

The KDM Dairy Report – October 2nd, 2015

What's Bullish:

- Spot Market: Blocks shot up 15¼¢ to close at \$1.74¼/lb on just 1 trade for the week. Barrels gained 6¼¢ to close at \$1.61¼/lb on heavy trading of 23 loads. Grade A NDM jumped 12¢ to close at \$1.06/lb, the first time it's been above \$1 since last March.
- Weekly cold storage numbers show butter stocks at USDA-selected storage centers declined 18% (3.1 million lbs) over the period 9/01 through 9/28. Cheese stocks were down 1% (1.2 million lbs).
- Dairy cow slaughter for the week ending 09/19 totaled 59,800 head, up 6.2% vs. the same period a year ago.
- Fluid Milk Northeast: Potentially dangerous and damaging rainfall is occurring in Florida and expected to continue up the East coast into New England into early next week. Conditions, which include flooding and road closures, are likely to have an impact on milk market supply/demand, and distribution channels. In the Northeast, producers' milk outputs are steady to slightly higher. Cooler conditions improved cow comfort and overall milk production in the Mid-Atlantic region, but butterfat and protein levels are not as high as some expected. Bottling orders picked up slightly.
- Fluid Milk Southeast: Milk production trickled lower in some areas but increased in other areas of the region. Class I demand is stronger due to the storm's effect. Milk loads into manufacturing are very limited. Florida's milk production indicates signs of bottoming out. Fluid milk sales are up, as storm forecasts trigger a rise in bottling orders. Milk imports increased, as reports indicate 220 spot shipments into the state this week, 100 more than last week. Cream supplies are balanced with good demand. Some tightness is reported, however. With the decline in ice cream usage, other Class II cream demand is building. Cream cheese production has increased, with dips, bottled cream, and whipping cream trending similarly, as processors prepare for yearend holiday demand.
- Fluid Milk Central: Demand from bottlers is steady to higher to support in-store specials in the north central area. A few balancing plant managers noted they are filling additional milk orders destined for the Southeast region as residents in that area stock up ahead of Hurricane Joaquin. Commodity and specialty cheese makers are still looking for spot loads of milk, but meeting with varied success in locating loads. Some marketers indicate they are short of meeting upcoming commitments from internal milk supplies, and they have been unable to find sufficient milk volumes to fulfill upcoming needs. Prices for manufacturing milk range from \$.50 to \$2.00 above Class.
- Fluid Milk West: California milk production is unchanged, despite an improvement in the weather and cow comfort. August 2015 pool receipts of milk in California totaled 3.21 billion pounds, 3.8% lower compared to August last year. Year-to-date through August 2015 receipts are 4.1% lower from the comparable months in 2014. Milk volumes in Arizona are steady to lower. Higher temperatures above 105 degrees are taking a toll on the milk yield.
- Fluid Milk Pacific Northwest: Milk production is a little lower and is following typical seasonal patterns. Bottling demand is steady, but industry contacts note demand for whole fat milk is higher and in line with current national trends. Milk production in Idaho and Utah is following a seasonal declining pattern. Demand for cream from ice cream makers is seasonally waning. However, the cream demand for churning is strong as Q4 holidays approach. Industry participants note a higher interest for cream from sour cream and cream cheese manufacturers.
- Butter Northeast: Buyers are continuing to place upcoming holiday orders. Regional sales are regarded as strong. New production and inventoried product is being utilized to meet the heavy demand at some plants, as those producers note having to turn away orders.
- Butter Central: Bulk butter demand is making a comeback as buyers witness lower pricing on various trading platforms. Microfixing continues for meeting upcoming demand. Bulk butter prices range from 2 cents under to 7 cents over the market, based on CME Group prices and various indices. Central butter manufacturers report cream is available. Some Western cream is clearing into the Central region to meet Class II/III/IV demand.
- Butter West: Although the recent price spike and decline for butter at the CME Group may have temporarily scared off a few buyers, active butter demand from retailers continues to push production and draw butter out of inventory. Some butter makers report full production schedules to stay ahead of the call for Q4 retail butter. Other processors are content to work into their inventories and sell available cream. Most of the production emphasis has been on print butter as manufacturers prepare for the upcoming holiday home baking season. As a result, some industry contacts note a little tightness for bulk butter supplies.
- Dry Whey Northeast: Some buyers are looking to purchase dry whey amid reports of some tightness in regional whey stocks. Supplies continue to move primarily through contracts, with moderate spot sales. Resale market trading saw raised activity this week. The market undertone is steady.
- Dry Whey Central: Late last week and early this week, a number of producers offered out single and block loads. In many cases, these loads were priced below offers of the previous week. Buyers stepped up to take these loads. In the latter half of the week, though, buyers and end users noticed a change in pricing strategy from some producers. By midweek, some producers were offering spot loads based on several cent premiums to the market. Buyers are now reassessing their holdings to determine when to reenter a market which seems to be shifting toward a seller's market. Dry whey production is steady to lower in the region as manufacturing milk is less available. Dry whey inventories are variable, from light to comfortable.
- Dry Whey West: Manufacturers suggest their sales activity in the previous weeks has allowed them to reduce inventories to more comfortable levels. Market participants are starting to contract for 2016.

