

The KDM Dairy Report – August 14th, 2015

What's Bullish:

- Spot Market: Butter gained 7½¢ to close at \$2.06½/lb on solid volume of 21 loads. NDM was unchanged at \$0.69/lb on ten trades.
- Dairy cow slaughter for the week ending 08/01 totaled 52,800 head, up 2,600 head vs. the same period a year ago. YTD the cull is up 68,000 head.
- Butter stocks at USDA-selected storage centers is down 7% (1.4 million lbs) through the first 10 days in August.
- Fluid Milk Mid-Atlantic: Milk production in the region is tapering. Balancing plants report lower milk intakes.
- Fluid Milk Southeast: Farm level milk production is seeing some sharp drops in the Southeast due to continued heat and humidity. Temperature issues are a concern for long haul loads. Sales to Class I are continuing to build, as most schools will be in session next week. Florida's weather has been very hot and heat indexes are reported in the triple digits. As a result, milk production continues to decline. Sales are climbing and expected to be stronger as schools head into full swing. Spot import milk shipments are increasing, with 60 loads this week, compared to 50 last week. The cream market looked as though it was softening into last weekend but that changed with heavy trading at the first of the week. Buyers scrambled to find loads as availability diminished. Production of sour cream, dips, and bottled cream is seasonally active.
- Fluid Milk Central: South Central milk production is trending lower as high daytime temperatures topping 95 degrees Fahrenheit settle into the area for a stretch forecast to last through next week. In the North Central area, milk production is also declining slowly from week to week, but weather has not had much impact. Demand for Class I milk is drawing raw milk from the North Central and the Southwest into the Southeast. Major metropolitan school districts in the South Central are placing orders this week, ahead of deliveries for next week.
- Fluid Milk West: The hot weather is reducing milk production in California. Milk cows continue experiencing heat stress during daytime hours with limited relief time at night. Some dairies report a reduction of returns due to the high cost of water. Bottlers are expecting an increase in fluid sales as schools start during the next few weeks.
- Fluid Milk Southwest: Milk output in Arizona is trending lower. Daytime high temperatures and a rise in humidity continue reducing the comfort of the dairy herd. Some processors note a seasonal decrease in the butterfat components of the milk. Balancing plants are receiving lower milk volumes for processing. Class I sales are higher. New Mexico milk volumes are decreasing below the last year's levels. Manufacturing plants from nearby states continue clearing up milk volumes. Class I sales are higher as most of the public schools are reopening during this week.
- Fluid Milk Pacific Northwest: Heat has led to a decline in milk components and production. Some manufacturers are reporting bottling demand increasing with educational institutions starting again. Also, there have been some retail promotions leading to higher sales. In Utah and Idaho, wetter weather conditions are not helping the alfalfa. Farmers are having difficulties harvesting without delays. Poorer quality is making prices drop. Demand for cream from butter churns and cream cheese makers continues strong in the West. Some processing plants are running with a shortage of cream due to the seasonal decrease of butterfat content in the milk.
- Butter Central: Demand is active from food service accounts for near-term use. Churners also report some grocery chain operators placed early orders for the holiday season. The more customary timeframe for yearend orders is in 6 - 8 weeks, but current trends on butter stocks and prices have motivated a few buyers to place orders well ahead of time. Also, some manufacturers are buying bulk butter on the spot market in an effort to meet near-term commitments. Some manufacturers indicate they would like to get additional cream. Thus, butter production is below capacity at most regional churns. Plant managers are moving some bulk butter into microfixing to help meet current and upcoming retail/food service demands.
- Butter West: Production is slowing. Most butter manufacturers are reporting selling excess cream, as it leads to higher profit margins. Consumer demand is steady as it has been all summer. Some manufacturers are pulling from inventories to supplement current orders.
- Dry Whey Northeast: Regional cheese plants are seeing small drops in milk supplies prompting marginal decreases in dry whey production. Dry whey supplies are variable, with sources noting that some producers may be sold out.
- Cheese Northeast: Cheese production is mostly steady. The market for cheddar is active with good demand noted by sources. Mozzarella interest is steady and building. International demand remains sluggish against strong global competition. Inventories levels are adequate. The ongoing hot weather continues to impact (lower) milk components, resulting in reduced cheese yields.
- Cheese Midwest: Milk volumes into manufacturing are decreasing. However, manufacturers are reporting very active production schedules. Domestic demand for cheese is strong, particularly from food service and pizza makers. Presently, some cheese makers are reporting higher sales and expect to remain active throughout the week.
- Cheese West: Production remains active with milk intakes strong. Processors are noting good demand for retail cheese. Western cheese producers are comfortable with current pricing levels.
- International: Fonterra dramatically reduced its milk forecast payout last Friday to \$3.85/kilo, down from \$5.25/kilo. Banks are putting pressure on struggling dairy farmers in the country, to sell off their assets in an attempt to preserve some of their equity. Average operating costs for New Zealand dairy farmers is about \$4.50/kilo of milk solids. Fonterra itself has been put on "credit watch" by Standard & Poor's due to its high debt.

