

The KDM Dairy Report – December 4th, 2015

What's Bullish:

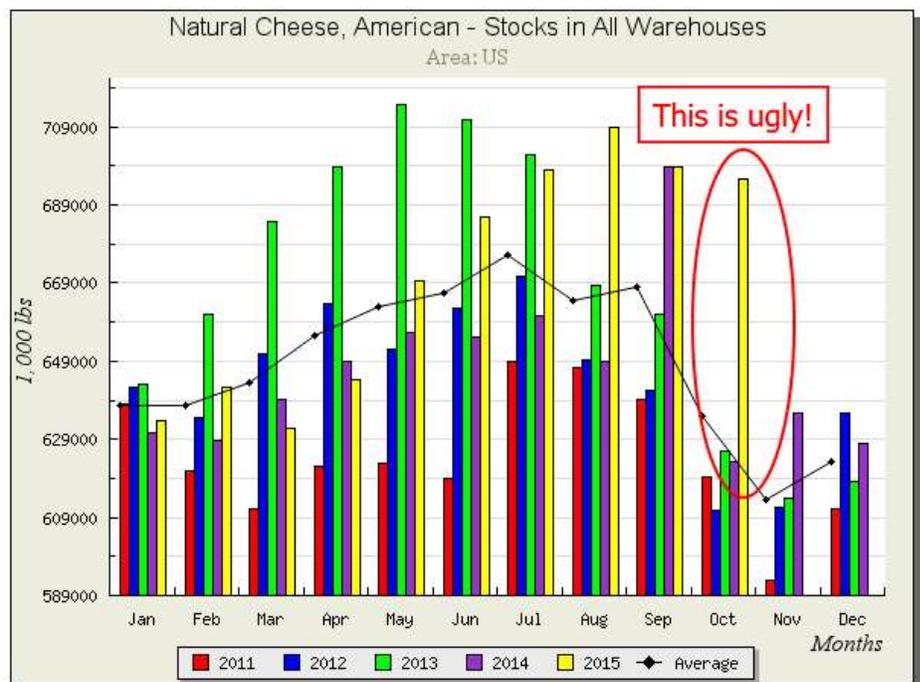
- Weekly cold storage numbers indicate both cheese and butter stocks experienced a strong, seasonal drawdown during November. Butter holdings at USDA-selected storage centers fell 35% over the month, while cheese holdings declined 6%.
- Dairy Cow Slaughter for the week that ended 11/21 totaled 59,500 head, up 7.6% vs. the same period a year ago.
- This week's Global Dairy Trade auction saw the dairy price index rise 3.6%, the first increase in three auction events. Gains were led by butter, up 5.7% and whole milk powder, up 5.3%.

Futures Month	Class III 12/04	Class III 11/27	Change	Dry Whey 12/04	Dry Whey 11/27	Change	Cheese 12/04	Cheese 11/27	Change
Dec-15	\$14.61	\$14.58	\$0.03	23.700c	22.775c	0.93c	\$1.580	\$1.591	(\$0.011)
Jan-16	\$14.28	\$14.35	(\$0.07)	25.350c	24.500c	0.85c	\$1.563	\$1.582	(\$0.019)
Feb-16	\$14.50	\$14.69	(\$0.19)	26.250c	25.250c	1.00c	\$1.586	\$1.615	(\$0.029)
Mar-16	\$14.92	\$15.06	(\$0.14)	27.050c	26.000c	1.05c	\$1.625	\$1.650	(\$0.025)
Apr-16	\$15.26	\$15.22	\$0.04	27.900c	26.475c	1.43c	\$1.657	\$1.664	(\$0.007)
May-16	\$15.60	\$15.47	\$0.13	29.800c	27.800c	2.00c	\$1.685	\$1.684	\$0.001
Jun-16	\$15.96	\$15.80	\$0.16	30.675c	28.575c	2.10c	\$1.712	\$1.711	\$0.001
Jul-16	\$16.28	\$16.07	\$0.21	30.925c	29.225c	1.70c	\$1.745	\$1.735	\$0.010
Aug-16	\$16.46	\$16.27	\$0.19	32.000c	31.050c	0.95c	\$1.758	\$1.750	\$0.008
Sep-16	\$16.59	\$16.44	\$0.15	33.000c	32.250c	0.75c	\$1.769	\$1.759	\$0.010
Oct-16	\$16.54	\$16.29	\$0.25	33.000c	30.900c	2.10c	\$1.765	\$1.746	\$0.019
Nov-16	\$16.39	\$16.22	\$0.17	33.250c	32.000c	1.25c	\$1.748	\$1.735	\$0.013
12 Mo Avg	\$15.62	\$15.54	\$0.08	29.408c	28.067c	1.34c	\$1.683	\$1.685	(\$0.002)

