

The KDM Dairy Report – June 26th, 2015

What's Bullish:

- Over the first 22 days of June, cheese stocks at USDA-selected storage centers fell 1% (675,000 lbs).
- CWT has accepted 20 requests for export assistance to sell 3,261 million pounds of Cheddar, Gouda and Monterey Jack cheese and 1,157 million pounds of butter to customers in Asia and the Middle East. The product has been contracted for delivery in the period from June through November 2015.
- Fluid Milk Southeast: Milk production is declining rapidly as prolonged hot, humid weather has taken its toll on cow comfort levels. Class I demand has increased

Futures Month	Class III 06/26	Class III 06/19	Change	Dry Whey 06/26	Dry Whey 06/19	Change	Cheese 06/26	Cheese 06/19	Change
Jun-15	\$16.69	\$16.74	(\$0.05)	42.250¢	42.500¢	(0.25¢)	\$1.719	\$1.723	(\$0.004)
Jul-15	\$16.15	\$16.33	(\$0.18)	38.775¢	38.600¢	0.17¢	\$1.690	\$1.697	(\$0.007)
Aug-15	\$16.50	\$16.51	(\$0.01)	36.575¢	36.000¢	0.58¢	\$1.734	\$1.740	(\$0.006)
Sep-15	\$16.63	\$16.71	(\$0.08)	35.600¢	34.350¢	1.25¢	\$1.755	\$1.765	(\$0.010)
Oct-15	\$16.70	\$16.80	(\$0.10)	35.000¢	34.125¢	0.88¢	\$1.767	\$1.778	(\$0.011)
Nov-15	\$16.75	\$16.83	(\$0.08)	34.800¢	34.225¢	0.57¢	\$1.773	\$1.781	(\$0.008)
Dec-15	\$16.70	\$16.69	\$0.01	34.650¢	33.500¢	1.15¢	\$1.773	\$1.776	(\$0.003)
Jan-16	\$16.50	\$16.40	\$0.10	35.500¢	33.700¢	1.80¢	\$1.750	\$1.750	\$0.000
Feb-16	\$16.46	\$16.46	\$0.00	35.125¢	34.525¢	0.60¢	\$1.745	\$1.750	(\$0.005)
Mar-16	\$16.51	\$16.49	\$0.02	36.500¢	36.000¢	0.50¢	\$1.747	\$1.743	\$0.004
Apr-16	\$16.47	\$16.46	\$0.01	37.500¢	37.000¢	0.50¢	\$1.730	\$1.730	\$0.000
May-16	\$16.55	\$16.68	(\$0.13)	38.350¢	38.350¢	0.00¢	\$1.735	\$1.737	(\$0.002)
12 Mo Avg	\$16.55	\$16.59	(\$0.04)	36.719¢	36.073¢	0.65¢	\$1.743	\$1.748	(\$0.004)

