

The KDM Dairy Report – September 18th, 2015

What's Bullish:

- Spot Market: Butter continued to scream higher, jumping 15¼¢ to settle at \$2.71¼/lb. NDM was up 4¢ to \$0.91/lb. 13 loads of butter and 5 loads of NDM exchanged hands during the week.
- Milk Production Report: August milk output in the U.S. was up just 0.8% vs. a year ago, according to USDA. Most analysts expected output to be slightly higher than 1%. The milking herd is estimated at 9.321 million head, unchanged from the prior two months. Milk per cow was up only 6 lbs/cow.
- Dairy cow slaughter for the week ended 09/05 totaled 57,400 head, up a solid 6,100 (11.9%) head from the year prior.
- Through the first 14 days of September, butter stocks declined 9% (1.5 million lbs) and cheese stocks fell a more modest 1% (616k lbs) at USDA selected storage centers.
- Fluid Milk Northeast: Milk production is steady to slightly lower in the region. School milk needs are settling into pattern as bottlers cancel some loads. Some contacts report unexpectedly, small declines in milk components levels. Manufacturing milk supplies at Mid-Atlantic balancing plants are being strained as milk needs from various Classes pull loads. As a result, some plants are finding it very demanding to satisfy customer commitments.
- Fluid Milk Southeast: Milk production is decreasing in certain areas of the region, while slightly higher in others. Bottled milk needs remain strong. Orders are heavy and pressuring handlers in some instances, as milk loads are sourced. Florida's milk production continues to decline, and the state continues to import milk.
- Fluid Milk Central: Milk production is steady to lower in the region. Higher temperatures and humidity are reducing the comfort of the dairy herd. The volume of spot milk loads is slightly lower. Sales for spot milk continue active with unchanged prices, ranging from \$.50 under to \$2.00 over Class. Class I demand from schools and retailers is steady to higher.
- Fluid Milk West: California milk production is lower. The recent high temperatures and humidity in the Central Valley are adversely affecting the milk yield of dairy cows. Some dairy operators are being forced to import fair/good quality alfalfa hay from nearby states due to the prolonged water crisis. The availability of spot milk loads is low in the market. Milk output in Arizona is lower. The combination of rain showers and high humidity is taking a toll on the dairy herd comfort. Manufacturing milk volumes are lower, though balancing plants are running on planned schedules. Milk volumes in New Mexico are steady to lower. Wet conditions in some dairies are adversely affecting milk production. Manufacturing milk volumes are lower but sufficient to meet needs of balancing plants.
- Butter: Demand for butter is strong. Sources indicate the upticks in butter pricing have increased demand as some buyers want to settle contracts in anticipation of prices going higher. Production is mixed throughout the country. Some manufacturers in the Central region are not able to find available cream, while others have no difficulties. Processors in the West are running at full production, while plants in the East are finding it hard to source enough cream. Production is expected to increase nationally as the holiday season nears. Inventory levels are mixed as manufacturers in the East are using stocks for current demand, processors in the West are building inventory levels and the Central region has mixed stocks, depending on production rates and cream availability.
- Dry Whey Northeast: Prices for dry whey were lower this week. However, production levels have slowed as cheese output is reduced, due to limitations in available milk supplies. Some producers' inventories are reported as moderate to tight. Spot sales are light and buying interest is improving.
- Dry Whey Central: Production is steady for most processors. Ingredient market demand is fair to good. Overall, interest is light to moderate, but improving. Sources note that dry whey is not as available in some channels.
- NDM: Prices for low/medium heat nonfat dry milk are higher in the mostly price series due to stronger spot prices. Milk supplies are tighter in the region and this led to some declines in plant drying schedules. Domestic demand is improving. Trading on the spot market is light, with most product clearing to committed customers. The market undertone is firm.
- Cheese Northeast: Production runs remain 6-7 days for some cheese operations; however, the milk supply situation has led to cheese vat schedule reductions for plants not vying for spot loads of milk. Low fat and aged cheddar are moving well. Sources note cheddar aging inventories are adequate to improving. Also observed is strength in the sales of mozzarella varieties. Processed cheese interest is fair. Cream cheese production is active and food service orders are increasing along typical seasonal trends.
- International: New Zealand milk output could fall by up to 10% in the coming months, according to a Rabobank analyst. However, the decrease is not expected to take effect until after Christmas.
- International: This week's GDT auction say the dairy price index rise a strong 16.5%. It's the third consecutive auction where prices increased, perhaps suggesting a bottom in global dairy prices is in. Gains were led by WMP up 20.6% and SMP up 17%. AMP saw a 13.7% increase, butter was up 13.3% and cheddar cheese was 10.7% higher than the last auction. The cheddar cheese price works out to a U.S.-equivalent \$1.45/lb.