- Fluid Milk West: Farm level milk output is steady in California. Fluid milk intakes moving into Class 1 and Class 2 are noticeably increasing. Orders from bottlers are improving as schools reopened during this week. In addition, bottled milk demand from retailers and food service is seasonally inching up.
- Dry Whey Northeast: Prices increased at the bottom of the range based on f.o.b. spot sales information. Cheese processors saw an increase in milk supplies over the holiday weekend, which improved dry whey production rates and relieved some tightness in the region's dry whey inventories. Dry whey orders are good, with light trading occurring in the resell market.
- Dry Whey Central: Prices are higher on the bottom of the range while steady on the top of the range and across the mostly series on light f.o.b. sales. Several cheese manufacturers report flat Class spot milk prices, plus a financial return from skimming and selling cream, are helping them cost-effectively meet end of the year cheese orders. This is also netting more dry whey on a weekly basis, but many manufacturers indicate dry whey inventories are not burdensome. In fact, some producers indicate inventories are short of near term order fulfillment.
- NDM East: Prices are steady to higher in the range and mostly series. NDM production was heavy during the holiday weekend, but activity slowed this week as Class I sales recovered. Regional producers' stocks are comfortable, at light to moderate levels.
- NDM Central: Prices for Central low/medium heat nonfat dry milk shifted higher on the bottom of the range and mostly series. Market buyers continue to take a wait and see attitude, as they believe availability of NDM loads is not of much concern. However, some Central manufacturers report their holdings are insufficient to fill both spot and contract needs.
- International: Australian milk production is showing signs of struggling to maintain desired volumes in some areas where dry conditions are developing. Southeastern Australia is a significant milk producing area which is beginning to have continuing dry weather. Eastern Victoria is now considered dry, resulting in concerns that milk production will suffer. Northern Victoria and Southern New Wales are also now struggling with increasing dryness and high irrigation water prices, which have reduced milk volumes in those areas. These reductions will be challenging to recover as the milk season progresses. Overall milk production is slowing with concerns that late into summer may yield negative growth in production.
- International: New Zealand milk production is trending lower on the shoulder. Expectations for lower milk production remain and pasture conditions have not abated those concerns. Previous milk production forecasts are expected to be lowered as pasture conditions contribute to bringing milk production below expectations.

What's Bearish:

- Spot Market: Blocks lost 6¼¢ on the week to settle at \$1.51¼/lb on 16 trades, while barrels gave up 6½¢ to close at \$1.48½/lb on 13 trades. Butter saw its first decline in weeks, losing ¼¢ on Friday to settle at \$2.09¼/lb with no trades, but Grade A NDM finished the week up 5¼¢ to \$0.78¾/lb on 18 trades.
- Cold Storage Report: Butter stocks at the end of October were 21% higher than a year ago, according to USDA. American cheese stocks were 12% higher than last year, while total cheese stocks jumped 15%.
- Dairy Products Report: Cheddar cheese output in October was up 0.6% vs. a year ago, while



total cheese output increased 1.5%. Butter production, however, was 1.7% lower than Oct '14.

