lower this week, averaging a U.S.-equivalent \$1.59/lb. Negotiations are ongoing with Japan for the second half of 2015 with plenty of competition coming from the EU. The market has a weak undertone and market analysts are anticipating further marginal price declines will result from the current negotiations. Domestic prices in Australia are declining as cheaper imports are coming into the country primarily via New Zealand.

#### Recommendation:

It may have been a holiday-shortened week, but the spot market was anything but on vacation. As we've mentioned the previous couple weeks, barrel cheese in particular seems to be loosening up. A huge 31 loads exchanged hands this week. While we expected this to pressure prices, the opposite was true. Where there were willing sellers, there were even more willing buyers. Offers posted above the market were often nabbed before bidders could reach the ask. A cheese plant we talked to this week reaffirmed that domestic interest is very strong. With all the milk floating around in the Midwest, they could fix the current tight cheese situation, but the fact is most plants in the region cannot make any more as they're already running on 7-day schedules. There's a growing consensus that this demand will last through the peak in the Midwest and into mid/late summer. We can't ignore the fact that spot cheese prices pushed into new highs for the year either. So, it looks like once again we have called this market wrong. At a minimum, it probably means there is not much downside to cheese prices. And on the international side, butter is tight and milk output in the EU is in the doldrums, despite the end to their quota system. Oceania is drying off cows as their milking season ends. The bottom line is, if you have made forward hedges for your milk production into the 2<sup>nd</sup> half of 2015, you need to get some upside protection in place in case this market starts heating up further. Look at bull-call spreads or 3-ways (buying a call, selling a call, selling a put). For milk you have not yet hedged, we would look for put options to establish a floor. Next week looks to be equally volatile as the spot market continues to shed light on price discovery.

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