

The KDM Dairy Report – October 23rd, 2015

What's Bullish:

- Milk Production Report: U.S. milk output in September was up just 0.4% vs. a year ago, which was on the lower end of expectations. In addition, August cow numbers were revised lower and September's herd fell 5,000 head vs. August. Milk per cow increased by just 1-lb. CA output fell 3.6% on 1,000 fewer cows and a loss in milk per cow.
- Livestock Slaughter Report: 14,100 more dairy cows were removed from the milking herd in September compared to a year ago, an increase of 5.9%.
- Dairy cow slaughter was strong for the second week in a row. 58,900 head were removed from the herd during the week ending 10/10, up 6.5% vs. the same period a year ago.

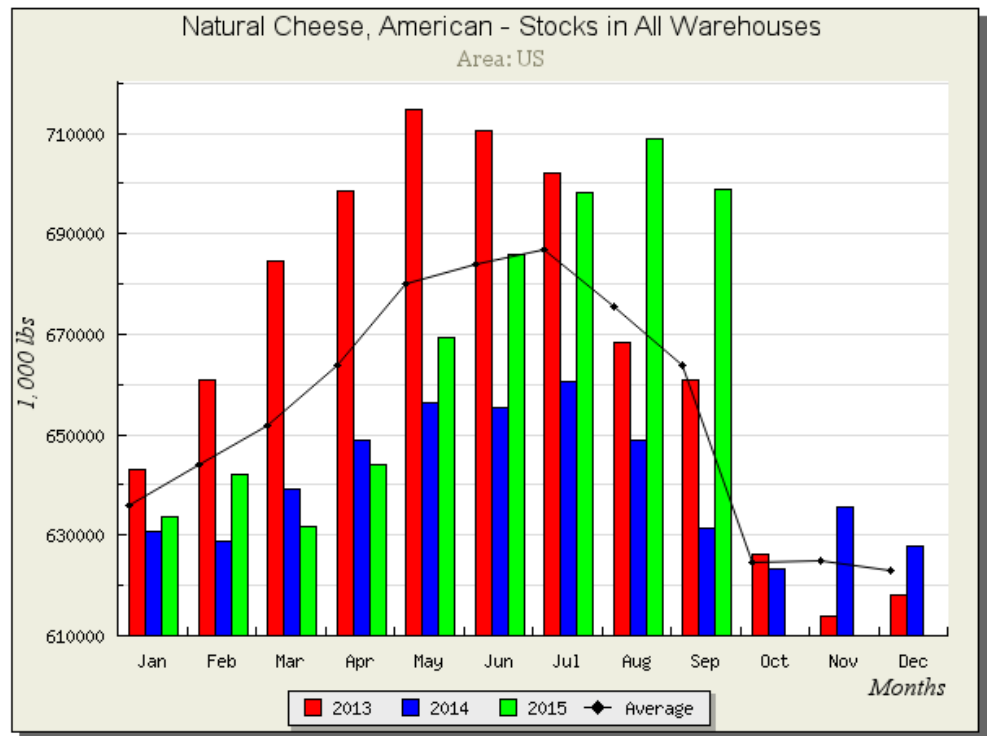
Futures Month	Class III 10/23	Class III 10/16	Change	Dry Whey 10/23	Dry Whey 10/16	Change	Cheese 10/23	Cheese 10/16	Change
Oct-15	\$15.49	\$15.60	(\$0.11)	23.250c	24.025c	(0.77c)	\$1.679	\$1.689	(\$0.010)
Nov-15	\$15.46	\$15.66	(\$0.20)	25.075c	26.625c	(1.55c)	\$1.682	\$1.698	(\$0.016)
Dec-15	\$15.51	\$15.68	(\$0.17)	27.375c	27.875c	(0.50c)	\$1.678	\$1.700	(\$0.022)
Jan-16	\$15.48	\$15.62	(\$0.14)	29.175c	30.100c	(0.93c)	\$1.669	\$1.687	(\$0.018)
Feb-16	\$15.66	\$15.70	(\$0.04)	30.875c	31.800c	(0.93c)	\$1.679	\$1.680	(\$0.001)
Mar-16	\$15.82	\$15.80	\$0.02	31.550c	32.125c	(0.57c)	\$1.698	\$1.700	(\$0.002)
Apr-16	\$15.93	\$15.95	(\$0.02)	32.350c	33.000c	(0.65c)	\$1.699	\$1.704	(\$0.005)
May-16	\$16.08	\$16.04	\$0.04	33.625c	34.725c	(1.10c)	\$1.707	\$1.710	(\$0.003)
Jun-16	\$16.48	\$16.29	\$0.19	34.500c	35.275c	(0.77c)	\$1.737	\$1.730	\$0.007
Jul-16	\$16.71	\$16.65	\$0.06	34.000c	35.500c	(1.50c)	\$1.775	\$1.765	\$0.010
Aug-16	\$16.85	\$16.73	\$0.12	35.875c	35.500c	0.38c	\$1.782	\$1.775	\$0.007
Sep-16	\$16.88	\$16.77	\$0.11	35.500c	35.500c	0.00c	\$1.782	\$1.775	\$0.007
12 Mo Avg	\$16.03	\$16.04	(\$0.01)	31.096c	31.838c	(0.74c)	\$1.714	\$1.718	(\$0.004)

- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic regions is mostly steady around typical seasonal low points. Sales to Class I operations are good, while continuing to limit manufacturing milk intakes.
- Fluid Milk Southeast: Milk production in the Southeast is steady in some areas, but slightly up in others. Manufacturing milk intakes are being moderated by strong Class I demand.
- Fluid Milk Central: Production in the region is slowing. Manufacturers report full production schedules, but less excess milk is available. Central milk is still finding its way to other regions to aid in filling demand. Processors in the region are gearing up for the holiday season. Crop harvesting is reportedly going well in the Upper Midwest, with some farmers disappointed in yield numbers throughout the region. Unfavorable weather conditions were a factor. Prices on milk spot loads range from \$1.25 to \$2.00 over. Spot loads of milk are less available than in the past few weeks.
- Fluid Milk Southwest: Output is steady to lower in California. High humidity in the Central Valley is adversely affecting cow comfort. Bottled milk sales to groceries stores and food service are improving. Bottled milk demand is steady to higher. Condensed skim interest from NDM processors is steady to higher. Arizona milk intakes are lower. Raining conditions are taking a toll on dairy herd comfort, thus milk volumes into manufacturing are lower. The current demand for Class I and Class II is higher. New Mexico milk production is lower. Thunderstorms with heavy rains are negatively affecting the milk yield of herd. Demand for cream from butter and cream cheese processors remains strong in advance of the Q4 holidays.
- Butter: Production remains active, especially for print butter. Manufacturers are not having trouble sourcing cream, but most processors are using in-house or contracted cream supplies and not buying on the spot market. Processors and end users are careful not to keep high stock levels with the price fluctuations happening lately at the CME Group, Inc. The strong demand levels are helping keep inventory levels in check. There are some buyers looking for imported spot loads, but are having trouble securing them with the recent tariffs that were added.
- Dry Whey Northeast: Prices moved up at the bottom of the range and adjusted lower at the top, a result of fob spot prices and changes to pricing indices. Dry whey output is equivalent to moderate regional cheese production. However, sources are reporting limited dry whey availability from some producers' inventories.
- Dry Whey West: Both prices and production held steady in an unsettled market. Buyer inquiries are active, and a few contacts are asking if the market is firming, though they are cautious about acting on the current market signals. Some manufacturers report not having stocks available for spot sales.
- NDM West: Spot prices are lower, but sales are active. Some processors indicate good demand from cheese makers and hot chocolate mix manufacturers. At this point, the market tone is mixed. Condensed skim milk availability for NDM is lower. Thus, drying schedules have slowed down throughout the region. Inventories are steady to lower.
- Cheese Midwest: Cheese is moving out of some plants faster than it is being made, leading to a draw on manufacturer inventories. Good cheese sales are welcome and plants intentionally have inventories to accommodate sales at this time of year when cheese production declines. Little spot milk is available to cheese manufacturers. A few loads have moved at from \$1.25 to \$\$2.00 over Class, but these transactions are rare.
- Cheese West: Cheese production is steady. Manufacturers report there is no problem getting milk for cheese making, but discounted loads of milk aren't widely available either. A strong domestic demand for natural cheese has continued into fall. Some manufacturers report being short certain varieties of cheese and adjusting production schedules to rebuild inventories a little.
- CWT has accepted 12 requests for export assistance to sell 2.196 million pounds of Cheddar, Gouda and Monterey Jack cheese to customers in Asia, the Middle East, North Africa and Central America. The product has been contracted for delivery in the period from October 2015 through April 2016.