- ahead of next week's holiday. Loads going to manufacturing plants have decreased significantly this week. There continues to be heat related issues and load rejections occurring with tanker transports. The hot weather pattern has also lowered milk production in Florida and there is no relief in the forecast. Class I demand saw some marginal increase. Export milk shipments declined this week, totaling 40 loads, 30 truckloads fewer than last week. The expectation is for no loads to be shipped out of state next week. Cream demand has increased throughout the week. Multiples for all Classes range 1.30-1.40. Very strong pulls on cream from ice cream and ice cream mix manufacturers ahead of the July 4th holiday are the primary contributing factors to the multiple increases.
- Fluid Milk Central: Dairy producers in the southernmost states report on-farm production is trending lower as daytime temperatures and humidity increases. However, in the northern tier of states, milk production has generally plateaued. Bottling demand is steady at some facilities, but moved higher at other plants serving vacation areas. School district managers are still ordering single serve milk packages for filling summer meal programs. As the malaise in dairy commodities markets continues, some dairy cooperatives are reducing milk premium payments to dairy producers as a way to bridge the gap between milk and dairy commodities prices.
- Fluid Milk Southwest: Milk intakes in California are declining week after week below last year. The severe drought is shorting soil moisture and water availability. Some dairy farmers are buying expensive water, which is adding to operating costs. Due to the current drought, part of the Central Valley is not producing alfalfa hay. With the decrease in availability of locally grown hay, some dairy producers are importing hay from Nevada, Oregon and Utah. May 2015 Pool Receipts of milk in California total 3.51 billion pounds, 3.3% lower compared to May last year, according to California Department of Food and Agriculture. Year-to-date through May 2015 receipts are 3.9% lower from the comparable months in 2014. Milk production in Arizona continues trending down. The high temperatures are increasing the heat stress of cows, negatively affecting their productivity.
- Fluid Milk Pacific Northwest: Very warm weather is expected for the upcoming week and may influence milk production, milk components and cow comfort. The National Weather Service issued an excessive heat watch and a heat advisory on Wednesday for parts of the Pacific Northwest. The heat wave is expected to spread across the region over the next week, with high temperatures in the upper 90s to 110.
- Butter: Production is active for bulk and print butter in the East, trending lower in the Central Region, and steady to lower in the West. Bulk butter prices are 5-7 cents over market in the Northeast, market to 5 cents over in the Midwest, and 4 cents under to 5 cents over in the West. Cream availability/pricing for butter churning shows more tightness in the Northeast and Central regions than the West, where some manufacturers are selling cream to ice cream producers. There is a mixed picture surrounding inventory building, with some manufacturers building and others focusing production schedules on contract fulfillment.
- Cheese Midwest: Milk is still readily available for cheese manufacturers but surplus milk priced below Class I is less available. Plant schedules remain very active and in a number of cases, are still at full production. Inventories of hard Italian varieties are reaching comfortable levels to be able to meet demand later in the year. This is causing some refocusing into cheddar production. However, cheese manufacturers are thinking about expected lower milk production as summer progresses, coupled with the typical August activity that begins drawing more milk for school programs. There is a growing consciousness of less demanding production schedules, and hence lower cheese output ahead.
- Cheese West: Domestic cheese demand has remained strong in the region. Industry contacts are looking at the upcoming heat wave and considering the impacts that will have on milk supply, milk components and ultimately, cheese yields. Until now, milk available for processing has decreased only slightly, and some manufacturers report seeing lower milk components.

What's Bearish:

- Spot Market: Pressure near the end of the week left block cheese down 6¢ to \$1.64/lb while barrels shed 3½¢ to close at \$1.62½/lb. Volume was big with 20 loads of blocks and 30 loads of barrels exchanging hands. Grade A NDM finished the week at 83¢/lb, down 4½¢ on 12 trades, but butter managed to hold steady at \$1.91½/lb with just 8 trades.
- Livestock Slaughter Report: 214,000 dairy cows were removed from the herd in May, up 2.2% from a year ago, but way down from 248,000 in 2013 and 251,000 in 2012.
- Cold Storage Report: Butter stocks at the end of May totaled 264 million lbs, up 26% from a year ago. American cheese stocks were up 1% while total cheese stocks increased 4% over the same period.
- Fluid Milk Northeast: Milk production continues to be strong in the Northeast and Mid-Atlantic regions. Most manufacturing plants are running at or near capacity levels. It is hoped that the current spell of warm weather will reduce manufacturing milk supplies and allow plants to catch up on maintenance projects. Class I demand is steady to weak.

