

The KDM Dairy Report – September 25th, 2015

What's Bullish:

- Spot Market: Butter exploded for a 41¼¢ gain on the week to settle at \$3.13½/lb on 18 trades, while Grade A NDM was up 3¢ to close at \$0.94/lb on 9 sales. Barrel cheese increased 5¼¢ to settle at \$1.55/lb on heavy sales of 33 loads, but blocks lost 5¼¢ to close at \$1.59/lb on 4 trades.
- Cold Storage Report: Butter stocks at the end of August totaled 209 million lbs, down a massive 45 million lbs from July. For comparison, just 1.5 million lbs were pulled during the month of July.
- Weekly cold storage numbers continue to reflect a sharp drawdown in butter stocks and seasonal drawdown in cheese stocks.

Futures Month	Class III 09/25	Class III 09/18	Change	Dry Whey 09/25	Dry Whey 09/18	Change	Cheese 09/25	Cheese 09/18	Change
Sep-15	\$15.80	\$15.84	(\$0.04)	24.275¢	25.250¢	(0.98¢)	\$1.714	\$1.712	\$0.002
Oct-15	\$15.50	\$15.81	(\$0.31)	24.700¢	24.000¢	0.70¢	\$1.667	\$1.715	(\$0.048)
Nov-15	\$15.77	\$15.74	\$0.03	27.500¢	24.500¢	3.00¢	\$1.690	\$1.716	(\$0.026)
Dec-15	\$15.76	\$15.71	\$0.05	29.950¢	25.575¢	4.38¢	\$1.695	\$1.712	(\$0.017)
Jan-16	\$15.62	\$15.58	\$0.04	30.250¢	27.025¢	3.23¢	\$1.684	\$1.694	(\$0.010)
Feb-16	\$15.67	\$15.58	\$0.09	30.025¢	27.250¢	2.78¢	\$1.687	\$1.691	(\$0.004)
Mar-16	\$15.83	\$15.70	\$0.13	30.250¢	27.550¢	2.70¢	\$1.701	\$1.701	\$0.000
Apr-16	\$15.85	\$15.74	\$0.11	30.750¢	28.425¢	2.33¢	\$1.705	\$1.697	\$0.008
May-16	\$15.97	\$15.92	\$0.05	31.050¢	29.850¢	1.20¢	\$1.710	\$1.721	(\$0.011)
Jun-16	\$16.24	\$16.13	\$0.11	33.000¢	31.125¢	1.88¢	\$1.730	\$1.737	(\$0.007)
Jul-16	\$16.37	\$16.36	\$0.01	32.425¢	31.600¢	0.82¢	\$1.748	\$1.750	(\$0.002)
Aug-16	\$16.43	\$16.39	\$0.04	32.100¢	30.750¢	1.35¢	\$1.760	\$1.760	\$0.000
12 Mo Avg	\$15.90	\$15.88	\$0.03	29.690¢	27.742¢	1.95¢	\$1.708	\$1.717	(\$0.010)

