

The KDM Dairy Report – September 4th, 2015

What's Bullish:

- Spot Market: While block cheese lost ½¢ for the week, settling at \$1.69½/lb on 9 trades, barrel cheese increased 7¢ to close at \$1.67/lb with just 3 trades. Butter jumped 11¼¢ to close at \$2.45¼/lb, but it was outshone by Grade A NDM which logged a 13¢ gain to settle at \$0.90/lb. Both butter and NDM traded 13 loads.
- Weekly cold storage numbers indicate demand for cheese and butter was strong in August. Stocks of butter at USDA-selected storage centers declined 10% (1.9 million lbs) while cheese stocks fell 1% (1.2 million lbs) during the month.
- McDonalds announced this week that they will no longer be using margarine, and replacing it with real butter. The change is likely to increase butter demand.
- Kraft has expanded its recall for Kraft Singles by 10-fold. 355,000 cases are now being returned, up from 36,000 cases on July 31. A thin strip of packaging film has been known to remain stuck to the cheese even after the wrapper has been removed, causing a choking hazard. That stock will need to be replaced with fresh product.
- Fluid Milk Northeast: Much of the Northeast and Mid-Atlantic is closing out August with a heatwave. Heat and humidity are moving throughout the regions as temperatures reach into the 90s. Milk production is waning along seasonal trends. Fall school year openings continue to strengthen fluid demand and tighten manufacturing milk supplies.
- Fluid Milk Southeast: Milk production in the region is lower as heat stress impacts cow comfort. Bottling sales are strong. Milk shipments from the Southwest and Mid-East are aiding the region's fluid milk needs. Heavy rainfall from tropical storm Erika caused flooding in areas of the Florida. Cloud cover has helped cow comfort, but soggy fields advance the current decline in milk production. Cream supplies remain tight. Condensed skim supplies are limited due to the strong pulls from Class I plants.
- Fluid Milk Central: Milk production continues to trend lower in the North Central area, but is stabilizing in the South Central area. Sales into bottling facilities are steady. There is an uptick in bottled milk interest from grocery outlets as they carry specials on milk and cereal breakfast combos. The number of spot milk loads shipping to the Southeast area is climbing steadily, although finding drivers and equipment is becoming more challenging. The volumes of spot milk available declined this week, and some processing plant operators indicated they were surprised at the light interest in placing milk loads for the upcoming holiday weekend.
- Fluid Milk West: Milk production in California is steady to lower. High heat and humidity are taking a toll on the milk yield. The lack of water is limiting the production of hay and corn. In addition, some milk producers continue having lower returns due to the high cost of water. Milk volumes into processing are lower but sufficient to meet the local demand. Orders from bottlers are higher to serve current needs of school and grocery stores. Class II sales are active as the holiday weekend is near. Milk output is lower in Arizona. Wet conditions caused by heavy rains are triggering health problems such an increase of SCC in dairy cows. Manufacturing milk volumes are lower. However, local processing plants are running along planned schedules. The demand for bottled milk from schools and retailers is higher.
- Butter Northeast: Some manufacturers are reducing production schedules as cream supplies remain tight. Some plants are microfixing butter supplies in order to meet current contract needs. Retail/print sales are strong, as some butter makers are turning away orders.
- Butter Central: Farm milk intakes and butterfat components are trending lower, but some churners are curtailing cream spot sales to help fill churning schedules. Regional butter inventories are mixed. Nationally, butter holdings are higher than year ago volumes. However, butter market participants cite concern over how much butter is actually uncommitted and available to meet Q3/Q4 upcoming needs, especially since a major restaurant chain announced its transition to butter use in many menu items.
- Butter West: While butter prices are moving higher at the CME Group, industry contacts suggest buyers are becoming more active as the Q4 holidays draw nearer. Retail demand for butter has been strong this summer and is expected to increase throughout the fall. Some western butter manufacturers are focusing on print butter to meet this demand. Production continues to be dictated by cream availability. Demand for cream has softened slightly with the decrease in ice cream production, but the demand is such that some processors still find it more economical to sell the cream than to churn. Other butter makers are actively seeking out available cream.
- Dry Whey Central: Current prices are sparking some interest in longer-term buying. A few end users report they finalized monthly, market-based contracts. Some export sales to Southeast Asia have concluded recently, and manufacturers are preparing those loads for shipment. Spot milk availability is light.
- Dry Whey West: Prices for western whey moved slightly lower this week. While the market tone for dry whey has remained weak, some industry contacts report an increase in interest from domestic and international buyers.
- NDM East: Prices are higher in the mostly series, as pricing indices move upward. Processers are seeing marginal declines in production due to diminishing condensed skim supplies. Interest is growing with noticeable increases in buyer inquires.
- NDM Central: Prices are mostly higher on a firmer market. Manufacturers indicate some buyers/end users stepped forward to purchase sufficient NDM low/medium heat loads to cover monthly needs. This is a change in buying patterns compared to just a few weeks ago when buyers followed hand to mouth patterns. Also, there are ongoing buyer/producer discussions centered on meeting NDM needs through the end of October or the end of the year. Producers feel this shows these buyers judge the downside risk is low enough to warrant purchasing at current prices.

