

The KDM Dairy Report – July 2nd, 2015

What's Bullish:

- Spot Market: Butter finished the week up 2½¢ to settle at \$1.94/lb on 8 trades, while Grade A NDM was up ¼¢ to 83¼¢/lb on solid buying of 24 loads.
- Weekly Cold Storage numbers show both cheese and butter stocks declined in June. Cheese holdings at USDA-selected storage centers declined 1% (880,000 lbs) while butter holdings decreased 2% (315,000 lbs).
- Ag Prices Report: The milk-feed ratio for May was virtually unchanged from last month, at 1.96, and below last May's level of 2.24. In general, a number below 3.0 discourages milk expansion.

Futures Month	Class III 07/02	Class III 06/26	Change	Dry Whey 07/02	Dry Whey 06/26	Change	Cheese 07/02	Cheese 06/26	Change
Jul-15	\$16.11	\$16.15	(\$0.04)	38.025¢	38.775¢	(0.75¢)	\$1.681	\$1.690	(\$0.009)
Aug-15	\$16.51	\$16.50	\$0.01	37.125¢	36.575¢	0.55¢	\$1.725	\$1.734	(\$0.009)
Sep-15	\$16.57	\$16.63	(\$0.06)	35.650¢	35.600¢	0.05¢	\$1.739	\$1.755	(\$0.016)
Oct-15	\$16.60	\$16.70	(\$0.10)	34.025¢	35.000¢	(0.98¢)	\$1.760	\$1.767	(\$0.007)
Nov-15	\$16.66	\$16.75	(\$0.09)	33.925¢	34.800¢	(0.88¢)	\$1.765	\$1.773	(\$0.008)
Dec-15	\$16.68	\$16.70	(\$0.02)	33.500¢	34.650¢	(1.15¢)	\$1.773	\$1.773	\$0.000
Jan-16	\$16.46	\$16.50	(\$0.04)	34.250¢	35.500¢	(1.25¢)	\$1.750	\$1.750	\$0.000
Feb-16	\$16.48	\$16.46	\$0.02	34.425¢	35.125¢	(0.70¢)	\$1.753	\$1.745	\$0.008
Mar-16	\$16.48	\$16.51	(\$0.03)	35.700¢	36.500¢	(0.80¢)	\$1.746	\$1.747	(\$0.001)
Apr-16	\$16.47	\$16.47	\$0.00	36.800¢	37.500¢	(0.70¢)	\$1.735	\$1.730	\$0.005
May-16	\$16.55	\$16.55	\$0.00	38.250¢	38.350¢	(0.10¢)	\$1.735	\$1.735	\$0.000
Jun-16	\$16.79	\$16.77	\$0.02	39.500¢	39.500¢	0.00¢	\$1.749	\$1.752	(\$0.003)
12 Mo Avg	\$16.53	\$16.56	(\$0.03)	35.931¢	36.490¢	(0.56¢)	\$1.743	\$1.746	(\$0.003)

- Dairy Products Report: Cheddar cheese output in May was up 0.4% vs. 2014 while total cheese output increased 1.4%. While these are obviously increases, they appear equal to less than the growth in domestic demand this year.
- Fluid Milk Southeast: The impact of warmer temperatures on cow comfort continues to weaken farm-level milk output. Bottling orders are stronger this week, as some operations look to meet production needs prior to a July 4th holiday break. Temperatures in Florida remain hot, although not at the heat index levels seen in past weeks. Milk production continues to drop. Milk export shipments declined to zero this week, down from 40 loads last week. Cream demand increased this week, prompting multiples above previous weeks. The push for cream, and tightening of supplies, resulted from strong Class II demand as part of a pre-July 4th processing effort.
- Fluid Milk West: Milk production in California is trending down. The severe lack of water and the hottest temperatures are negatively affecting the milk yield of cows. The National Weather Service issued an excessive heat warning for the Sacramento Valley, with temperatures ranging from 110 to 115 degrees. In addition, the precipitation probability remains at 0% for the Central Valley, continuing shorting soil moisture levels. This issue is reducing the local alfalfa hay availability for feeding. Some dairies are importing hay from neighboring states. Milk output in Arizona continues seasonally decreasing. The high temperatures, above 105 degrees, are raising the heat stress of cows. This situation is adversely affecting their productivity.
- Fluid Milk Pacific Northwest: The Pacific Northwest normally sees strong milk production well into July, however industry contacts report they have already started to see decreases in milk intakes. Recent hot, dry weather has been putting strains on cows and milk cooling equipment. It is anticipated that hot days and warm nights may reduce milk production further. Industry contacts in Idaho and Utah report milk production is beginning to slow. Milk is still readily available for processors, however some manufacturers have started seeing the components in milk drop. Current hay production is proceeding. Some sources suggest hay may not be as plentiful as in an average year.
- Butter Northeast: Butter production has been lighter in recent weeks and remains that way as Class II demand consumes pre-holiday cream supplies at an increased rate. Contacts note that overall butter demand is seasonally good. Retail feature activity is up over the last two weeks, and encouraging consumer buying interest. Current bulk butter prices for domestic sales are reported 5-7 cents over the market of the CME Group.
- Butter Central: Churn rates are declining as cream levels tighten. Some butter manufacturers are selling excess cream instead of churning due to current pricing levels. Cream was tighter at the end of last week and the beginning of this week.
- Butter West: Butter production has slowed somewhat as some manufacturers are willing to sell cream and milk. The seasonal increase of ice cream production has pulled cream away from butter making, while milk is being diverted to keep cheese production full. Consumer demand for butter remains steady.
- Cheese Central: Strong cheese sales have been normal in the Midwest for some time and that is contributing to some manufacturers playing more hardball in price negotiations. There were early week calls to some manufacturers seeking spot loads of cheese which manufacturers had available, but opted to hold for later sale when buyers would not meet seller's current price expectations. Noteworthy is the confidence of manufacturers in being willing to hold cheese for future sale, rather than accept slightly fewer cents a pound to sell in early July rather than late June. The overwhelming majority of comments looking forward a few months are confident about selling however much cheese a plant can make.
- Cheese West: Western cheese manufacturers suggest that although export cheese sales have dropped a little this year, strong domestic demand has helped make up the difference. Some manufacturers are experiencing decrease in milk intakes and milk components. This will impact cheese yields into the summer months.
- CWT has accepted 17 requests for export assistance to sell 354,944 pounds of Cheddar, Gouda, and Monterey Jack cheese, and 2.028 million pounds of whole milk powder to customers in Asia, the Middle East, and South America. The product has been contracted for delivery in the period from June through November 2015.
- Grains: Feed costs for dairy operations look set to rise in the coming months. This week's Grain Stocks and Acreage reports set off a wild rally on Wednesday as both corn and soybeans came in well under analyst expectations. Combined with saturated areas of the grain belt states, there is a heightened likelihood that yields could be trimmed.

