

The KDM Dairy Report – September 11th, 2015

What's Bullish:

- Spot Market: While cheese and NDM finished the week lower, butter shot up 11¼¢ to settle at a new high for the year at \$2.56½/lb. Just six loads exchanged hands.
- Butter stocks at USDA-selected warehouses fell a full 6% in just the first seven days of September, according to weekly cold storage numbers.
- CWT has accepted 6 requests for export assistance from member cooperatives who have contracts to sell 47,069 pounds of Cheddar cheese, and 393,423 pounds of whole milk powder to customers in Asia, the Middle East and South America. The product has been contracted for delivery in the period from September through November 2015.
- Fluid Milk Northeast: Hot and dry conditions persist throughout much of New England. In some locations, field corn matured at a faster rate than normal due to dry conditions. Milk production is steady to lower. Sales to Class I are seasonally active. Mid-Atlantic farm milk output continues to drop. Hot and muggy conditions are hampering cow comfort. Due to maintenance downtime, some plants reduced their milk receipts.
- Fluid Milk Southeast: Milk production is seeing a slight bounce back, but very little milk is clearing to manufacturing. Milk production in Florida continues to decline. Class I demand is fair to good. Daytime high temperatures are in the mid-90s. Import milk shipments totaled 160 spot loads this week, 20 less truckloads than the previous week. Condensed skim supplies are adequate for customer needs, but spot loads continue to decline.
- Fluid Milk Central: Milk processors in the North Central region indicate farm milk intakes registered a decline this week following a bout of hot and humid weather. Although cooler temperatures arrived in the area early this week, the toll on cow comfort during last week's higher temperatures is now evident. Intra and extra-regional orders for loads of milk from bottlers are active. Interest in spot milk loads is active, however, availability is light. Some marketers report they have orders for many more loads of milk than are readily available. Spot milk prices range from \$.50 under to \$2.00 over Class. Cream availability is limited as a result of milk loads clearing to bottling facilities outside the region and seasonally lower butterfat components in milk intakes. Also, some bottlers report keeping more cream to fulfill orders for bottled whole milk.
- Fluid Milk West: Milk volumes in California are lower. A heat spell with triple digit temperatures is increasing the stress of cows. Manufacturing milk supplies are adequate for post-holiday orders, but fewer milk shipments for processing are moving out of the state. Arizona milk production is mixed. In some areas, lower temperatures are improving the comfort of the dairy herd. In other zones, wet conditions from current rainfalls are adversely affecting the production of the dairy herd.
- Butter Northeast: As cream continues to elude butter churns, some market participants are concerned as to the level of impact on Q4. Some buyers/sellers report salted butter is tight; however supplies can be sourced at a premium price.
- Butter Central: Production of butter in the region is slowing as butterfat components decline alongside farm milk intake volumes. Some churn operators are looking for cream spot loads, but they report cream is clearing into Class II and III ahead of butter. Foodservice and retail butter interests are active, with some retailers looking for volumes to cover their needs through October and November.
- Butter West: Demand has been firm. Recent press announcements and study releases have further bolstered demand for butter and milk fats. Some market participants point to the increase in positive press and greater interest in using butter by food manufacturers as a reason market prices at the CME Group have risen over the last few weeks. In addition, the seasonal baking time is starting and will continue through the end of the year. Some concern over rising butter prices have prompted buyers to make purchases early to lock in their costs. Industry contacts state butter manufacturers are willing to hold onto butter in advance of anticipated stronger demand in Q4.
- Dry Whey Northeast: Surplus milk was made available to a few cheese plants over the Labor Day holiday weekend, which facilitated increased whey production. However, moderate demand is clearing inventory and leaving most manufacturers comfortable with holdings. Ice cream and baking interest is active.
- Dry Whey Central: Spot sale activity was active, with buyers nabbing advantageous pricing on multi-load orders. These purchases also show an emerging willingness of more buyers/end users to take on the risk of building stocks in an unsettled market. Buyers are also diligently sorting through numerous producers' and second tier offers to lock in prices.
- NDM East: Prices are higher as the market strengthens. Sources note that aggressive buying on the CME is likely influencing what market participants are willing to pay. Some market participants expect sustained price strength. Most inventories are adequate, but producers note that low/medium heat NDM sale volumes are picking up with fair to good domestic demand. As well, some global interest is noted. Sources suggest that f.o.b. spot offerings seem to be slowing as the market goes up.
- NDM Central: Prices shifted higher across the range and mostly price series, following the trend of various indices. Sales are limited from some manufacturers by light uncommitted holdings. A few producers indicate they are sold out until the beginning of October. Low/medium heat NDM production is noticeably lower, as farm milk intakes decline.
- NDM West: Prices are higher in a firming market. Sales are active in the f.o.b. spot market. Current sales activity at the CME Group is encouraging the interest of buyers, who are expecting higher prices in the future.

