

The KDM Dairy Report – July 9th, 2015

What's Bullish:

- Spot Market: Blocks gained 10½¢ on the week to close at \$1.72½/lb while barrels added 7¼¢ to settle at \$1.66/lb. Just 7 loads of blocks and 12 loads of barrels exchanged hands.
- Dairy cow slaughter for the week ended 06/27 totaled 50,500 head, up 3.7% vs. the same period a year ago.
- Fluid Milk Northeast: In the Northeast and Mid-Atlantic regions, milk production is seasonally declining, although sources note year over year growth is sustaining. Field representatives in the Northeast report periods of very dry conditions followed by heavy rain are making new crop forage quality less-than-desired.

Futures Month	Class III 07/09	Class III 07/02	Change	Dry Whey 07/09	Dry Whey 07/02	Change	Cheese 07/09	Cheese 07/02	Change
Jul-15	\$16.47	\$16.11	\$0.36	39.325¢	38.025¢	1.30¢	\$1.714	\$1.681	\$0.033
Aug-15	\$16.56	\$16.51	\$0.05	38.150¢	37.125¢	1.03¢	\$1.721	\$1.725	(\$0.004)
Sep-15	\$16.44	\$16.57	(\$0.13)	36.050¢	35.650¢	0.40¢	\$1.731	\$1.739	(\$0.008)
Oct-15	\$16.48	\$16.60	(\$0.12)	34.100¢	34.025¢	0.08¢	\$1.741	\$1.760	(\$0.019)
Nov-15	\$16.50	\$16.66	(\$0.16)	33.325¢	33.925¢	(0.60¢)	\$1.755	\$1.765	(\$0.010)
Dec-15	\$16.45	\$16.68	(\$0.23)	32.375¢	33.500¢	(1.13¢)	\$1.755	\$1.773	(\$0.018)
Jan-16	\$16.27	\$16.46	(\$0.19)	32.250¢	34.250¢	(2.00¢)	\$1.736	\$1.750	(\$0.014)
Feb-16	\$16.23	\$16.48	(\$0.25)	32.975¢	34.425¢	(1.45¢)	\$1.728	\$1.753	(\$0.025)
Mar-16	\$16.08	\$16.48	(\$0.40)	33.875¢	35.700¢	(1.83¢)	\$1.709	\$1.746	(\$0.037)
Apr-16	\$16.05	\$16.47	(\$0.42)	35.100¢	36.800¢	(1.70¢)	\$1.705	\$1.735	(\$0.030)
May-16	\$16.21	\$16.55	(\$0.34)	36.025¢	38.250¢	(2.23¢)	\$1.705	\$1.735	(\$0.030)
Jun-16	\$16.50	\$16.79	(\$0.29)	36.950¢	39.500¢	(2.55¢)	\$1.720	\$1.749	(\$0.029)
12 Mo Avg	\$16.35	\$16.53	(\$0.18)	35.042¢	35.931¢	(0.89¢)	\$1.727	\$1.743	(\$0.016)

- Fluid Milk Southeast: Milk production is waning in the region. Balancing plants' milk supplies are fairly manageable. No Grade A spot milk shipments are reported. Production in Florida is flat, with a slight downtick. As weather conditions return to seasonal norms, the heat index will likely move back into the 100s, affecting cow comfort and limiting milk output. Ice cream manufacturing continues to clear heavy cream volumes. Supplies remain tight. Some butter processors are opting to sell cream on the spot market rather than churn.
- Fluid Milk West: California milk output continues its downward trend. Some dairy farmers report a decline in the solid components of the milk. This situation is negatively influencing its operational returns. In addition, they are purchasing expensive water.
- Fluid Milk Pacific Northwest: The recent heat wave in the region has placed a strain on cows. Industry contacts note a reduction in milk intakes and milk components. Demand for cream has been strong with the seasonal increase in ice cream production. A few regional showers have provided some relief from the heat within Idaho and Utah. However, dairy manufacturers are still observing lower milk intakes and components. The reductions are following typical seasonal trends, but have appeared earlier than usual this year. Strong ice cream production has increased the demand for cream.
- Butter: Production is steady to lower this week as cream supplies tighten. Some butter manufacturers are selling additional cream due to higher profits. Print orders are steady to lower in the East and West, but have started to pick up in the Central region.
- Cheese Midwest: Manufacturers are experiencing some seasonal declines in milk intakes and in milk components. Some cheese makers have purchased a few additional loads of milk to keep their plants at full capacity. Consumer demand remains steady for most varieties of cheese.
- Cheese West: The recent heat wave in the West has begun to impact milk supply and cheese yields. Industry contacts suggest the cows are willing to drink water, but are not interested in getting up to eat. Cheese makers report relatively steady domestic demand for cheese.