- Fluid Milk Southwest: Milk production in New Mexico is trending seasonally lower. However, there are plentiful milk volumes in the state. In addition, milk is coming from out of the state. Some processors are running at full capacity, while others are clearing milk loads to Central states for bottling. Sales into Class I and Class II are slightly lower than last week. The market tone for cream is steady, but cream volumes are plentiful.
- Fluid Milk Pacific Northwest: Milk production in the region has slowed slightly, but the seasonal decrease in bottling has made milk more available for manufacturing. Processors report they still have access to plenty of milk. Cream is generally available, and some processors continue to sell a few loads of cream. Idaho and Utah milk production remains strong and milk is still readily available for processors.
- Dry Whey Northeast: Prices moved lower with substantial declines on the low end of the range. Dry whey production is very active, reflecting the heavy milk volumes going into cheese plants. Supplies are building with manufacturers becoming increasingly concerned about their expanding inventory levels. Exporters and some domestic buyers have been able to negotiate lower prices for multiple load sales.
- Dry Whey Central: The market tone is weak as many buyers are content to dip into the spot market on a weekly basis to fill near-term needs. With strong milk supplies continuing to enter cheese manufacturing, dry whey production is active. Inventories are variable. Some manufacturers have light inventories, but others indicate dry whey holdings are above their previous projections and current needs.
- Dry Whey West: Prices moved slightly lower this week. A few spot sales occurred this week, but market activity has generally been slow. Demand is limited as buyers seem unwilling to purchase any additional product beyond regular contract orders. Dry whey production is still active due to heavy cheese production and inventories of dry whey are long.
- NDM Northeast: Prices for low/medium nonfat dry milk moved lower on the full range, but held steady on the mostly. Manufacturing milk volumes remain heavy in the East, keeping most drying operations near maximum capacity. Some manufacturers are selling condensed skim at significant discounts to reduce the strain on their drying operations. Supplies are building. Demand is sluggish with many buyers only purchasing to cover their immediate needs, knowing future supplies will be readily available at possibly lower prices. The market has a weak undertone.
- NDM Central: Prices are lower on a weak market. NDM producers indicate buyers are reluctant to shift out of the current hand-to-mouth purchasing pattern while the market shows weakness.
- NDM West: Prices are lower this week and the market tone is weak. Sales are sporadic in the spot market. Low/medium heat nonfat dry milk production activity is seasonally lower and the majority of NDM manufacturers are running below capacity. However, inventories are steady to higher above the current demand from buyers.
- Cheese Northeast: Cheese production is very active, following the strong milk production trend in the Northeast. Plants are operating 6-7 days per week to handle the heavy milk volumes. Cheese inventories are increasing at varying rates with some plants seeing good orders for cheddar.
- International: Western European milk production saw only marginal seasonal declines compared to the previous report. Short periods of hot, dry weather had little impact on milk production. Feed is considered relatively inexpensive which is contributing to strong milk production in some countries. Another factor contribution to production strength is farm investments contributing to higher production. Eastern European milk production is just coming off their seasonal peak. Weather conditions have been favorable for milk production. Dairy manufacturers have been very busy handling the heavy volumes of milk coming into their facilities.
- International: Milk production in Australia is steady at seasonally low levels with year to date production ahead of last year. Conditions over most of the major dairy producing areas are favorable for milk production. Most export markets have a weak undertone as global supplies are abundant and demand from China and Russia remains low. Oceania cheddar cheese prices moved lower on both ends of the range. The recently concluded Japan negotiations saw increased competition from Europe. The market tone is weaker as supplies in the northern hemisphere are increasing.
- Rabobank's Dairy sector analysts have pushed back their dairy price recovery forecast into 2016, according to their Q2 Dairy Report. Excess global milk supply is still larger than demand, they argue. This will likely pressure international prices, which in turn will limit U.S. prices.

Recommendation:

Despite showing a willingness to own product, spot cheese buyers this week were not able to hold prices. With both blocks and barrels either steady or losing a little each day, and Class III futures holding a decent premium, prices finally ended Friday sharply lower, though the loss for the week was more muted. We continue to trade a swinging market, with this latest show of offers in the spot market likely to carry over in to next week and continue to pressure prices. Indeed, current spot prices work out to about \$15.80 Class III. Combined with the apparent loosening in the cheese supply and increased trading volume in the spot market, it looks as if the trend will be lower in the short term. Class IV prices also headed lower as both NDM and dry whey deal with very bearish fundamentals. Class IV works out to just \$13.33, despite a resilient butter price. But we do sense a change is coming. We are now at or past the peak in all or nearly all of the country, and still do not have burdensome cheese supplies. Domestic demand is holding up. Extreme heat coming out West and normal heat and humidity in the Southeast appear likely to curtail milk production as well as hurt components. And we only about 30 days away from Class I pipelines beginning their refilling in preparation for the start of the next school year. Surplus milk is less available in the Midwest and at a smaller discount. Recall that the spot market specification is for under 30-day old cheddar. This supply could tighten up significantly in the coming weeks. Finally, grains put in a big turnaround this week as too much moisture in some states is increasing the potential to impact yields. Further upside in grains, should it happen, will begin to increase the cost of milk production. So, what do you do with this? We would recommend buying PUT options July-Aug for any near term weakness. For milk already sold Sep-Dec, look at buying CALL options to open the upside of these fixed contracts. The Sep 18.00 call settled at 19 cents. If you have milk sold near 17.50 or higher, you will give up less than \$1 upside if the market rallies this fall. No matter which way the market moves, there is always an opportunity to either enhance a hedge, or establish a new hedge. But don't sit on your hands. Take action!

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