

The KDM Dairy Report – August 7th, 2015

What's Bullish:

- Spot Market: Cheddar blocks managed a ¼¢ gain for the week and settled at \$1.75/lb, while barrels gained 1½¢ to close at \$1.71¾/lb. 8 loads of blocks and 20 loads of barrels exchanged hands. Grade A NDM lost a penny, settling at \$0.69/lb on 10 trades, but butter held steady at \$1.99/lb with just one load trading.
- Fluid Milk Southeast: Southeast milk production rates are inching lower. Bottling is consuming the majority of available milk supplies as orders grow ahead of school openings. Manufacturing milk intakes have declined compared to a week ago. Florida's milk output is continuing the downward trend. Production received some support as rainfall suppressed hotter temperatures. However, the steady precipitation is creating wet, soggy field conditions that hamper cow comfort. Milk sales are likely to trend upward, with schools back in session in the next few weeks. Milk imports totaled 50 loads, 30 loads higher than last week's shipments.

Futures Month	Class III 08/07	Class III 07/31	Change	Dry Whey 08/07	Dry Whey 07/31	Change	Cheese 08/07	Cheese 07/31	Change
Aug-15	\$16.47	\$16.41	\$0.06	34.100¢	35.675¢	(1.58¢)	\$1.738	\$1.727	\$0.011
Sep-15	\$16.56	\$16.56	\$0.00	32.600¢	34.500¢	(1.90¢)	\$1.757	\$1.748	\$0.009
Oct-15	\$16.54	\$16.36	\$0.18	31.000¢	32.950¢	(1.95¢)	\$1.765	\$1.737	\$0.028
Nov-15	\$16.27	\$16.07	\$0.20	30.500¢	32.100¢	(1.60¢)	\$1.745	\$1.712	\$0.033
Dec-15	\$15.95	\$15.90	\$0.05	29.000¢	31.475¢	(2.48¢)	\$1.726	\$1.704	\$0.022
Jan-16	\$15.54	\$15.58	(\$0.04)	28.500¢	31.450¢	(2.95¢)	\$1.685	\$1.676	\$0.009
Feb-16	\$15.39	\$15.46	(\$0.07)	28.500¢	31.575¢	(3.08¢)	\$1.675	\$1.661	\$0.014
Mar-16	\$15.47	\$15.39	\$0.08	28.900¢	32.550¢	(3.65¢)	\$1.670	\$1.654	\$0.016
Apr-16	\$15.50	\$15.50	\$0.00	29.900¢	33.925¢	(4.03¢)	\$1.670	\$1.667	\$0.003
May-16	\$15.84	\$15.80	\$0.04	32.250¢	35.275¢	(3.03¢)	\$1.700	\$1.684	\$0.016
Jun-16	\$16.07	\$16.12	(\$0.05)	33.250¢	36.250¢	(3.00¢)	\$1.720	\$1.715	\$0.005
Jul-16	\$16.40	\$16.51	(\$0.11)	34.250¢	37.375¢	(3.13¢)	\$1.747	\$1.745	\$0.002
12 Mo Avg	\$16.00	\$15.97	\$0.03	31.063¢	33.758¢	(2.70¢)	\$1.717	\$1.703	\$0.014