What's Bearish:

- Spot Market: Grade A NDM only lost a penny during the week, but it was enough to punch in a new record low at the CME, of 79½¢/lb. Butter shed 2¢ to settle at \$1.92/lb. 11 loads of NDM and 2 loads of butter were all that traded this week.
- Fluid Milk Central: Milk production continues to be mixed, with most manufacturers reporting steady farm intakes. The favorable weather continues to aid in cow comfort. Most manufacturers are working with the milk supplies that they have because the dry products markets are so weak they do not want extra. Bottling demand is flat. Class II demand is strong, but ice cream orders are starting to decline.
- Fluid Milk Southwest: Arizona milk production has seen declines from week to week, under pressure from high daytime temperatures. However, the state has sufficient levels of milk. Processors are getting enough loads, helping to clear the volumes of nearby states. The intake of milk in New Mexico is seasonally lower. However, the state has adequate levels. Some milk processors are still sending loads of milk to Midwest. Heavy rains are falling in most parts of New Mexico. With these showers, farmers expect a slight improvement in the quality of feeding hay. The region has plenty of cream.
- Dry Whey Northeast: Prices are steady to lower. Production is in general steady, while domestic demand is quiet. Stock levels continue to build in a weak market.
- Dry Whey Central: Sellers are noting a wider spread in pricing than usual with pressure to go lower. Dry whey production is steady to stronger as cheese production picked up slightly this week. Dry whey inventory levels are increasing. There is little buying interest as most buyers do not want to have too much inventory as prices move lower. Other purchasers have plenty of product on hand so they feel no urgency to buy.
- Dry Whey West: Sales activity remains limited. Market contacts note buyers are still taking contracted loads, but some resellers are selling at a loss to be competitive. Inventories of dry whey remain long.
- NDM East: Prices inched lower this week, with downward moving spot prices. Current production is adding to growing NDM inventories. Cash trading is very light, as buyers are content with shopping for the lowest possible prices. Export demand remains light.
- NDM West: Prices are lower this week. The market tone is unbalanced and weak. The sale activity is trending steady to lower. Some sellers are trying to clear up inventories with reductions in prices. Exports of nonfat dry products are intermittent.
- Cheese Northeast: Cheese production in the region remains very active because of ample milk receipts. Yields are trending lower. Mozzarella demand has slowed. Swiss sales are steady. Some area processors are surprised by the level of interest, considering the lower import Swiss cheese price. Cheese stocks, overall, are growing as the cyclical demand eases. The market remains unsettled.
- International: Milk production in Western Europe has shown only marginal declines since reaching the seasonal peak. Weather conditions are favorable and cow comfort levels are generally good. Producers are supplementing feed rations with grain in order to maximize and capture

current prices and margins, prior to expected declines. Dairy commodity prices are declining and will likely see little recovery in the near term. Russia has extended the import embargo covering dairy products from the European Union. Eastern Europe milk production is marginally declining along the typical seasonal trend. Weather conditions have varied in recent weeks, but have not hampered milk production to any great extent.

- International: Australia's dairy industry continues to see significant investments into expanding dairy operations and enhancing manufacturing capabilities and capacities to meet various dairy product demands coming from Asia. Dairy Australia reports that May 2015 milk production in Australia was 1.1% above May 2014. New Zealand's milk production is at seasonally low levels as most dairy cows are dried off and on winter pastures. Calving will begin in another week or so and milk production will start to increase. Pastures and forages are in normal to good condition for this time of year. Dairy manufacturers are attempting to reduce their remaining stocks of dairy commodities by the end of July with mixed results. Supplies are currently available for nearly all dairy commodities and will likely increase as the new season begins in August. Demand is sluggish as many buyers have more than adequate supplies. Numerous market analysts expect the bearish market conditions to continue through 2015 and into 2016.

Recommendation:

Sales activity in the spot market really slowed down this week, despite it being a “back to business”, regular week after the July 4th holiday. Interestingly, bidders led the way seeking product, and in the process pushed both blocks and barrels higher. We are most likely past the peak now in all parts of the country. Heat is impacting production in southern reaches while components appear to be falling just about everywhere. There's still plenty of milk out there for manufacturing, however. Cheese production remains strong, with a larger share of the milk going in to cheddar vs. other varieties than a few weeks ago. On the positive side, cream is tightening up as ice cream production is in full force in many parts of the country. As a result, butter output is somewhat limited. Outside the U.S., the growing economic crisis in Europe (Greek default) and fears of a stock market meltdown in China (down over 33% YTD) have stoked fears of an overall drop in consumer spending/demand. For the first time we saw heavier trade volume in the 2016 Class III contracts as sellers (hedgers) decided to get some coverage. Jan-Jun 2016 settled the week down double-digits, from a \$16.54 average on 07/06, to a \$16.22 settlement today. Similarly, the 2016 annual average of \$16.75 fell to \$16.54 over the same period. We're not certain it's time to get a huge amount of coverage in those months yet, but the honest answer is nobody really knows. A drop in exports would do it. If you are a dairy operation that can make a profit with those numbers, consider at least getting a start on your hedge program. Or, consider the Jan-Sep 16.00 x 17.75 fence for a cost of about 25c/mo. This will at least put a floor of \$16.00 on your milk production, while allowing you to rally up to a cap of \$17.75. Worth a look. Grains continue to pull away from long-term lows with increased weather premium being built into the market. Excessive moisture has many fields in parts of grain states under water, with the 6-10 day forecast wetter than usual. The biggest risk is for soybeans, with over 3 million acres yet unplanted and the potential for a decline in yields due to all the rain. Next week's spot market will be critical in determining price direction for both cheese and Class III. If young cheese truly is on the tighter side, we could see an additional rally in the front months. However, both dry whey and NDM markets are just sick. Over production and over supply are pushing NDM to record lows, while demand remains weak as buyers sit on the sidelines. Current spot prices put Class III at about \$16.30/cwt, but Class IV is down to about \$13.00/cwt. Ultimately that should push more milk towards Class III/cheese production, limiting how high we take Class III.

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