

The KDM Dairy Report – August 21st, 2015

What's Bullish:

- Spot Market: Barrels lost ¼¢ for the week on 16 trades to settle at \$1.69½/lb, but blocks gained 4½¢ to close at \$1.74/lb on just 3 trades. Grade A NDM jumped 9½¢ to settle at \$0.78½/lb on 21 trades, while butter rocketed 21½¢ higher to close at \$2.37/lb on just 5 trades.
- Livestock Slaughter Report: 238,600 dairy cows exited the milking herd in July, up 3% vs. last July. YTD, 70,000 more head have gone to slaughter, and increase of 4.5%.
- Fluid Milk Southeast: Milk production is trending lower. Very few loads are moving into manufacturing, as fluid sales increase with the reopening of area schools. Milk import shipments increased to 110 spot loads this week, up from 60 last week. High temperatures and humidity are expected to continue its effect on cow comfort. Florida weather conditions are impacting milk production levels as volumes trend lower. Prolonged heat and humidity continues to take a toll on cow comfort. Contacts note cream availability as tight-to-balanced through the course of the week. Cream sales are good to soft serve mix production.

| Futures Month | Class III 08/21 | Class III 08/14 | Change | Dry Whey 08/21 | Dry Whey 08/14 | Change | Cheese 08/21 | Cheese 08/14 | Change |
|------------------|-----------------|-----------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Aug-15 | \$16.41 | \$16.43 | (\$0.02) | 32.750¢ | 33.400¢ | (0.65¢) | \$1.742 | \$1.739 | \$0.003 |
| Sep-15 | \$16.78 | \$16.46 | \$0.32 | 31.000¢ | 31.825¢ | (0.82¢) | \$1.778 | \$1.747 | \$0.031 |
| Oct-15 | \$16.81 | \$16.42 | \$0.39 | 30.000¢ | 30.500¢ | (0.50¢) | \$1.789 | \$1.753 | \$0.036 |
| Nov-15 | \$16.61 | \$16.14 | \$0.47 | 27.975¢ | 28.925¢ | (0.95¢) | \$1.790 | \$1.737 | \$0.053 |
| Dec-15 | \$16.28 | \$15.86 | \$0.42 | 27.650¢ | 27.325¢ | 0.32¢ | \$1.764 | \$1.718 | \$0.046 |
| Jan-16 | \$15.77 | \$15.38 | \$0.39 | 25.975¢ | 27.025¢ | (1.05¢) | \$1.727 | \$1.685 | \$0.042 |
| Feb-16 | \$15.48 | \$15.22 | \$0.26 | 25.750¢ | 26.750¢ | (1.00¢) | \$1.710 | \$1.670 | \$0.040 |
| Mar-16 | \$15.44 | \$15.25 | \$0.19 | 27.000¢ | 27.500¢ | (0.50¢) | \$1.700 | \$1.670 | \$0.030 |
| Apr-16 | \$15.54 | \$15.30 | \$0.24 | 27.550¢ | 29.000¢ | (1.45¢) | \$1.700 | \$1.664 | \$0.036 |
| May-16 | \$15.94 | \$15.67 | \$0.27 | 29.000¢ | 30.775¢ | (1.78¢) | \$1.723 | \$1.690 | \$0.033 |
| Jun-16 | \$16.30 | \$16.03 | \$0.27 | 30.500¢ | 32.250¢ | (1.75¢) | \$1.745 | \$1.720 | \$0.025 |
| Jul-16 | \$16.47 | \$16.29 | \$0.18 | 32.050¢ | 33.550¢ | (1.50¢) | \$1.752 | \$1.740 | \$0.012 |
| 12 Mo Avg | \$16.15 | \$15.87 | \$0.28 | 28.933¢ | 29.902¢ | (0.97¢) | \$1.743 | \$1.711 | \$0.032 |