Futures Month	Class III 09/18	Class III 09/11	Change	Dry Whey 09/18	Dry Whey 09/11	Change	Cheese 09/18	Cheese 09/11	Change
Sep-15	\$15.84	\$15.97	(\$0.13)	25.250¢	25.500¢	(0.25¢)	\$1.712	\$1.722	(\$0.010)
Oct-15	\$15.81	\$16.01	(\$0.20)	24.000¢	25.100¢	(1.10¢)	\$1.715	\$1.724	(\$0.009)
Nov-15	\$15.74	\$15.96	(\$0.22)	24.500¢	24.650¢	(0.15¢)	\$1.716	\$1.731	(\$0.015)
Dec-15	\$15.71	\$15.82	(\$0.11)	25.575¢	24.950¢	0.63¢	\$1.712	\$1.726	(\$0.014)
Jan-16	\$15.58	\$15.62	(\$0.04)	27.025¢	25.750¢	1.28¢	\$1.694	\$1.706	(\$0.012)
Feb-16	\$15.58	\$15.58	\$0.00	27.250¢	27.500¢	(0.25¢)	\$1.691	\$1.699	(\$0.008)
Mar-16	\$15.70	\$15.68	\$0.02	27.550¢	28.250¢	(0.70¢)	\$1.701	\$1.703	(\$0.002)
Apr-16	\$15.74	\$15.67	\$0.07	28.425¢	27.800¢	0.63¢	\$1.697	\$1.700	(\$0.003)
May-16	\$15.92	\$15.86	\$0.06	29.850¢	29.275¢	0.58¢	\$1.721	\$1.712	\$0.009
Jun-16	\$16.13	\$16.06	\$0.07	31.125¢	30.800¢	0.32¢	\$1.737	\$1.723	\$0.014
Jul-16	\$16.36	\$16.35	\$0.01	31.600¢	31.000¢	0.60¢	\$1.750	\$1.755	(\$0.005)
Aug-16	\$16.39	\$16.44	(\$0.05)	30.750¢	30.750¢	0.00¢	\$1.760	\$1.760	\$0.000
12 Mo Avg	\$15.88	\$15.92	(\$0.04)	27.742¢	27.610¢	0.13¢	\$1.717	\$1.722	(\$0.005)

What's Bearish:

- Spot Market: Blocks lost ¼¢ to settle at \$1.69¼/lb while barrels gave up 4¾¢ to close at \$1.54¼/lb. Just 4 loads of blocks exchanged hands, but 27 loads of barrels were traded.

- The U.S. Dairy Export Council published an article this week saying the U.S. is losing dairy export market share to the EU, Australia and Belarus. For the first half of the year, the U.S. accounted for 16% of global exports of major dairy products, down from 17.6% in 2014.
- Fluid Milk Pacific Northwest: Cooler temperatures in the Pacific Northwest are aiding in cow comfort. Processors report slightly lower milk intakes, but milk components are starting to increase following seasonal patterns.
- Cream West: Cream supplies are less tight in the West. The increase of milk bottling is making cream more available for processing. In addition, the demand for cream from ice cream and frozen desserts manufacturers is trending seasonally lower.
- Dry Whey West: Prices moved slightly lower this week. Industry contacts suggest they are working through heavy inventories. Production volumes are still above plans.
- Cheese Midwest: Recent heat and humidity has resulted in some processors report being short a few loads of milk to run at full production. However, cheesemakers have been able to buy the occasional spot load at about \$1 over Class, keeping cheese production relatively steady. Consumer demand is strong and some cheesemakers note a slight uptick in sales since the Labor Day holiday, though industry contacts suggest cheese inventories are long, especially for barrels. They also note some inventory for blocks, but at this point producers are willing to hold these inventories in advance of Q4 demand.
- Cheese West: Output in the region is steady with some production shifting to natural cheese varieties. Manufacturers report milk intakes are a little lower, but components are beginning to increase and help improve cheese yields. Consumer demand is strong and sales are good for natural cheese. Industry contacts suggest inventories for barrels are long.
- International: Milk production in the EU is still above year ago levels. As the quota system expired, many farmers expanded herd sizes. The increase in production has led to historic lows in farmgate pricing. The low farm level prices have many farmers protesting, but have no plans to slow down production. Trying to aid farmers, intervention volumes allowed have increased as well as the closed date has been extended. Farm level milk prices are still expected to go lower. The wet weather recently has not affected production or cow comfort.
- International: Australia has been fairly dry lately after a cool, dry winter. Milk production is up from year ago levels, and even with the low prices, output does not seem to be slowing down.

Recommendation:

It seems everyone is concerned about the Chinese economy, even the Fed. In what was billed as a surprise, they voted 9-1 to keep their long-standing “zero-interest rate policy”, refusing to raise rates just one quarter of one percent. While the jobless rate in the U.S. has reached their target, Fed Chair Yellen cited concern over the Chinese economy and the devaluation of the yuan as primary reasons. The stock market first surged, then sold off as concerns over the global health of the economy weighed on the market (and the fact that the Fed believes our own economy is so frail it couldn’t even handle a ¼% rate increase!). Those concerns weighed on commodities in general as well. Initially the idea of a weaker USD was supportive to commodities, but the larger concern over demand extinguished most rallies. Milk was not immune. We have very tight butter supplies at the moment, but that provides minimal support to Class III prices. On the other hand, we have abundant barrel cheese supplies. 27 loads were purchased this week, but that didn’t help close the current 15¢ spread with blocks. As we’ve learned from the past, that wide a spread usually doesn’t last too long, so the question becomes, which side gives. The current long barrel supply is up against a slightly more snug block supply, with Q4 demand around the corner. Sellers are more willing to hang on to blocks than barrels, which are more abundant. Domestic demand remains strong for now, but if we continue to lose export market share, supply could overwhelm demand. This has been one of the most difficult years in memory as far as trying to predict where future prices may head. Demand surprises, currency valuations, geopolitical events (eg. Russian ban), world economies; basically a lot of variables with little ability to forecast. We might very well stay range bound in Class III for the rest of the year. Class IV on the other hand is on the move. With butter pushing in to new highs, spot prices work out to about \$17.35 Class IV vs. just \$15.05 for Class III. The spread is widening, which should help Class III longer term, but as far as when, who knows. It’s boring to give the same old advice, but here goes. We’d look to continue to purchase upside protection on existing hedges Nov/Dec in the form of call options. We still believe the upside risk from here is greater than the downside risk. Consider disaster insurance for 2016. Your best bet may be USDA’s margin protection program at about the \$6 level for initial coverage. We can enhance those with options by lowering your overall cost at a later date, if the market should rally.

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