Futures Month	Class III 09/11	Class III 09/04	Change	Dry Whey 09/11	Dry Whey 09/04	Change	Cheese 09/11	Cheese 09/04	Change
Sep-15	\$15.97	\$16.14	(\$0.17)	25.500¢	26.600¢	(1.10¢)	\$1.722	\$1.733	(\$0.011)
Oct-15	\$16.01	\$16.37	(\$0.36)	25.100¢	27.500¢	(2.40¢)	\$1.724	\$1.755	(\$0.031)
Nov-15	\$15.96	\$16.18	(\$0.22)	24.650¢	27.000¢	(2.35¢)	\$1.731	\$1.741	(\$0.010)
Dec-15	\$15.82	\$15.92	(\$0.10)	24.950¢	26.750¢	(1.80¢)	\$1.726	\$1.738	(\$0.012)
Jan-16	\$15.62	\$15.68	(\$0.06)	25.750¢	27.000¢	(1.25¢)	\$1.706	\$1.717	(\$0.011)
Feb-16	\$15.58	\$15.65	(\$0.07)	27.500¢	28.000¢	(0.50¢)	\$1.699	\$1.713	(\$0.014)
Mar-16	\$15.68	\$15.74	(\$0.06)	28.250¢	28.000¢	0.25¢	\$1.703	\$1.714	(\$0.011)
Apr-16	\$15.67	\$15.69	(\$0.02)	27.800¢	28.975¢	(1.18¢)	\$1.700	\$1.705	(\$0.005)
May-16	\$15.86	\$15.90	(\$0.04)	29.275¢	30.250¢	(0.98¢)	\$1.712	\$1.725	(\$0.013)
Jun-16	\$16.06	\$16.15	(\$0.09)	30.800¢	32.150¢	(1.35¢)	\$1.723	\$1.735	(\$0.012)
Jul-16	\$16.35	\$16.34	\$0.01	31.000¢	33.000¢	(2.00¢)	\$1.755	\$1.745	\$0.010
Aug-16	\$16.44	\$16.44	\$0.00	30.750¢	33.925¢	(3.18¢)	\$1.760	\$1.755	\$0.005
12 Mo Avg	\$15.92	\$16.02	(\$0.10)	27.610¢	29.096¢	(1.49¢)	\$1.722	\$1.731	(\$0.010)

- Cheese Northeast: Cheese production is limited as seasonal milk moves to fluid accounts. However, volumes are adequate for fulfilling near-term orders. Cheese vats are active, especially for mozzarella, as pizza sales are increasing with schools and universities back in session.
- International: Fonterra is expecting steeper-than-expected drops in milk production this year as New Zealand dairy farmers slaughter cows at a higher rate. They had forecast milk production to drop 2-3% vs. a year ago but said that number could slip further as more farmers cull cows to generate cash. High beef prices have provided additional incentive.
- Grains: USDA reported global corn stocks fell to 189.69 mmt, down from 195.09 mmt last month and below analyst expectations of 193.44 mmt. Corn finished trading on Friday near the highs and up double-digits. Beans were initially down double-digits but finished positive, as corn led the way.