Futures Month	Class III 08/14	Class III 08/07	Change	Dry Whey 08/14	Dry Whey 08/07	Change	Cheese 08/14	Cheese 08/07	Change
Aug-15	\$16.43	\$16.47	(\$0.04)	33.400¢	34.100¢	(0.70¢)	\$1.739	\$1.738	\$0.001
Sep-15	\$16.46	\$16.56	(\$0.10)	31.825¢	32.600¢	(0.78¢)	\$1.747	\$1.757	(\$0.010)
Oct-15	\$16.42	\$16.54	(\$0.12)	30.500¢	31.000¢	(0.50¢)	\$1.753	\$1.765	(\$0.012)
Nov-15	\$16.14	\$16.27	(\$0.13)	28.925¢	30.500¢	(1.58¢)	\$1.737	\$1.745	(\$0.008)
Dec-15	\$15.86	\$15.95	(\$0.09)	27.325¢	29.000¢	(1.68¢)	\$1.718	\$1.726	(\$0.008)
Jan-16	\$15.38	\$15.54	(\$0.16)	27.025¢	28.500¢	(1.48¢)	\$1.685	\$1.685	\$0.000
Feb-16	\$15.22	\$15.39	(\$0.17)	26.750¢	28.500¢	(1.75¢)	\$1.670	\$1.675	(\$0.005)
Mar-16	\$15.25	\$15.47	(\$0.22)	27.500¢	28.900¢	(1.40¢)	\$1.670	\$1.670	\$0.000
Apr-16	\$15.30	\$15.50	(\$0.20)	29.000¢	29.900¢	(0.90¢)	\$1.664	\$1.670	(\$0.006)
May-16	\$15.67	\$15.84	(\$0.17)	30.775¢	32.250¢	(1.48¢)	\$1.690	\$1.700	(\$0.010)
Jun-16	\$16.03	\$16.07	(\$0.04)	32.250¢	33.250¢	(1.00¢)	\$1.720	\$1.720	\$0.000
Jul-16	\$16.29	\$16.40	(\$0.11)	33.550¢	34.250¢	(0.70¢)	\$1.740	\$1.747	(\$0.007)
12 Mo Avg	\$15.87	\$16.00	(\$0.13)	29.902¢	31.063¢	(1.16¢)	\$1.711	\$1.717	(\$0.005)

- International: Fonterra is significantly reducing its GDT offer quantity forecasts for the next 12 months. Volumes over the next 12 months have been decreased by 56,045 MT, with a 62,930 MT decrease occurring over the next three months. The export giant cited a shift away from WMP and predicted decrease in the milk supply as reasons.
- International: New Zealand dairy farmers feeling the pinch are selling off their cows at an increasing rate. As a result, dairy cow prices have fallen to their lowest levels since 2009, according to a news articles this week. In fact, the high rate of dairy cows currently being culled has sparked concerns that New Zealand beef exports to the US could see it run out of its 2015 quota. At the end of June, 69% of that quota had been filled, about 9% more than last year.