- Fluid Milk Central: Dairy processors report milk volumes are trending lower both on a tanker load and overall throughput basis. There are some spot loads available, and sales are capturing Class to \$1.25 over. Bottlers are ramping up their orders ahead of more schools reopening. Milk continues to stair step to the Southeast to meet growing Class I demand in that region. Manufacturers note the increasing sales of raw milk are also removing some cream from the region, and tightening cream supplies.
- Fluid Milk Southwest: California milk production is steady to lower. High temperatures above 100 degrees continue decreasing the comfort of the dairy herd. Processing capacity in the state is adequate to handle most of the milk production. Fewer milk loads are moving outside the state. The demand for bottled milk is higher as public schools reopen during the next week. Therefore, milk volumes into processing are decreasing. Arizona milk volumes are decreasing. The present excessive heat, topping 115 degrees, is taking a toll on milk yield. Milk loads moving into processing plants are lower in state and out of the state. Bottled milk sales are improving as schools recently reopened. Class II sales are steady. New Mexico milk output is unchanged to lower. The butterfat component of the milk is slightly declining. Western cream demand from ice cream manufacturers is trending lower, but demand from butter churns operators is strong with expectations to increase during Q4. Cream inventories vary throughout the West, but are mostly tight.
- Butter: Cream availability is tight in all regions. Central and West processors are actively churning as producers are trying to rebuild inventories in advance of the typical seasonal increase in orders during Q4. The butter production activity is light to moderate in the Northeast. The demand for bulk and printed butter is active across the country.
- NDM East: Prices are steady to higher in the mostly series. Eastern production has slowed. Plants are seeing reduced milk intakes due to declines in seasonal milk outputs, and heavy milk volumes moving into Class I school-focused production. Due to existing market dynamics, some nonfat dry milk producers are resisting lower bids, with expectations that prices will improve seasonally.
- NDM Central: Prices are unchanged to higher this week. Low/medium heat nonfat dry milk production in the Central region is ongoing. Cheese production, though, continues to take gulps out of the milk volumes available to clear through dryers. The Class III use and some decreases in overall regional milk production have eased NDM inventory build-up at several locations.
- Cheese Northeast: Cheese production in the region remains relatively active, with adequate milk supplies on hand. Nonfat dry milk continues to be used by some cheese makers to offset declining milk volumes and boost yields. With schools set to reopen, orders for mozzarella are increasing. Aged cheddar sales are good and production is mostly steady. Foodservice orders are holding up fairly well. Cheese retail advertising volumes are up as promotions move into the pipeline for the period surrounding Labor Day.
- Cheese Midwest: Milk volumes clearing into manufacturing are declining in the Midwest as most of public schools are reopening during the next week. Thus, some cheese manufacturers are buying additional milk loads from other regions to meet production schedules. However, most producers are receiving adequate regional milk intakes for processing cheese. Overall, Midwest cheese output is steady. Buyer interest for mozzarella and cheddar is high. The demand for cheese from food service and grocery stores remains strong. Inventories are not building.
- Cheese West: Production has been active as cheese makers continue to use the readily available milk. Manufacturers have relied on strong domestic cheese demand to offset limited export opportunities. This demand has allowed processors to keep inventories in check.
- CWT has accepted 5 requests for export assistance from member cooperatives who have contracts to sell 242,509 pounds of Cheddar, Gouda and Monterey Jack cheese, and 551,156 pounds of butter to customers in Asia, and the Middle East. The product has been contracted for delivery in the period from August through December 2015.
- A Bloomberg article this week reports demand for dairy fats in the U.S. is surging as Americans' attitudes toward dairy products shift. The new demand is tightening the supply of cream, as well as butter. Dairy fats are no longer considered health villains and people are re-embracing foods like whole milk and butter rather than skim milk and margarine.
- International: Russia lifted a ban on 29 companies in New Zealand, and will allow them to supply some dairy product ingredients again, according to a Reuter's article this week. Russia is experiencing a dairy shortage due to its ongoing ban on milk products from the European Union.