- Fluid Milk Northeast: Northeast and Mid-Atlantic farm level milk production is increasing along seasonal trends. Milk pulls from Class I and Class II have strengthened, with schools resuming and heightened manufacturers' production schedules.
- Fluid Milk Southeast: Milk production is steady and fluid sales are stronger as bottlers add to orders. However, milk production in Florida is climbing at a steady rate. Sales are down compared to last week, but will likely increase moving to next week. Import milk shipments dropped significantly this week, as 20 loads moved into the state to end the import milk season.
- Fluid Milk Central: North Central area milk production is steady while there are some small week to week gains in the South Central. Milk volumes clearing into bottling facilities are trending lower overall compared to last week, with retail outlets posting fewer orders for milk items. Spot milk availability improved within several areas, and cheese plant operators took the opportunity to nab loads to meet higher production goals for the week. Cream availability varies by area, with buyers reporting an increase in offers originating from outside the Central region. Some Eastern cream is clearing into the Central.
- Fluid Milk Southwest: Arizona milk production is ramping up, heading into the seasonal flush. The cooler temperatures and dry weather are helping to raise cow comfort. Bottled milk sales are steady. Ice cream demand is below the latest summer's levels. Wintry weather conditions affected New Mexico by the end of last week. As a result, farm level milk production is slightly lower. However, manufacturing milk volumes are more than adequate.
- Fluid Milk Pacific Northwest: Milk production is mostly steady to slightly lower. Farmers are hopeful recent precipitation will improve soil moisture levels and build the snowpack for next year's growing season. Utah and Idaho milk production is steady. Manufacturers report no problems getting milk for processing needs. A few processors are buying additional spot loads of milk to run the plants at full production.
- Dry Whey West: Industry contacts note demand is steady and product is available. Inventories at manufacturers have become more comfortable.
- Cheese Northeast: Milk supplies are ample and lend to active cheese production in the region. Manufacturers are not anticipating problems handling likely increases in yearend holiday milk supplies. Reports indicate mozzarella interest has picked up, as orders increase beyond the previous week's level. Over-all, offerings and current demand are closely balanced. The market undertone is steady.
- Cheese Midwest: While cheese inventories are generally comfortable, the longstanding experience of strong seasonal cheese sales into January still resonates with cheese manufacturers and factors into current production. It will become more clear in the coming weeks whether that is true this year, or whether late year demand was pulled earlier in the year leaving retail and food service therefore less in need of cheese in December and January. Export demand is light, except to Mexico which has remained active.
- Cheese West: Cheese makers continue to see good domestic retail and food service demand for natural cheeses. Some manufacturers say orders for holiday goods are also quite strong. Cheese production is active as processors use available milk to run at or near full schedules. A few manufacturers are buying spot loads of milk in order to fill production runs. Extra loads of milk are generally available at or slightly above Class. However, some industry contacts say cheddar production is overwhelming the demand for cheese blocks and barrels. Inventories for cheese barrels are heavy, and although cheddar blocks may not be as plentiful, they are also long. Manufacturers are concerned that weak international sales, generally lighter demand for process cheese and increases in imported milk solids used in process cheese production may push cheese prices downward.
- The U.S. Dairy Export Council published a report this week, predicting the dairy markets may not rebound until 2017. Continued strong global milk production, combined with a drop in imports to China and Russia, have resulted in excess supply. These inventories may not get worked down as quickly as once thought, especially if milk production remains strong.

Recommendation:

November Class III was announced this week at \$15.30/cwt, making it the lowest settlement since May, 2012 (\$15.23). Unfortunately, the near term looks to head even lower, with Dec set to finish in the \$14's and the possibility of seeing some \$13's in Feb-Mar. While domestic demand has supported this market for much of the year, inventories are growing (see cheese stock graphic). It appears that at least some of the strong demand we saw this summer went in to storage. It remains to be seen if demand can remain at levels high enough, post holidays, to continue to support prices. Pressure in this week's spot market would seem to indicate that there is cheese out there to sell, while Dairy Market News updates this week painted a more negative picture, with Western block and barrel inventories both described as long. With current spot prices working out to about \$14.15 Class III, further erosion could get us in to those \$13's, even with the premium carried in the weekly NDPSR prices. It was just two weeks ago in our last report that we recommended holding off selling Q1 and waiting for a bounce. We never really got one. Bearish Cold Storage and Dairy Products reports, strength in the USD and continued strong milk output everywhere east of the Rockies are hanging over the market. While technically oversold, continued weakness leads into more weakness. Producers with little to no protection in Q1 should stake some risk protection, either selling futures or buying PUT options, or putting on a 3-way spread to protect against further price weakness. Hang on, the ride looks like it might get bumpy from here.

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