

The KDM Dairy Report – November 20th, 2015

What's Bullish:

- Milk Production Report: October milk output in the U.S. increased by just 0.1% vs. a year ago. The gain was on the lower end of expectations. In addition, cow numbers declined 1,000 head vs. Sep. The herd size has declined month-to-month, four out of the past five months. Milk per cow was lower than year ago numbers for the first time this year. The West continues to struggle, with CA output down 3.6% and NM down 2%. That was made up by the Midwest, with SD up 13.2%, MI up 4.3% and WI up 3.1%.
- If fall demand season. Cheese stocks at USDA-selected storage centers declined 6% (6.1 million lbs) over the period 11/01 through 11/16. Butter stocks were pulled down 24% (2.9 million lbs) over the same period.
- Livestock Slaughter Report: 256,500 cows were removed from the milking herd in October, up 1.9% vs. last year. Through October, the dairy cull is up 3.8% vs. 2014.
- Dairy cow slaughter for the week that ended 11/07 totaled 60,300 head, up a strong 7.9% vs. the same period a year ago.
- CWT has accepted 8 requests for export assistance on contracts to sell 1.332 million pounds of Cheddar, Gouda and Monterey Jack cheese to customers in Asia. The product has been contracted for delivery in the period from November 2015 through May 2016.
- Fluid Milk Mid-Atlantic: Milk production is steady. Class I demand continues to be strong ahead of the holiday, limiting manufacturing milk supplies.
- Fluid Milk Southeast: Milk production in the region remains steady. Milk supplies are nearly in balance with demand, as few loads clear to manufacturing. Bottlers are adding to orders, to increase in-house stocks, in expectation of next week's fluid milk needs. Florida's milk production is steady to improving. Seasonal residency in the state is accelerating fluid milk sales. Spot import shipments of Grade A milk rose sharply, as 123 loads were imported, vs. just 40 loads a week ago.
- Cream West: Cream usage for cream cheese, sour cream, whipping cream, dips, eggnog and other popular holiday dairy products remains strong. Cream supplies vary all over the West. Some butter processors are opting to sell the cream instead of churning, as multiples are steady to higher.
- Butter: Cream supplies are generally tight to moderate across most of the country. Some butter makers have slowed production and are unwilling to churn butter at current multiples. Cream cheese and other Class II producers are pulling heavily at cream supplies. A few butter makers are opting to sell the cream in lieu of churning. However, in the West and Central regions, some butter plant managers are seeking additional loads of cream to boost production. Butter demand is steady to higher. A few market participants indicate pre-Thanksgiving holiday butter orders are heavier than expected. Buyers are cool to current butter prices, but a few retailers have placed orders to cover retail butter needs through the balance of Q4. Many contacts anticipate a price correction before the end of the year. Manufacturers' inventories are light to moderate, but are not creating concern.
- Dry Whey Northeast: Inventories remain tight, as dry whey supplies clear mostly to contracted customers. In light of low stock levels and good holiday demand, some orders are being pushed back. Spot offerings are limited.
- Dry Whey Central: The top of the mostly price moved fractionally higher on the strength of sales to domestic buyers shopping brand specifically. Manufacturers indicate stocks run the gamut from tight to having some spot load availability. There is a push to lighten holdings before the end of Q4, but sales are active within the broker/trader market sector.
- Dry Whey West: Manufacturers report steady production and reasonably good interest from regular customers. Contracting for Q1 2016 is ongoing. Inventories are mixed. Although a few manufacturers report long inventories, most other processors' stocks are committed.

| Futures Month | Class III 11/20 | Class III 11/13 | Change | Dry Whey 11/20 | Dry Whey 11/13 | Change | Cheese 11/20 | Cheese 11/13 | Change |
|---------------|-----------------|-----------------|--------|----------------|----------------|---------|--------------|--------------|-----------|
| Nov-15 | \$15.41 | \$15.41 | \$0.00 | 22.975¢ | 24.100¢ | (1.13¢) | \$1.657 | \$1.666 | (\$0.009) |
| Dec-15 | \$15.06 | \$15.06 | \$0.00 | 24.175¢ | 25.750¢ | (1.58¢) | \$1.604 | \$1.638 | (\$0.034) |
| Jan-16 | \$15.12 | \$15.12 | \$0.00 | 25.500¢ | 27.500¢ | (2.00¢) | \$1.614 | \$1.642 | (\$0.028) |
| Feb-16 | \$15.07 | \$15.07 | \$0.00 | 25.500¢ | 27.275¢ | (1.78¢) | \$1.640 | \$1.648 | (\$0.008) |
| Mar-16 | \$15.25 | \$15.25 | \$0.00 | 26.100¢ | 27.550¢ | (1.45¢) | \$1.665 | \$1.661 | \$0.004 |
| Apr-16 | \$15.43 | \$15.43 | \$0.00 | 27.475¢ | 28.325¢ | (0.85¢) | \$1.670 | \$1.675 | (\$0.005) |
| May-16 | \$15.73 | \$15.73 | \$0.00 | 28.550¢ | 29.900¢ | (1.35¢) | \$1.680 | \$1.700 | (\$0.020) |
| Jun-16 | \$16.16 | \$16.16 | \$0.00 | 30.000¢ | 30.925¢ | (0.93¢) | \$1.712 | \$1.732 | (\$0.020) |
| Jul-16 | \$16.55 | \$16.55 | \$0.00 | 31.075¢ | 31.550¢ | (0.48¢) | \$1.738 | \$1.773 | (\$0.035) |
| Aug-16 | \$16.73 | \$16.73 | \$0.00 | 32.000¢ | 32.875¢ | (0.88¢) | \$1.756 | \$1.785 | (\$0.029) |
| Sep-16 | \$16.82 | \$16.82 | \$0.00 | 32.750¢ | 33.850¢ | (1.10¢) | \$1.767 | \$1.788 | (\$0.021) |
| Oct-16 | \$16.78 | \$16.78 | \$0.00 | 33.250¢ | 34.500¢ | (1.25¢) | \$1.756 | \$1.788 | (\$0.032) |
| 12 Mo Avg | \$15.84 | \$15.84 | \$0.00 | 28.279¢ | 29.508¢ | (1.23¢) | \$1.688 | \$1.708 | (\$0.020) |