Futures Month	Class III 10/02	Class III 09/25	Change	Dry Whey 10/02	Dry Whey 09/25	Change	Cheese 10/02	Cheese 09/25	Change
Oct-15	\$15.69	\$15.50	\$0.19	24.600¢	24.700¢	(0.10¢)	\$1.685	\$1.667	\$0.018
Nov-15	\$15.63	\$15.77	(\$0.14)	26.700¢	27.500¢	(0.80¢)	\$1.695	\$1.690	\$0.005
Dec-15	\$15.69	\$15.76	(\$0.07)	29.850¢	29.950¢	(0.10¢)	\$1.690	\$1.695	(\$0.005)
Jan-16	\$15.72	\$15.62	\$0.10	32.000¢	30.250¢	1.75¢	\$1.682	\$1.684	(\$0.002)
Feb-16	\$15.77	\$15.67	\$0.10	32.650¢	30.025¢	2.63¢	\$1.682	\$1.687	(\$0.005)
Mar-16	\$15.88	\$15.83	\$0.05	32.925¢	30.250¢	2.68¢	\$1.700	\$1.701	(\$0.001)
Apr-16	\$16.01	\$15.85	\$0.16	32.525¢	30.750¢	1.78¢	\$1.705	\$1.705	\$0.000
May-16	\$16.15	\$15.97	\$0.18	33.050¢	31.050¢	2.00¢	\$1.711	\$1.710	\$0.001
Jun-16	\$16.35	\$16.24	\$0.11	33.775¢	33.000¢	0.77¢	\$1.740	\$1.730	\$0.010
Jul-16	\$16.50	\$16.37	\$0.13	32.500¢	32.425¢	0.08¢	\$1.760	\$1.748	\$0.012
Aug-16	\$16.60	\$16.43	\$0.17	33.350¢	32.100¢	1.25¢	\$1.760	\$1.760	\$0.000
Sep-16	\$16.51	\$16.37	\$0.14	34.000¢	32.750¢	1.25¢	\$1.756	\$1.754	\$0.002
12 Mo Avg	\$16.04	\$15.95	\$0.09	31.494¢	30.396¢	1.10¢	\$1.714	\$1.711	\$0.003

- NDM East: Prices in the mostly series are higher in a firming market. As plants note an increase in milk receipts, low heat nonfat dry milk production volumes are only seeing marginal growth. Low/medium inventory sales have been slower than desired for some, but holiday interest is improving.
- NDM Central: Prices are mostly higher as manufacturers factor in contract and spot sales based on variable indices. Market participants report domestic and international buyer interests are firming as acceptance increases of the idea that a market rebound is taking place. As the new month looms, some producers are now less willing to enter into fixed price contracts compared to those based on a variable index. Low/medium heat nonfat dry milk production is steady and below maximum throughput at most locations. Inventories are comfortable.
- NDM West: Prices for low/medium heat nonfat dry milk are mostly higher. Inventories are mixed. Some processors note a little tightness of NDM supplies. Spot sales to cheese makers (for cheese fortification) are active. In addition, NDM spot sales to dry hot chocolate mix manufacturers are increasing as Q4 approaches. The market tone is firmer.
- Cheese Northeast: Cheese production is mostly moderate. Competition for milk supplies from bottlers remains active. Fall eating patterns are significant, while aiding increases in mozzarella orders. Retail sales are improving with football and weekend gatherings.
- Cheese Midwest: Most cheesemakers are producing cheese using regular milk supplies, with little evident interest in securing extra milk. Cheesemakers looking for extra milk were offered milk at 50 cents to \$1.00 over Class. Barrel cheese manufacturers are fielding multiple calls this week from buyers looking for barrels. With production mostly geared toward regular milk supplies, some prospective customers for barrels may have to keep checking around. Manufacturers are better situated to accommodate block buyer interest, relying on current output and inventories. There is some additional current buyer interest geared toward having cheese ready to go into the pipeline and ultimately to retail stores for end of year holiday demand. Mozzarella demand continues to be strong for frozen pizzas and food service sales.
- Cheese The pizza demand pull for mozzarella cheese is good. Cheese production is steady and trying to keep pace with consumer demand. Branded natural cheeses continue to perform well in the marketplace. Industry contacts note American style cheese stocks are a little heavy, however.
- International: Milk production in Western Europe is seasonally low, but varies from country to country. Farm level prices remain low, even as dairy commodity prices are rising. Eastern Europe milk production is at lower than normal seasonal levels. The lower milk prices are still concerning for most farmers. Processors are reporting adequate milk supplies for current demand, however.
- International: Australia milk production is moving towards the seasonal peak. Milk production for the season is slightly up on last year, however month to date for September is very slightly behind last year. Spring is continuing to be dry in some key dairy areas which is causing some concern. The cold, wet weather in New Zealand has not been conducive to forage growth. This has decreased production. Coupled with the low farmgate level pricing, this has led to an increase in cow culling. The milk production forecast is predicted to be lower than last year.