What's Bearish:

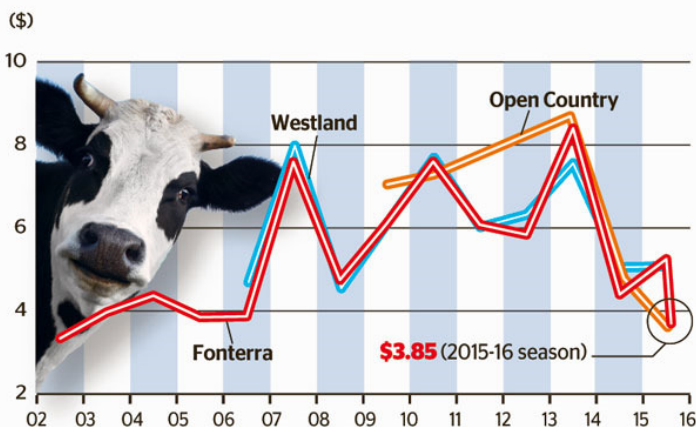
- While spot butter climbed higher, block cheese lost 5¼¢ during the week to settle at \$1.69¢/lb and barrels gave up 2¢ to close at \$1.69¢/lb. Blocks saw 10 trades while barrels had just 4.
- WASDE Report: USDA lowered their Class III price forecast for 2016 by 45¢/cwt from last month's report. Citing lower exports due to global competition, they now expect Class III to average \$15.95/cwt for the year.
- Grains: USDA's estimates on yields and the crop size were mostly far above analyst expectations, sending grains sharply lower for the week. Lower feed costs appear headed our way.
- Fluid Milk Northeast: Farm-level milk production in the region is off the peak. However, output remains strong after maintaining higher than anticipated levels for several weeks. Manufacturing milk supplies are ample.
- Dry Whey Central: Prices moved lower in a weak market. Dry whey production is ongoing, with active cheese making sending condensed whey into the dryers. Buyers are aware of the current weak tone throughout the whey complex, and they are willing to wait for anticipated price decreases during this buyers' market. Contacts also indicate some sellers are now asking for bids on available dry whey loads in hopes of garnering interest. Dry whey inventories are steady to building due to slow sales activities.
- Dry Whey West: Prices are moving lower in a weak market. Production is steady as cheese production continues to be strong. Demand is slow as prices keep moving lower. Buyers are purchasing hand-to-mouth for current needs as they wait to see how low prices will go. Most sellers are reporting having ample inventory levels.
- NDM Northeast: Prices continue to trend lower. Dryer schedules are seeing a slight reduction at most plants, but supplies remain plentiful.
- NDM Central: Prices shifted mostly lower on a weak market. Interest is light outside of contracts. To spur some f.o.b. single load/block spot interest, a few producers secured sales by shaving prices incrementally.
- NDM West: Prices for low/medium heat nonfat dry milk are steady to lower, while weakness remains in the spot market. According to some buyers, their current activity in the market is very quiet. Domestic sales and export are lower. Buyers are waiting for discount prices.
- International: A news article this week noted China's milk powder stockpile is so large it may not be a buyer until after the second quarter of 2016.

Recommendation:

Butter finally climbed above the \$2 handle and kept going, but most other dairy components were weaker. Trade volume overall was quiet but it may be the calm before the storm. Domestic cheese demand remains strong and it may be that the barrel market is tightening up a bit. With milk output falling and hot weather over much of the country, spot barrels settled the week above blocks. In addition, there were 10 block trades, but just 4 barrels exchanged hands. Current spot prices work out to about \$16 Class III, with Sep futures beginning its calculation next week. At \$16.46 settlement today, it's carrying a premium, so there is some anticipation that cheese prices will be steady to slightly higher over the next four weeks. Time will tell. On the international side, the bad news is that China may not be back as a buyer of powder until after Q2 2016. That would hurt. But on the positive side, at least from a supply standpoint, it appears milk prices have been low enough, long enough for New Zealand operations to reduce output. Not only are they culling more aggressively, but their pay price going in to the new milking season is very low. Indeed, the graphic shows prices haven't been this bad for NZ since the early 2000's. While we understand the hardship this will bring to real dairy operations, it will likely help bring the current global supply glut under control. U.S. dairy operations have an opportunity to grab global market share if they can remain viable over the next 6-12 months, when we hopefully see a resurgence in international buying of dairy products. We still think we could see a short rally in Class III over the near term as a typical spike in seasonal demand combines with seasonal declines in milk output. Producers should be ready to sell rallies in Q4.

Dairy disaster

New Zealand dairy payouts by the leading three companies which account for 93 per cent of production, excluding dividends and retention payments.



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