What's Bearish:

- Spot Market: Blocks gave up 5¼c for the week to settle at \$1.61¼/lb on 6 trades, while barrels lost 9c to close at \$1.55/lb on 24 trades. Grade A NDM fell 4¼c to close at \$0.84¼/lb with 28 loads exchanging hands, but butter managed a 2c gain to the week to settle at \$2.47/lb on 18 trades.
- Cold Storage Report: American cheese stocks at the end of Sep were up 11% vs. a year ago (see chart below), according to USDA. Total cheese stocks climbed 13%, while butter stocks were 23% higher.
- Fluid Milk Pacific Northwest: Milk production continues to slow a little and is following seasonal trends, but intakes are adequate for processing needs. Bottling demand remains steady. Utah and Idaho milk production is also in a typical fall decline. But industry contacts say there is no problem getting enough milk for processing needs. Milk components are increasing slightly.

- Dry Whey Central: Prices are steady to lower. Contract demand is steady for dry whey, but spot sales are lower. Dry whey production is strong.
- NDM Northeast: Prices for low/medium nonfat dry milk moved lower in the range. Production is steady at most drying facilities; however, there are indications of some decline in overall production with reports of dryers being down. Some buyers are in a wait-and-see mode prior to stepping back into the market, as they anticipate prices will move lower. Price drops in the low/medium heat NDM market, as noted by some market participant, have not stimulated the expected level of interest from some cheese markets. Overall, low/medium nonfat dry milk demand is fair to good. Producers' inventories range from fair to ample.
- NDM Central: Prices were lower this week. Production remains strong. Spot demand is mixed as some sellers report being tight on supplies while others cannot find buyers.
- Cheese Northeast: Cheese output in the region is steady to increasing. In general, milk supplies are adequate; however, reports indicate milk availability at some plants is near levels that lead to capacity production. As retail ad volumes increase, cheese sales range from steady to improving. Orders are good for aged cheddar and mozzarella cheeses. Stocks are balanced.
- International: This week's GDT auction resulted in the first loss after 4 consecutive gains. The dairy price index fell 3.1%, led by an 11.1% drop in butter. Cheddar cheese declined 2.2% to a U.S.-equivalent \$1.43/lb.



Recommendation:

With spot prices working out to only about \$14.80/cwt Class III, more premium was taken out of the front months this week. The last half of 2016, however, finished in the green. There still appears to be plenty of barrels and NDM to go around, as more than 20 loads traded for each in this week's spot market. Reports this week from Dairy Market News would seem to indicate that cheese is beginning to tighten slightly, but that has yet to be born out in the spot market. This week's cold storage report shows American cheese stocks are still at historic highs and may easily be able to satisfy holiday demand. If cheese can't mount a rally, expect the Nov/Dec contracts to potentially put in the low settlements for the year, possibly sub-\$15. Butter demand remains strong, and even though there is plenty of cream available, manufacturers appear to be doing a good job managing inventories. Butter buyers looking for imported product are now having a harder time of it with import tariffs now being applied. Class III futures tried to rally early in the week, but offers in the spot market quickly dissipated enthusiasm and we fell back into a seller's market. We really have no idea what to expect next week. Holiday demand would suggest perhaps prices should strengthen, but with the number of sales this week in barrels and the apparent continued available supply, it just may not happen. Hedgers should be looking at Q1. Post holidays could see a drop in demand and price deterioration along with it. The Q1 average settled today at \$15.65. We don't have any great ideas at this level, but one could do a 15.00 x 17.00 fence (15 minimum, capped at 17) for a net cost of 15¢/mo.

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