What's Bearish:

- Spot Market: Block cheddar fell 5¢ during the week to settle at \$1.57/lb, but barrels rallied on Friday, ending the week up 3½¢ to close at \$1.50¼/lb. 21 loads of barrels and 7 loads of blocks exchanged hands. Grade A NDM finished the week down 6½¢, settling at \$0.73¾/lb on 14 trades, but butter was quiet all week, closing unchanged at \$2.88½/lb with zero trades.
- Fluid Milk Northeast: Throughout the region, milk handlers are gearing up for Thanksgiving week as bottling is expected to slow, causing increases in surplus milk supplies. This week, Northeast milk production inched higher. Manufacturing milk supplies are mixed, steady to slightly higher.
- Fluid Milk Central: Milk production is holding steady in the North Central region, while some increases in production are showing up in the South Central. Weather has not impacted cow comfort. Class I demand is steady to higher as orders arrive to restock store coolers ahead of the holiday shopping weekend. With the block and barrel cheese markets showing uncertainty, orders for milk loads are lower for the week into Class III plants.
- Fluid Milk West: Farm level milk output is up in California. Requests for milk from bottlers are lower as some educational institutions will close next week. However, orders of milk and other seasonal fluid products from retailers and food service are inching up. Milk output is on the rise in Arizona. Favorable weather conditions are supporting the comfort of dairy cows. Milk sales into Class I are lower. Winter storm Ajax was present in New Mexico at the beginning of the week. Nevertheless, this storm had marginally affected dairy herds. As a result, milk production is mostly flat in the state. Milk sales into Class I are lower. Manufacturing milk volumes moving into Class III and Class IV are up.

- Cheese Northeast: Ample milk supplies to some processing plants encourage the region's cheddar production. Yields are higher, as sources notice comparative improvements in component levels. Interest in process cheese is mixed. Generally, orders are steady to lighter. Inventories are adequate for current buyer interest. Holiday cheese buying continues, supported by numerous cheese promotions and features.
- Cheese Midwest: Weakening cheese prices are increasingly hanging over cheese production scheduling decisions. The ever present factor of spot milk is at the core of the calculations, especially with long holiday weekends ahead this month and next. Manufacturers expect price narrowing toward the generally accepted normal situation where barrel cheese sells for a \$.0300 to \$.0400 discount to block cheese. Many manufacturers and brokers believe there will be future block weakness to narrow the price spread, rather than barrel strength. Sellers will have more milk to move as holidays approach. Spot milk for Thanksgiving next week is being discussed in the \$3.00 to \$4.00 under class range. Cheese manufacturers feel confident in holding out for desired discounts through the holidays due to the volume of milk sales offers coming forward, including from even milk suppliers who normally do not offer spot milk. Most manufacturers are generally able to easily fill cheese orders.
- Cheese West: Cheese production is steady in the region, with balanced milk supplies coming into cheese plants. Strong domestic retail demand for cheese is continuing into the Q4 holiday season. The pull from food service and pizza makers is good. Manufacturers report solid demand for natural varieties of cheese. However, the call for process cheese is lighter. Inventories of cheese barrels are long. Some manufacturers are working to clear stocks through the exchange.
- International: This week's GDT auction saw the Dairy Price Index decline 7.9%. After 4 consecutive auctions of price increases, this is now the third consecutive decline. WMP fell the most (-11%), followed by SMP (-8.1%). Cheddar cheese lost 5% to a U.S.-equivalent \$1.30/lb.

Recommendation:

Barrel cheese continued to be offered in this week's spot market, with 21 loads trading, to just 7 loads of blocks. This is down from last week's 38 loads, but we have a holiday week ahead of us which typically means discounted spot loads head towards manufacturing. Domestic demand remains strong, though we are getting closer to the end of the Holiday demand window. People in the industry we spoke with this week think there is not much upside for cheese prices over the next 3-6 weeks at least. That said, in Friday's spot session, barrels rallied 8¼¢, which helped it finish the week higher. After several weeks of heavy barrel trading, are we beginning to see the end of the excess supply? It's hard to say, and next week's holiday-shortened trade will most likely provide little insight. One sleeper to watch is the dry whey price. Dairy Market News updates this week reported stocks are balanced to tight from coast to coast, with good demand. Dec-Feb dry whey futures all settled below 26¢ this week. We might eventually see a move higher in this market if demand continues to be decent and cheese output declines. Every penny higher in dry whey raises Class III by 6¢. Current spot prices work out to about \$14.50 Class III, but weekly NDPSR numbers continue to be at a premium to spot. Thus, Dec and Jan Class III at \$14.77 and \$14.76 are trading at about parity to spot. If spot barrels can continue to find a bid going in to next week, we might see a small rally up front. Technically, these contracts have been beaten up badly the past few weeks and are due for a bounce as well. For that reason, we wouldn't sell Q1 at current levels, but would wait for some price strength to sell in to. We wish all of you a wonderful weekend, and safe Thanksgiving.

Note: There will not be a report next week, in observance of Thanksgiving. Dairy markets at CME Group are closed both Thursday and Friday.

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