- Fluid Milk Central: Milk production in the North Central area is trending lower in response to recent, short-term heat and humidity. In the South Central area, milk production continues to trail off. Bottler demand is higher, with some milk imports from the Southwest to meet current demand. Several public K-12 school districts begin classes next week, and milk orders for meal programs are being filled now.
- Fluid Milk West: California milk output is waning week after week. Moreover, production is below the previous year levels. Cows' stress is still increasing as temperatures remains high during current seasonal long days. In addition, some dairy operations are drying off cows with low yield. Spot milk shipments are quiet with few loads moving outside the state. Some dairy operators are importing alfalfa hay from nearby states. Others have left their hay fields in an unproductive state to conserve water for other operational purposes.
- Fluid Milk Southwest: Arizona milk volumes are decreasing as the season advances. The current excessive heat with temperatures ranging from 110 to 115 degrees is taking a toll on cows' comfort. Milk volumes for manufacturing are lower. Sales for bottled milk are higher as most of the schools reopen this week. Milk production in New Mexico is lower. Some processors report a little decline in the butterfat component of the milk. Levels of milk into processing facilities are slightly lower. However, milk levels into nonfat dry milk are noticeably lower.
- Butter Northeast: Production is mixed. Butter stocks are mostly adequate, but seasonal orders are showing signs of increasing as buyers' inquiries grow.
- Butter Central: Manufacturers report week to week demand for butter is active into retail, food service, and grocery accounts. Also, producers indicate they are looking forward to filling demand for the November/December holidays. Cream availability is tight, with Class II still taking cream volumes away from the churns.
- Butter West: Manufacturers continue to weigh the decision between churning and selling spot loads of cream. Demand for cream has been strong for a number of months and some market participants are wondering when it may decrease. Domestic consumer demand for butter has been strong. Cumulative butter production is down. Some industry contacts suggest the combination of strong demand and lower production has helped keep prices up.
- Cheese Midwest: Many industry contacts suggest the prices are defying the odds by holding at current levels. Trading is holding within a range and is bouncing back and forth. Milk production in the Midwest is declining somewhat, but without hot days and nights, manufacturers report the decline has been slow and steady. There is plenty of milk for manufacturing and spot loads of milk can be found at or slightly above Class prices. Production remains steady. Strong domestic consumer demand continues to provide a lift for cheese prices and is helping keep inventories at comfortable levels.
- Cheese West: Cheese producers report domestic consumer demand is strong. Cheese making has remained active as manufacturers continue to try to absorb the available milk. Milk intakes have decreased somewhat, following typical summer patterns. Trading at the CME has bounced within a range, but above prices that were anticipated for the market earlier this summer. Industry contacts are considering whether these prices can hold through the end of summer. Inventories remain at comfortable levels.
- CWT has accepted 9 requests for export assistance to sell 1.334 million pounds of Cheddar, Colby, Gouda, and Monterey Jack cheese, and 440,925 pounds of whole milk powder to customers in Asia, Central America, and North Africa. The product has been contracted for delivery in the period from July 2015 through January 2016.
- International: The heat that was a factor for the dairy regions in the center of Europe has declined, but now droughts are affecting dairy and crop production. Output continues to be above year ago levels, but is declining monthly.
- International: Heavy milk volumes have lowered milk prices. Farmers in Australia are looking to decrease input costs as they struggle with profitability. Cold weather in New Zealand has slowed production, but has started to rise slightly. Some dairy products processors are looking to increase exports as there are some buyers refilling pipelines.

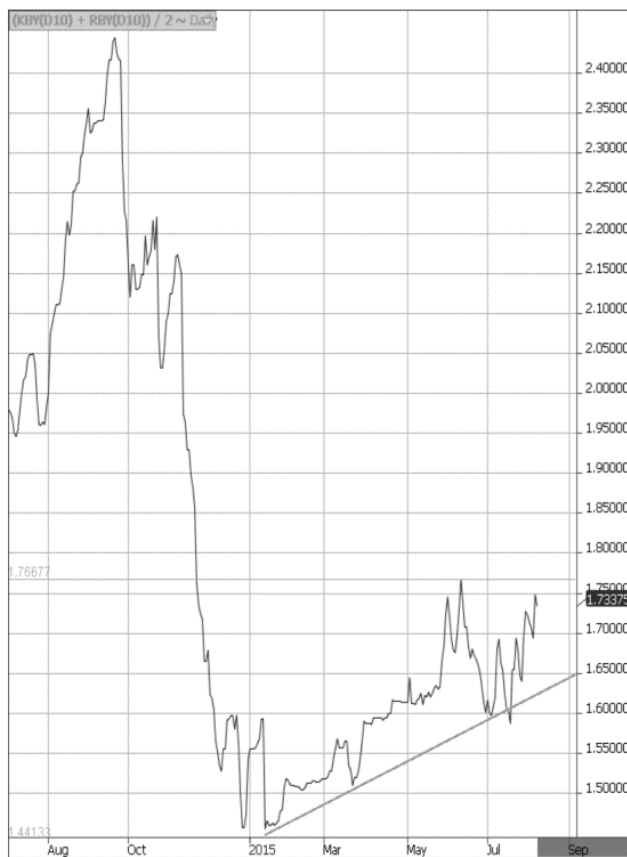
What's Bearish:

- Exports: U.S. dairy exports in June were the worst in four months, a result of weak global demand and international competition. Numbers confirm the weakness in powder as NDM/SMP exports saw a 23% decline vs. a year ago, while WMP exports plummeted 45%. Not to be outdone, butterfat exports plunged 75% vs. June '14. Cheese exports fell 22% vs. a year ago, and are down 12% YTD (Jan-Jun).

