KDM Trading, Inc.
877.695.8538 www.kdmtrading.com
Dan Schindler, Mark Potter, Keith Schnese & Nick Potter

The KDM Dairy Report – November 13th, 2015

What's Bullish:

Futures Month	Class III 11/13	Class III 11/06	Change	Dry Whey 11/13	Dry Whey 11/06	Change	Cheese 11/13	Cheese 11/06	Change
Nov-15	$15.41	$15.63	($0.22)	24.100¢	24.100¢	0.00¢	$1.666	$1.689	($0.023)
Dec-15	$15.06	$15.54	($0.48)	25.750¢	26.000¢	(0.25¢)	$1.638	$1.690	($0.052)
Jan-16	$15.12	$15.34	($0.22)	27.500¢	27.050¢	0.45¢	$1.642	$1.673	($0.031)
Feb-16	$15.07	$15.29	($0.22)	27.275¢	27.900¢	(0.63¢)	$1.648	$1.664	($0.016)
Mar-16	$15.25	$15.55	($0.30)	27.550¢	28.375¢	(0.82¢)	$1.661	$1.682	($0.021)
Apr-16	$15.43	$15.89	($0.46)	28.325¢	30.175¢	(1.85¢)	$1.675	$1.711	($0.036)
May-16	$15.73	$16.19	($0.46)	29.900¢	31.500¢	(1.60¢)	$1.700	$1.739	($0.039)
Jun-16	$16.16	$16.49	($0.33)	30.925¢	32.975¢	(2.05¢)	$1.732	$1.761	($0.029)
Jul-16	$16.55	$16.80	($0.25)	31.550¢	32.800¢	(1.25¢)	$1.773	$1.790	($0.017)
Aug-16	$16.73	$16.90	($0.17)	32.875¢	33.400¢	(0.52¢)	$1.785	$1.802	($0.017)
Sep-16	$16.82	$16.98	($0.16)	33.850¢	34.025¢	(0.17¢)	$1.788	$1.803	($0.015)
Oct-16	$16.78	$16.90	($0.12)	34.500¢	34.500¢	0.00¢	$1.788	$1.791	($0.003)
12 Mo Avg	**$15.84**	**$16.13**	**($0.28)**	**29.508¢**	**30.233¢**	**(0.72¢)**	**$1.708**	**$1.733**	**($0.025)**

- World Ag Supply & Demand Report: USDA reduced both their 2015 and 2016 milk production forecasts, as they expect the dairy herd to decline more rapidly from its second quarter peak. Strong domestic demand for butter is expected to support high butter prices through the end of the year.
- Weekly cold storage stats show butter stocks at USDA-selected warehouses were drawn down a strong 16% over just the first 9 days of November. Cheese stocks were down 1% over the same period.
- Dairy cow slaughter for the week ended 10/31 totaled 59,200 head, up a strong 8.2% vs. the same period a year ago.
- Cream East: Supplies are tight throughout the region, and spot loads are hard to find. This week cream cheese interest grew, bringing about heavier cream use at some plants.
- Fluid Milk Central: Weather continues to support farm milk production, but strong demand is absorbing milk increases. Class I demand is very active, with several bottlers reporting that, outside of school meal programs, orders for full fat milk varieties are increasing. Orders for manufacturing milk clearing into Class II are active as production of seasonal items continues. For milk spot loads, prices range from flat to $1.50 over Class. Interest is steady to higher as manufacturers respond to new orders ahead of Thanksgiving.
- Fluid Milk Pacific Northwest: Milk intakes are steady and adequate for most processing needs. Manufacturers are short an occasional load or two of milk to run at full production. The lighter volumes have allowed more time for maintenance and special production runs.
- Cream West: Demand from butter makers is strong. In addition, the interest from whipped cream, sour cream, and cream cheese makers is growing.
- Butter: In the Northeast, butter makers are finishing production and delivery for the Thanksgiving holiday. Butter output is active and demand is steady. However, some retailers expect to boost buyer interest with a notable growth in promotional ads. In the Central region, butter production is steady to slightly tighter. Orders from retailers and food service remain strong. In the West, butter output is steady. Demand is still good.
- Dry Whey: In the Northeast, prices moved higher on the strength of limited spot trading. Cheese production is steady to weakening, and in turn further tightening the whey supply. The market undertone is firm. Central region stocks have moderated as production is steady. Buyer interest is increasing, especially for 2016 needs. Western whey prices moved slightly higher within the mostly price series. Manufacturers' inventories are mixed with some reporting heavy stocks but other processors reporting committed supplies. Several large volume sales were made into export markets for delivery over the next few months.
- Cheese Midwest: Cheese production is steady. Manufacturers are scheduling several planned maintenance days within their facilities this month, but are receiving enough milk to stay near full production. Food service and pizza demand is robust. Many cheese makers are seeing natural cheese varieties leave their facilities without going into inventory. However, a new barrel cheese facility is scheduled to come online in Southwestern Wisconsin within the next month.
- Cheese West: Cheese production is active with milk readily available for processing. However, retail and food service demand for block cheese varieties is strong. Cheese makers say they are not building inventories of these cheese types. Demand for cheese barrels has also been relatively good.
- International: New Zealand's Central Bank has warned of excessive debt building up on dairy farms as farmers struggle with low prices. The dairy sector in New Zealand faces a second consecutive season of weak cash flow due to low international dairy commodity prices. Many indebted farms are coming under increased pressure, which would be exacerbated if low dairy prices are sustained or dairy farm prices fall significantly.