Futures Month	Class III 09/04	Class III 08/28	Change	Dry Whey 09/04	Dry Whey 08/28	Change	Cheese 09/04	Cheese 08/28	Change
Sep-15	\$16.14	\$16.17	(\$0.03)	26.600¢	28.750¢	(2.15¢)	\$1.733	\$1.732	\$0.001
Oct-15	\$16.37	\$16.40	(\$0.03)	27.500¢	29.175¢	(1.68¢)	\$1.755	\$1.750	\$0.005
Nov-15	\$16.18	\$16.17	\$0.01	27.000¢	28.500¢	(1.50¢)	\$1.741	\$1.743	(\$0.002)
Dec-15	\$15.92	\$15.92	\$0.00	26.750¢	27.700¢	(0.95¢)	\$1.738	\$1.730	\$0.008
Jan-16	\$15.68	\$15.54	\$0.14	27.000¢	26.525¢	0.48¢	\$1.717	\$1.704	\$0.013
Feb-16	\$15.65	\$15.45	\$0.20	28.000¢	25.750¢	2.25¢	\$1.713	\$1.693	\$0.020
Mar-16	\$15.74	\$15.45	\$0.29	28.000¢	27.000¢	1.00¢	\$1.714	\$1.688	\$0.026
Apr-16	\$15.69	\$15.57	\$0.12	28.975¢	27.500¢	1.48¢	\$1.705	\$1.693	\$0.012
May-16	\$15.90	\$15.90	\$0.00	30.250¢	28.750¢	1.50¢	\$1.725	\$1.729	(\$0.004)
Jun-16	\$16.15	\$16.29	(\$0.14)	32.150¢	30.500¢	1.65¢	\$1.735	\$1.749	(\$0.014)
Jul-16	\$16.34	\$16.25	\$0.09	33.000¢	32.050¢	0.95¢	\$1.745	\$1.750	(\$0.005)
Aug-16	\$16.44	\$16.36	\$0.08	33.925¢	32.250¢	1.68¢	\$1.755	\$1.760	(\$0.005)
12 Mo Avg	\$16.02	\$15.96	\$0.06	29.096¢	28.704¢	0.39¢	\$1.731	\$1.727	\$0.005

- NDM West: Milk volumes into NDM are declining. Thus, production is lower and prices are higher. Inventories of NDM are steady to lower. Some processors are noting improved spot sales throughout the week.
- Cheese Northeast: Manufacturing schedules are steady to slowing for cheese makers. A few plants are postponing production while completing maintenance activities. Fluid milk needs in the southeast region are pulling heavily on available milk supplies. Cheddar packaging has picked up and will continue through Q4. Restaurant and food service demand remains active. Cream cheese production is strong around holiday orders.
- International: A news article this week reported China has surpassed the U.S. as the largest ice cream market. The total market value for ice cream sales in China has nearly doubled in just the years 2008-2014. Rising incomes and a developed retail market are driving growth.
- International: This week's GDT auction saw the price index rise 10.9%. It was the second consecutive jump, following a 14.8% increase on Aug 18th. Powders were again sharply higher, while cheddar cheese improved 4.7%.
- International: New Zealand dairy farmers are bracing for their lowest payout in a decade, according to a news article this week. A study by AgriHQ analyzed milk prices around the world and determined Kiwi dairy operations are now the lowest paid in the world.
- International: The size of the New Zealand dairy herd is expected to shrink for the first time in a decade, according to a news article this week. Low milk prices are causing some farms to convert back to beef operations. In addition, most dairy farms are in the process of cutting back their total cow numbers by 3-6% in response to the low payouts, and to help manage costs. New Zealand beef exports to China are booming, up 44% in the first half of 2015.
- International: EU dairy farmers are having a tough time in their new post-quota market. Hurt by a Russian ban on dairy products and drop-off in Chinese imports, EU milk prices are down 20% from a year ago, leaving some farms operating below their cost of production.
- International: The historically low farm level prices have many farmers in New Zealand culling low producing cows. Farmers do not feel that they can sustain at current pricing levels. Production is up slightly up year to date, but this is largely due to early calving. Production is expected to trend back in line with last year over the course of September. Weather has been generally cold and wet, which is not conducive to good grass growth.