What's Bearish:

- Spot Market: Butter was the star, but barrel cheese lost 8¢ to settle at \$1.59/lb on 8 trades and Grade A NDM gave up 3¢ to close at \$0.87 on 15 trades. Block cheese was unchanged at \$1.69½ with no activity all week.
- WASDE Report: USDA lowered their 2016 Class III milk price forecast by 45¢/cwt from last month's report, now expecting an average of \$15.50/cwt. A weaker whey market was noted as the primary driver of the price reduction.
- Dairy cow slaughter for the week ending 08/29 totaled 53,900 head, down 1,900 (-3.4%) vs. the same period a year ago.
- Fluid Milk Southwest: New Mexico milk output is slightly higher. Cooler temperatures ranging from 85 to 90 are aiding cow comfort. In addition, fair/good quality feed is helping milk yield.
- Fluid Milk Pacific Northwest: Milk production continues to follow seasonal declines. Bottling demand has been pulling some extra milk from manufacturing, but the impact to date has been minimal. Some bottlers have observed an increased demand for whole milk. Supplies of milk for processing are adequate. Utah and Idaho milk production is steady. Warm daytime temperatures followed by cool nights have aided cow comfort. Processors report adequate milk intakes and only a minimal draw of milk into bottling.
- Dry Whey West: Prices were mostly lower for the week. Production has remained steady and comparable to cheese production. Some manufacturers continue to choose to dry whey as opposed to whey protein concentrates. Inventories of dry whey are heavy.
- Cheese Midwest: Adequate milk supplies continue to flow into cheese vats. Cheese production is steady. Some processors report a little lull in sales. Industry contacts note there is plenty of cheese available. Although inventory levels are a little higher, they have not concerned many cheese makers because of the anticipated increase in cheese demand from football season, school meal programs and the upcoming Q4 holidays.
- Cheese West: Industry contacts state cheese is readily available for buyers. Regular customer demand is steady, but spot sale activity has been limited. Cheese production has remained relatively strong through the end of summer. The dip in cheese production that normally occurs in late August through September has yet to materialize fully. Milk intakes have held higher than normal. Currently, cheese supply is a little stronger than demand, causing inventories of some varieties to build. Although manufacturers are not yet concerned, they are hopeful that the fall demand will increase and start to draw down inventories.

Recommendation:

With the October Class III contract beginning pricing next week and a potential slight slow-down in domestic cheese demand, more premium was taken out of the front months. Dry whey prices continue to decline in weekly survey prices, pushing the Class III formula lower. Current spot prices work out to about \$15.30/cwt, so Oct futures are about 70¢ premium still. Unless cheese prices find some support, further erosion of the front months is likely. Or is it? Butter is on a rocket right now. Cream is tight. As reported last week, McDonalds is converting to all butter, while favorable press is changing consumer buying habits. More restaurants are using butter and full cream, while consumers are even beginning to drink more fluid whole milk! More analysis on the McDonalds' change has estimated the increase in butter demand would more than replace the decline in butter exports this year. Butter prices may be elevated for some time to come. As a result of the strength in this week's spot market, butter has helped push Class IV to about \$16.40; more than a dollar premium to Class III. Evidence continues to grow that both NDM and Dry Whey prices have bottomed out. Buyers are more motivated to lock in long-term contracts at these prices while Dairy Market News reports some operations are sold out until October. As Q4 holiday demand begins to increase further, it should support the entire dairy complex. Granted, there is available cheese right now, and this will limit any increases in the short term. But the recent heat-wave that went through the Midwest and Eastern regions of the country did some significant damage to milk production, in regions that were overflowing with milk just a few weeks ago. Add to that the potential for a grain rally and we still maintain the upside risk to milk prices is greater than the downside risk. Producers with existing hedges should continue to look to protect that upside risk with CALL options. Any unsold milk in Q4 could be sold on a rally of 30-50 cents.

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