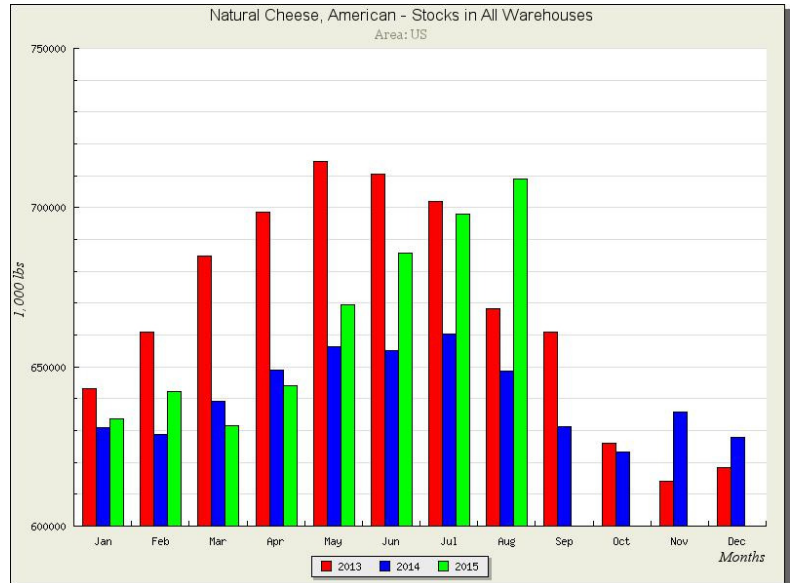
- For the period 09/01 through 09/21, butter holdings at USDA-selected storage centers declined 15% (2.5 million lbs) while cheese holdings fell 2% (1.5 million lbs).
- Fluid Milk Northeast: Manufacturing milk supplies are light, while recovering from previous weeks' lows. Some manufacturing plants, particularly yogurt, are seeing increased seasonal demand for fluid supplies. In the Mid-Atlantic, milk production is declining, as hot-dry conditions takes a toll on cow comfort. Balancing plants continue to report drops in milk receipts but are able to cover existing contract orders.
- Fluid Milk Southeast: Milk production in the region is lower. Manufacturing supplies are being held at minimums to ensure bottling plants needs are met. In Florida, milk production is steady to lower in some areas. Import milk shipments are unchanged from last week. Fluid sales are steady.
- Fluid Milk Central: Central milk production is mixed as handlers in the north report farm milk pickups are both lower and higher. In the south, handlers and processors note slight increases in milk intake volumes. Bottled milk demand is active into grocery outlets and education systems. Manufacturing milk demand is active, especially from cheese plant operators, but availability is limited. A few milk handlers indicate intakes are currently not sufficient to meet contracted volumes. Milk buyers/end users are reaching into the East region looking for milk, but those forays have met with limited success. On limited regional sales, prices for manufacturing milk range are above Class, up to \$2.00. Cream demand is active as aerated cream, cream cheese, and sour cream production ramp up seasonally. Also, some ice cream/soft serve operations are pushing production beyond usual calendar limits.
- Butter East: Cream availability is not as strained, which has led to a slight uptick in churning rates. However, with increasing butter orders, surplus cream in significant volumes can be a challenge to find by manufacturers. The rise in butter prices at the CME Group has surpassed the expectations of some. The market undertone is firm.
- Butter Central: Churning activity is steady to lower as butterfat components in milk intakes trend lower. Spot cream load availability for butter production is tight as active aerated cream, sour cream, cream cheese, and moderate ice cream/frozen dessert manufacturing draw heavily on regional cream supplies. Manufacturers in the region are looking for bulk butter to fill needs through the balance of the year; however, buyers report there is a scarcity of bulk butter loads available. Producers are microfixing in addition to running bulk and print butter lines to keep pace with order fulfillment.
- Butter West: Strong domestic demand for butter has helped make the market more resilient. Manufacturers report a wide range of production strategies at this time. Some butter makers are running full schedules to stay ahead of Q4 demand. Others are working into their inventories and have slower production rates. Many butter makers report a drawdown of their butter inventories. Although there is more production emphasis on print than bulk butter as the Q4 holidays approach, a few manufacturers are seeing bursts of bulk butter sales activity.
- Dry Whey Central: While prices moved lower this week, the market tone is mixed. Buyers are returning to the market and putting together mid-term contracts. Some are entering into discussions for 2016. A few end users indicate they've had trouble locating dry whey spot loads for near term use. While some buyers don't expect a quick market turnaround, they feel the downside risks are minimal at this point.
- NDM East: The market continues to firm as spot prices and indices move higher. Low/medium heat nonfat dry milk production is steady to lower. Class I demand and increased yogurt production are reducing milk intakes for some manufacturers, thereby limiting levels of NDM output. In addition, condensed skim contracts being fulfilled by a few producers, result in limited supplies remaining for the drying process.
- NDM Central: The market is firming and prices are higher. Manufacturers report their light volume offers are garnering immediate acceptance from purchasers. Buyer interest is improving for both near and mid-term NDM purchasing. Balancing plant operators report that milk orders from Class II and III operations are keeping NDM dryers operating below capacity.
- NDM West: Prices are higher in a stronger market. The interest of buyers is increasing as Q4 holidays season approaches. Industry participants note a higher sales activity in the f.o.b spot market throughout the West.
- Cheese Northeast: Production is as active as milk supplies are available, but stretches of hot temperatures have reduced milk into manufacturing. Some manufacturers have voiced they would make more cheese if they could get more milk, as heavy sales orders are pulling on existing milk supplies. Mozzarella plants are increasing output to keep pace with improving pizza sales. Most production is fully committed to near-term customers' needs. Cream cheese is very active and foodservice orders have increased behind typical seasonal trends.
- Cheese Midwest: Milk intakes continue to slowly decline, thus steady cheese production is making a home for all available milk. Consumer cheese demand remains strong. Some cut and wrap operations report a seasonal increase in sales, but a few contacts note the strength of the draw has not been as strong as last year. The demand pull from pizza makers for mozzarella cheese is good. Industry contacts suggest

inventories for commodity cheeses may be longer than usual for the end of Q3. However, manufacturers anticipate cheese stocks can be drawn down by Q4 purchases.

- CWT has accepted 6 requests for export assistance from member cooperatives who have contracts to sell 456,357 pounds of Cheddar and Monterey Jack cheeses and 264,555 pounds of whole milk powder to customers in Asia, the Middle East and Central America. The product has been contracted for delivery in the period from September 2015 through March 2016.