- International: Milk production in Oceania is up over last year, but due to falling prices, farmers are looking for other companies that might have higher payments. Farmers are also looking for ways to cut operating costs. Most will not be able to buy any additional feed, so they are hoping for favorable spring weather for ample pasture. Cheddar cheese prices moved higher due to an increase from the GDT auction. Some processors are reporting strong demand for hard cheeses into the U.S. Most manufacturers are utilizing milk intakes for cheese production due to higher returns. Some producers are reporting demand in China is starting to increase.
- International: The GDT Dairy Price Index in this week's auction vaulted 14.8% higher on strong gains from AMF (up 26.6%) and WMP (up 19.1%). Butter gained 10.8% while cheddar cheese saw a 4.4% increase.

What's Bearish:

- Milk Production Report: July milk output in the U.S. was up 1.2% vs. a year ago, according to USDA. This increase was higher than most analyst expectations of less than a 1% increase. In addition, after a decline in cow numbers from May to June, July saw an increase of 1,000 head from the prior month. Gains were led by SD up 12.3%, MI up 6.3%, and WI up 5.3%. CA saw a 3.3% decline.
- Cold Storage Report: Butter stocks in U.S. warehouses at the end of July saw an increase of 41% vs. a year ago. American cheese stocks were 6% higher than last where while total cheese inventories jumped 10%.
- Fluid Milk Northeast: Milk production is slightly lower in the Northeast, and steady to lower in the Mid-Atlantic. Although milk loads are decreasing, manufacturing milk supplies are fairly strong.
- Fluid Milk Pacific Northwest: According to some contacts in the region, milk production has exceeded expectations this summer. Although the region has experienced several heat waves, milk intakes have rebounded with each period of cooler temperatures. The net effect has been a slow seasonal decline in milk production. Bottling demand is now increasing with the start of school terms. There has not been much decrease in Utah/Idaho milk production. Manufacturers report there is still plenty of milk for processing.
- A report released this week by the U.S. Dairy Export Council concluded that global milk production growth in Q2 exceeded dairy exports. As a result, inventories from the world's five major suppliers grew.
- International: Strong U.S. prices have made it more difficult for U.S. cheese makers to find export opportunities. Some industry contacts are seeing an increase in price competition from European imports. Most international manufacturers are surprised by the U.S. prices and are clearing additional milk volumes into cheese for export to the U.S., especially hard cheeses.
- International: With the elimination of the quota system, there have been antidotal suggestions that farm level production is up. Commodity price drops are leading to farmgate level prices paid out declining. The droughts in Western Europe have affected production some, but it is still above year ago levels. Most manufacturers are choosing to make cheese with available milk, due to better returns. In Eastern Europe, production is growing as the temperatures have dropped. Most commodities are readily available, but cream supplies have tightened. As the cooler weather sets in, the demand for fluid milk is increasing.

Recommendation:

The rally in Class III we predicted finally started to take shape this week as short term tightness in the spot market gave bidders the upper hand. Nearly all Class III contracts finished the week solidly in the green. Tuesday's result in the GDT auction certainly helped as suddenly buyers found value at current powder prices and bid them higher. Cream remains tight in the country, and by far, the star in the spot market was the 21½¢ rise in butter, to a price not seen since last October. As nice as it was to see strength in the market this week, there are abundant reasons to contain one's enthusiasm. By now, most of you will be aware of the significant correction going on the stock market, with a massive 531 point plunge in the Dow today. Fears over a global economic slowdown, fueled by a weak Chinese economy, turned in to panic selling. And it may just be the start. The stock indices have not seen a "healthy" correction of this magnitude since 2008, and it was past due. However, while corrections are normal and good for the market, it's the emotional impact that can start a snowball effect. Consumers tend to "tighten their belts" to ride out the storm. The impact for dairy means less eating out, fewer pizza deliveries, etc. While lower dairy prices are sending the signal to reign in supply, should demand also weaken, it would prolong the time before recovery. Not only was the stock market affected today. Everything from grains to energy were hit by the "sell anything and everything" mentality today. Milk was not immune, seeing double-digit losses Sep-Dec in Class III. With so many unknowns and possible outcomes, it's nearly impossible to predict the mid to long term. Hedgers should take less risk at this time. We would look to buy PUT options Oct/Nov to take advantage of the recent rally. If current futures prices are profitable, consider selling some milk through the end of the year. Hopefully over the weeks ahead the picture will become more clear, but for now, expect the level of volatility to increase.

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