- Dairy Products Report: Cheddar cheese output in June was 4.3% higher than a year ago while total cheese output increased 1.5% over the same period. Butter output was 1.7% higher than June '14, but down 15.9% from May.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic is mostly steady. Weather conditions encourage farm-level milk output. Bottling orders are expected to increase as some schools start to reopen, but milk available for manufacturing is still ample.
- Fluid Milk Pacific Northwest: Daily fluctuations in temperature have not seemed to significantly impact milk production. Dairy observers note a little more tightness of milk due to the typical summer milk production declines, but there is still plenty of milk for processing needs. Grain harvesting is ahead of schedule and industry contacts note crops look good.
- Dry Whey Northeast: Prices are lower at the top of the range due to declines in regional spot pricing. Dry whey production is steady and consistent with cheese manufacturing output. Inventories are increasing marginally. Light spot activity is noted, as transactions occur mainly through contracts. The market tone remains weak.
- Dry Whey Central: Prices are lower on the range this week. Producers report the steady cheese market is keeping usual milk volumes, milk spot loads, and condensed skim clearing through cheese vats. That is keeping dry whey production active. Cheese and dry whey manufacturers are caught between wanting to capitalize on the current active cheese demand, while knowing the attendant dry whey production is undercutting the whey market. Dry whey interest is light as many end users have made incremental purchases through the last few months and are now looking at emptying warehouses before the beginning of Q4. A few manufacturers are doing the same, clearing inventories at lower than usual prices before the advent of their new fiscal years. Dry whey inventories are generally higher than projected for this time of year.
- Dry Whey West: An increase in spot market activity and willingness of manufacturers to sell at lower prices helped push West whey prices lower. There is significant price competition between regions and in international markets. Inventories are long. Manufacturers want to clear some stocks prior to the end of the fiscal year. Meanwhile, buyers are willing to wait on lower prices. The market tone for whey continues to be weak.
- NDM East: Prices shifted lower at the top of the range on weak F.O.B spot trading. Production is mostly steady in the region. Producers are adding to inventories at most balancing plants as condensed skim milk supplies still necessitates heavy drying. Domestic demand is weak. Many buyers are procuring small quantities around their immediate needs and using caution by not taking a decisive position in a falling market.
- NDM Central: Prices are unchanged to lower as the market seeks support. Sellers report interest is steady for contract loads, which are shipping on schedule. However, interest in f.o.b. spot offers is light. Buyers indicate they have offers from manufacturers, brokers, and resellers to choose among, and the offers appear consistently from week to week. At this time, few buyers are ready to take positions for balance for the year.
- NDM West: The market undertone for low/medium heat NDM is weak. Some resellers are waiting and studying the market before making any purchases. Some manufacturers note a considerable decrease in production. Others producers report adequate domestic sales but a decrease in exports. Inventories are steady to higher.
- Cheese Northeast: Most cheese manufacturers are operating heavy production schedules in preparation of the expected demand from food service and pizza makers, ahead of the fall school-term. Cheese makers are improving yields through fortification processes, as solid contents decline at seasonal rates. Manufacturing supplies are sufficient for fulfilling existing orders, as inventories levels steadily increase.
- International: At this week's GDT auction, the dairy price index fell another 9.3%, the tenth consecutive decline. Powders led the way lower with SMP down 14.4%, WMP down 10.3% and AMF down 11.7%.

Recommendation:

After a rising a nickel or more each on Thursday, spot blocks and barrels gave up some of that ground on Friday, leaving them both up slightly for the week. Class III has shown a reluctance to rally in the face of ongoing pressure in other commodity markets as well as generally poor economic news abroad. It's worth noting, though, that since falling from its peak of \$2.40/lb last fall, the spot cheese average has been steadily, but slowly increasing (see chart). The upper \$1.70's looks like an area of resistance (horizontal line) which we nearly touched this week. We still think we have a chance to break through to the upside in the short term. Despite a small weekly gain, it was the bidders in this week's spot market that felt more aggressive, eagerly taking on 20 loads of barrels. Cheese inventories are not burdensome and domestic demand is still good. We would expect buyers to come back next week to retest that resistance line. Fonterra is likely to announce a pay cut for the upcoming milking season in New Zealand. Already, their pay prices are only in the low \$10/cwt (U.S. equivalent). European Union pay prices are also under \$11/cwt, with British farmers protesting for better pay. Despite the dropping of quotas, these prices will not induce expansion; in fact, more likely the opposite. This week's export numbers show how week the powder market is globally, while our cheese exports are also suffering. Fortunately schools are beginning to open soon and football season is nearly here. In summary, we think a rally is still possible in the near term (Sep/Oct months), but it will still take time to balance supply (especially powder) with demand. Producers should look for opportunities to protect existing hedges (buy call options) as well as pull the trigger on new hedges going into Q1 2016 should contract prices rise in the near term.



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