What's Bearish:

- Dairy Products Report: American cheese output in July was up 3.4% vs. a year ago and 2.4% higher than June, according to USDA. Total cheese output increased 3.1% and 2.5%, respectively. However, butter output fell 3.2% vs. last July and was down 6.2% from June.
- U.S. Dairy Export Council data indicate U.S. exports in July fell for the third straight month. Total volume was down 13% vs. a year ago, with steep declines in WMP (-67%) and butterfat (-65%). Cheese exports were down 21%. In light of the poor export numbers, USDEC does not predict a global dairy market rebound until mid-2016 at the earliest. It's estimated that China could still be sitting on 300-400 thousand tons of powder in inventory.
- Fluid Milk Pacific Northwest: Cooler temperatures and a little moisture have aided cow comfort in the Pacific Northwest. Although milk production is in a slow seasonal decline, manufacturers report good milk intakes. Milk intakes are adequate for processing with only a minimal impact from increased bottling demand. Farmers are busy working on fourth crop hay. The corn crop looks good and there should be good supplies of corn silage. The supplies of cream are mixed throughout the West. Higher milk volumes into bottling are increasing the availability of cream for processing.
- Dry Whey Northeast: Prices moved lower with spot sales and pricing indices. Production is steady as vat schedules for some cheese plants continue to fulfill heavy cheese orders with the restart of schools. Most buyers are in a wait-and-see mode while making purchases as needed. The market undertone remains weak.
- Cheese Midwest: The current heat wave and bottling demand are pushing milk intakes slightly lower, but manufacturers report available milk is adequate for processing needs. Spot loads of milk are obtainable at Class to \$1-2 above Class. Cheese production is active with many of the plants operating near full capacity. Some manufacturers report shifting their production to varieties such as Colby and Monterey jack. Others are putting some extra mozzarella into storage to carry through the fall pizza season. Industry contacts report ample cheese stocks. Although sales have slowed slightly, strong domestic demand has helped cheese makers keep their inventories manageable. Demand for cheese destined for retail is strong.
- Cheese West: While increases in bottling demand and the seasonal decline in milk production have reduced milk intakes, western manufacturers report cheese production has remained active with milk readily available for processing. Export opportunities for cheese are down. However, current domestic cheese demand is good, and is allowing cheese makers to keep inventories from getting out of control. Industry contacts are speculating whether consumer demand can hold through fall school terms and the Q4 holidays.
- International: Aussie milk production is slowing, but still up from year ago levels. Dairy Australia is reporting July milk production was up 5.4% from a year ago. Most of Australia has had favorable weather, with some regions seeing drought like conditions. This, however, does not seem to be affecting production.
- International: Oceania cheese exports are stable to increasing, especially into the U.S. Milk supplies are being diverted away from whole milk powder in order to make cheese. Current cheddar prices work out to a U.S.-equivalent \$1.36/lb.

Recommendation:

Class III 2015 contracts finished the week within pennies of where they started in lackluster trading. Elevated milk and cheese production combined with steady demand is keeping the market in a tight holding pattern. More news of disastrous prices for international dairy operations may have given a bid in the 2016 contracts, however, as most finished solidly in the green. While fundamentals point to a bottom being carved out, there is still a reluctance for prices to move higher, yet. The rally in spot NDM and butter pushed Class IV prices over Class III for the first time in months. Perhaps that will be the "fuel" that eventually gets the market moving. Time will tell. On the bearish side, news that cheese is coming to the U.S. from Oceania will likely temper cheese prices this fall. Producers should look to use rallies to get more coverage in the remainder of 2015. For 2016, consider some initial coverage with the Jan-Mar 3-way option trade, buying the 15.25 PUT, selling the 17.00 CALL and selling the 13.75 PUT for a net cost of 20¢/month. Basic coverage but it would protect a disaster if indeed, prices don't recover until the second half of 2016. Have a wonderful weekend. **Note:** Our offices will be closed on Monday, September 7th in observance of Labor Day.

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