What's Bearish:

- Spot Market: Butter/NDM finished the week higher, but block cheddar settled 2¢ lower to \$1.62/lb on 11 trades, and barrels gave up 4¼¢ to \$1.58¼/lb on 29 trades.

- Fluid Milk Northeast: "Too much milk" continues to chime around balancing plants in the Northeast and Mid-Atlantic regions. Plants are anticipating being slammed with added milk surpluses as production schedules ease for some manufacturers over the July 4th holiday. Sales to Class I began the week steady to strong, but orders are expected to decline leading into the holiday weekend.
- Fluid Milk Central: Most manufacturers report steady production, with some saying farm intakes are still climbing. Supplies remain plentiful. Some sources indicate processors are discarding skim milk. Spot loads of milk are down this week, but are still available with most selling at \$1-2 under Class, with some reports showing \$3-6 under. Bottling demand is lifeless. The warmer weather has consumers looking for other beverage options.
- Fluid Milk Southwest: Milk volumes in New Mexico are seasonally lower. Nevertheless, there are plenty of milk volumes in the state. In addition, plentiful loads of milk are coming from neighboring states. Some processors are running at full capacity and clearing milk loads to Central states. New Mexico has plenty of fair/good pasture to feed cows. All the state's regions are in the third cutting of alfalfa.
- Dry Whey Northeast: Dry whey is being produced at high levels in the region, as heavy milk volumes continue to clear into cheese manufacturing. Demand for whey is fair with increased discounted loads moving through contracts. Northeast stocks are ample, creating a weak market undertone.
- Dry Whey Central: Prices were steady to lower in a weak market. Whey production is up as cheese manufacturing continues to increase. Whey manufacturers are offering discounts for condensed whey so drying availability can be used elsewhere. Some whey producers will take sharp discounts for condensed in order to not have to dispose of the whey. Demand is steady to decreasing as most buyers have ample supplies.
- Dry Whey West: The price range moved lower this week. Market activity remains slow, and buyers seem in no hurry to make transactions. Dry whey production is still active due to heavy cheese production and inventories of dry whey remain long.
- NDM: Prices were mostly lower this week. The market tone is weak. Processing remains active as milk supplies continue to be strong.
- Cheese Northeast: Heavy milk supplies continue to boost production as cheese plants in the Northeast maintain extended work schedules. Inventory levels are fully adequate for the fair to good seasonal demand as stocks build.
- International: This week's GDT auction saw the dairy price index fall 5.9%. Whole Milk Powder led the way, plunging 10.8%. Cheddar cheese was down 4.9% vs. the last auction just two weeks ago, to a U.S.-equivalent \$1.39/lb.

Recommendation:

The holiday-shortened week didn't keep cheese sellers from continuing to offer product at the exchange. A total of 40 loads traded this week. News that most Italian varieties have what they need for Fall means more milk will now go in to Cheddar production. And recall that over the past several weeks, spot loads of milk had been trading as low as \$10 under Class in some regions. Cheap cheese was made so there is probably no hesitation by the holders of said cheese to offer it at current prices. That probably limits, somewhat, how much we can rally going in to the Fall. On the other hand, cheese makers are holding on to product with confidence and are being tough price negotiators. Strong domestic demand continues to hold up, with some manufacturers growing increasingly confident they will be able to sell every pound of cheese they make, despite running at or near capacity. There's also the growing realization that the peak is past, components in many areas are falling, and that in 30 short days, Class I pipelines will start to be refilled for the next school year. All this means lower cheese output is headed our way. While we mentioned a limitation on how high we can rally, these fundamentals probably mean we won't see a collapse in price either. Consider the 40 loads that traded in the spot market this week. While there were eager sellers, there were also eager buyers. In summary, the market looks to continue to be range-bound for a while, until either supply or demand gets the upper hand. Indeed, through the first six months of 2015, Class III settlements have ranged only \$1.26/cwt between the high and low. The breakout in grains this week could also be a supportive factor as feed costs look set to rise. We continue to view the upside risk as greater than the downside risk in the medium/long term. Existing hedges should take advantage of any market weakness to purchase upside protection Aug-Dec.

Note: Our offices will close at noon on Thursday, July 2nd and will be closed Friday, July 3rd, in observance of Independence Day. Markets will be closed. Enjoy a safe weekend and cherish your freedom!

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