What's Bearish:

- Cold Storage Report: While butter stocks saw a large drawdown, American cheese stocks actually increased nearly 11 million lbs from July to August in what is usually a period of seasonal decline (see graph). Holdings at the end of August were 9% higher than a year ago, while total cheese stocks were 12% higher than Aug '14.



- Dairy cow slaughter for the week ended 09/12 totaled 51,500 head, down 3,500 head (-6.4%) vs. the same period a year ago.

- Livestock Slaughter Report: 225,400 cows were removed from the milking herd in August, down 3,100 head (-1.4%) vs. a year ago and the lowest total for this month since 2007.

- Fluid Milk West: Milk output in California is slightly higher. Lower temperatures in the Central Valley are helping to reduce the heat stress of the dairy herd. A cooler climate in Arizona is helping to raise the comfort of milking cows. Thus, milk levels are steady to higher. Class I demand is steady. Milk production is higher in New Mexico. The milk yield of the dairy herd is improving due to lower temperatures. Manufacturing milk volumes are higher as some processing plants are doing maintenance work. Some areas of the state are starting the sixth cutting of alfalfa hay.

- Fluid Milk Pacific Northwest: Milk production is running a little lower and is following seasonal declining milk patterns, but manufacturers report sufficient milk supplies for processing. Industry contacts say forage supplies are adequate. Recent rains have helped pastures green somewhat in parts of the region. Milk production in Utah and Idaho is steady to lower, but processors are not having much trouble getting milk for their needs. Manufacturers note slightly better cheese yields as milk components start to improve.

- Dry Whey Northeast: Prices are lower at the top of the range. Production is steady, with the bulk of whey transactions through existing contracts. Buying interest is light. Inventories are mixed. The market undertone is weak.

- Dry Whey West: Prices moved lower in a weak market. Production remains active. Industry contacts suggest buyers are becoming a little more engaged as the baking industry ramps up for Q4. Inventories are above what is needed to meet market demands.

- Cheese West: Cheese makers report strong cheese demand, especially from consumers and retail outlets. Manufacturers say retailers are stocking up in advance of the Q4 holiday season. Cheese production has remained steady with a little more devotion to making natural varieties. A few industry contacts feel inventories for barrels and blocks are long.

Recommendation:

Spot butter set a new all-time high, settling at \$3.13½/lb, beating last year's run to \$3.06/lb. But will it crash as spectacularly as it did a year ago, when it went from \$3.06/lb to \$2.00/lb in just three weeks? We doubt it. While \$3+/lb butter might be unsustainable, new butter demand appears here to stay. The McDonalds announcement to cook everything in real butter is alone, expected to add 22-25 million lbs of new butter demand in 2016. Restaurants and homes around the country are abandoning margarine in droves as the public comes to realize the government was wrong about saturated fats, and even more wrong about poly-unsaturated fats. The drought in California and subsequent drop in their milk production this year has not helped, since California produces over 30% of the nation's butter supply. It's a classic case of increased demand meeting limited supply. Cheese making regions like the Midwest, on the other hand, have seen a big jump in milk production this year, helping to explain the sharp increase in cheese stocks, despite strong domestic demand. As a result, we've seen weakness in spot cheese prices, while spot butter sets record highs. Recent price increases in NDM suggest a bottom is in for that market, while dry whey continues to struggle. All of that combined to increase the spread between Class III and Class IV from \$2.30 last week, to \$4.50 this week. Most of that was Class IV jumping from \$17.35 a week ago to \$19.40 this week. As has happened in the past, we expect the strength in Class IV to benefit, and lead Class III higher eventually. Barrel cheese continues to be more available than blocks, with a healthy 33 loads of barrels exchanging hands this week, and just 4 block loads. Remembering that our spot market is restricted to cheese made in the last 30 days, at some point that barrel supply will get under control. Buyers appeared ready and willing to take on loads this week in the \$1.50s, and helped close the block/barrel spread to an acceptable 4¢. Yes, stocks in warehouses are high, but part of that can be explained by demand coming forward early, thus stashing cheese away early. As long as domestic cheese demand remains strong, inventories should stay manageable. Indeed, with the seasonal decreases we're seeing in milk production in both the Midwest and Northeast, it appears some cheese manufacturers are aggressively looking for more milk in order to meet existing contracts. Spot cheese could be forming a bottom here. Cheese futures paint a rosier picture than spot, with Nov cheese futures at \$1.69/lb. A big unknown here, is what both cheese and butter imports from Oceania will do to limit any price increases. And will demand ever come back from China. The bottom line is, we think producers should hold off making large sales unless the market rallies at least 50¢ from current prices. Producers with milk already sold/contracted should aggressively purchase upside protection, which is very cheap right now. Lastly, watch grains, which may have bottomed. A strong rally there could help milk.

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