What's Bearish:

- Spot Market: While other Class III components were higher, butter plunged 59½¢ on the week to close at \$2.50/lb. 27 loads exchanged hands.
- Dairy Products Report: Both Total and American cheese output in August were 3.5% higher than a year ago, according to USDA. Butter output, however, declined 1.2% vs. last year. Even though cheddar cheese output in California fell 4.5%, Wisconsin increased output by 7.8% to more than make up for it.
- International: Ag analysts Rabobank published their 3rd quarter dairy update this week. While globally we appear to still be awash with milk, they think the rebalancing of supply and demand is within sight. The only problem is, they predict prices will decline further, before finally beginning to correct after June 2016. Their current forecast has Class III averaging just \$14.52 in Q4, then falling to just \$13.19 in Q1, to \$14.15 in Q2, before recovering to \$16.32 in Q3.
- International: Fonterra increased their farm gate milk price forecast for the 2015/16 season in light of recent higher global dairy prices. With three consecutive increases seen in the bi-monthly GDT auction, the jump in pay for Oceania's dairy farmers was warmly welcomed.

Recommendation:

This week's report again looks bullish on the face of it, but we have to remember one thing. Between USDA reports and relationships with producers, we generally get a pretty good picture of the supply side of the equation, but we get much less good demand side data. We can be in a situation of contracting milk supply and thus easily get bullish on prices, while demand might be deteriorating at an even faster rate, allowing for no price recovery and maybe even further weakness. That said, we're more optimistic than this week's forecast by Rabobank. While butter has come down from its peak, changing attitudes in the U.S. about dairy fat consumption is yielding a lot of potential new demand. Competition for fat even from increased whole milk consumption could keep butter prices at a new "higher norm" next year. Meanwhile, nonfat dry milk appears to have put in a classic "bottom" and buyers are now anxious to lock in 2016 prices before they go higher. Spot NDM popped over \$1/lb this week for the first time since March. Domestic demand for cheese is still strong, but so is production. Football season is aiding mozzarella demand and buyers looking to build holiday inventory are showing more interest. The bottom line is we think a modest price increase may come sooner than what some other analysts think; perhaps even this quarter. As producers in the EU struggle with profitability and dairies in Oceania have increased culling, the outlook for 2016 prices is improving. Indeed, the Class III 2016 average has increased from a low settlement of \$15.84 on 08/24, to \$16.22 today. In this week's spot market, block cheese settled at \$1.74¢, within ¼¢ of the high for the year of \$1.75, set on 06/10. We have not been higher than \$1.75 since last November. Is this finally the time for cheese to break out and reach the \$1.80's? Current barrel supplies still appear to be on the long side, with 23 loads exchanging hands this week, to just 1 block trade. But Dairy Market News indicated this week that some buyers in the Midwest were looking for barrels. Over the last three weeks, when barrel trading really picked up, we've moved 83 loads of barrels but just 9 loads of blocks. If our barrel market is finally getting more balanced, as DMN implies, we could see a push higher in spot cheese over the coming weeks. Producers who have already sold milk should aggressively purchase upside protection through the end of the year. For 2016, we would wait for prices to approach \$16.50 before beginning any hedging. Just to reiterate: All of this assumes demand, which we have less good data on, remains steady or improves.

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