What's Bearish:

- Spot Market: Block cheese fell 8¢ during the week to settle at $1.62/lb with 6 loads exchanging hands. Barrels careened 18¼¢ lower to $1.46¾/lb on heavy volume of 38 trades. Grade A NDM lost 1¢ on 1 trade to close at $0.80/lb, while butter was steady at $2.88½/lb with no trade activity all week.
- Fluid Milk Northeast: Milk production is increasing incrementally. Manufacturers' milk supplies are mostly balanced. Balancing plant operators, who were recently concerned by lower milk intakes, are noting marginal increases in milk receipts.
- Fluid Milk Southeast: Cooler temperatures in the region will likely advance milk production. In Florida, milk import spot shipments continue to fall off, with 40 loads moving into the state this week, compared to 60 the previous week.
- Fluid Milk West: California milk production is steady to higher. Lower temperatures in the Central Valley are helping to ease the stress on dairy herds. Demand for Class 1 is mixed. Therefore, manufacturing milk volumes moving into Class 2 are higher. Arizona milk output is steady to higher. Lower humidity conditions are enhancing the milk yield. Bottled milk orders are slightly lower. Milk production in New Mexico is higher. The cooler weather with temperatures averaging 59-60 degrees is helping to raise cows comfort. Bottled milk sales are steady to lower.
- Cheese Northeast: Cheese plants' production rates are fairly steady. Orders are softening as most Thanksgiving needs have shipped from producing plants. Typically, buyers are now waiting to see where prices will settle before re-entering the market. Wholesale supplies are adequate for current buying interest.

- International: Milk production in Western Europe is trending steady to slightly higher, moving off the seasonal low point. Compared to year ago volumes, gains in milk production are higher for most countries. The move off the quota system is being credited as producers are not worried about being charged with levies against additional milk. The current milk prices are not yet restricting the milk flow.
- International: Australian milk production is holding mostly steady at volumes just off the seasonal peak levels likely seen just a few weeks ago. Substantial rainfall has been received across much of Australia. The hope is that the moisture can replenish soil conditions and help crops and hay.
- International: The New Zealand milk production peak was reached in mid-October. Milk production projections are still expected to be lower by 5% or so, but dairy commodity prices are trending lower across categories. There are more pricing pressures as demand has slowed and product offerings are increasing.

Recommendation:

For weeks we've been talking about the fact that the barrel supply is more abundant than blocks, and this week's spot market put an explanation point on it. A stunning 38 loads (at 42,000 lbs each!) of barrels traded this week and sellers probed for buyers, while only 6 loads of blocks exchanged hands. Lower prices encourage consumption, so let's hope the excess supply gets taken care of soon. Domestic demand is still strong, with indications that cheese manufacturers are not building much inventory. Class III futures have not seen much volatility all year, but with the spread between blocks and barrels at an unusual 15¼¢, something has to give. Because blocks are actually on the tighter side, we wouldn't be surprised to see barrel prices rally at some point. With the amount of barrel product that has exchanged hands over the past few weeks, the day sellers disappear will be a day of fireworks in Class III to the upside. Now, this has more to do with the front months than anything. Current spot prices work out to just $14.55 Class III, which is why December futures saw the biggest loss this week. With this contract starting its calculation next week, it's simply shaving off more premium. However, don't be surprised to see it surge if suddenly the barrel market finds some support. For that reason, we would not recommend selling Dec-Feb at these levels. These contracts have been beaten up badly over the past two weeks and are technically oversold. If you still need to get something done in Q1, wait for a bounce. With the 2016 average falling to $16.06 this week, we can attest that producers are getting pretty worried, and rightfully so. For those that are taking action and selling for the year, you need to have a plan for the second half. A news article this week quoted a Rabobank analyst who thinks milk prices should start to recover by Q3. We agree. China is getting closer to balancing their powder stockpiles, while producers in Oceania have been culling fairly aggressively. We think there is quite a lot of upside potential July-Dec 2016, and perhaps earlier. Producers who have marketed their milk should be buying CALL options or putting on bull-call-spreads to protect their fixed contracts. In the near term, broader markets are providing headwinds for commodities, with declines in grains, energy, metals and nearly everything in between. The assumption that the Fed will raise interest rates in Dec has seen the USD rally strongly vs. other currencies, making our exports less competitive on the global market. Don't be surprised, however, if the Fed raises rates by just 25 basis points and the USD falters after that. What is known has already been "baked in" to the market, and short of the unexpected, wouldn't be surprised to see a round of USD profit-taking after the Fed meets. All in all, still a lot of uncertainty in this market.