

The KDM Dairy Report – December 24th, 2015

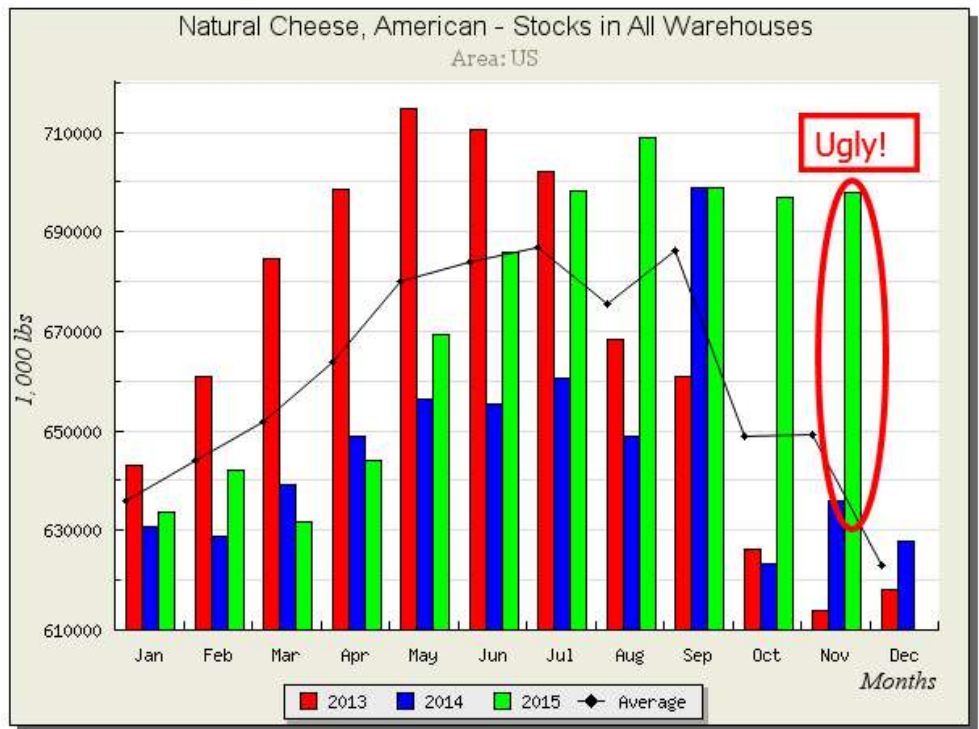
What's Bullish:

- Livestock Slaughter Report: 230,000 dairy cows were culled from the milking herd in Nov, up 5.7% vs. a year ago.
- International: Australia just had the first real extreme weather for the year, with the hottest December day for many years throughout Victoria and the hottest December night on record in many parts of the state as well. Some processors report milk volumes received are slightly below levels at this time last year. Pasture growth in Victoria, a substantial milk producing state, continues to decline due to dryness. While irrigation has historically helped maintain pasture growth, water this year is more expensive and difficult to source. This has led to purchasing more feed, which is also more expensive due to dry conditions. With lower milk prices this year, there has been some selling of cows, which reduces milk production. That is also being encouraged by higher beef prices. Some New Zealand milk producers will receive higher pay prices in the current milk year. The New Zealand dairy herd mid-year was just over 5 million cows, 3.3% lower than one year earlier and the first contraction in some years.

What's Bearish:

- Spot Market: Block cheese lost 3½¢ for the week to settle at \$1.40/lb on 10 trades, while barrel cheese was down 2¢ to close at \$1.43/lb on 7 trades. Grade A NDM was unchanged at \$0.76/lb on just 1 trade, and butter declined 2¼¢ to \$2.03/lb on a heavy 31 trades.
- Cold Storage Report: American cheese stocks at the end of November were 10% higher than a year ago, while total cheese stocks were up 13%. Butter stocks were 23% higher than last November, according to USDA.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic regions is mostly flat, although output tends to be somewhat higher in New York. With declines in bottling orders and shifting of milk to processing, capacity production is likely for both churns and dryers over the course of the holiday week.
- Fluid Milk Southeast: Milk production in the Southeast is level. Multiple supporting plants are taking in surplus milk, as bottlers shrink orders. Florida milk production is up slightly over last week. The rise has led to an increase in export milk shipments, from 10 spot loads last week to 60 this week. Bottling sales are fairly flat. Condensed skim markets continue to exhibit little spot movement. Loads are being discounted, with prices lower for both Class II and Class III. Heavy volumes of condensed skim are being cleared to nonfat dry milk processing. Heavy cream supplies will linger into next week, as some cream processing plants will remain closed until the New Year.
- Fluid Milk Central: Milk production is generally steady to higher. Milk availability on the spot market is higher. Prices range from \$7.00 to \$3.00 under Class. Sales into bottling are trending sharply lower as the week advances as most K-12 and many higher education institutions enter the semester break. Class II end uses are lower as several ice cream operations scheduled closures over the holiday weekend. Cream interest is light for Class II end uses.
- Fluid Milk Southwest: Despite winter storm Ferus is bringing rain, snow, and high winds to California, milk production is steady to higher. Sales into Class 1 and Class 2 are trending lower as some bottling plants will be closed over the extended holiday weekend. In addition, most schools will be closed during the winter break period. As a result, milk volumes clearing into Class 4a (butter/NDM) are increasing. Temperatures continue dropping in Arizona. This is boosting comfort of milking cows. Consequently, milk production is still inching up. Some producers note an increment in the butterfat component level of the milk. Milk production in New Mexico is on the rise. Manufacturing milk volumes are heavy.

Futures Month	Class III 12/24	Class III 12/18	Change	Dry Whey 12/24	Dry Whey 12/18	Change	Cheese 12/24	Cheese 12/18	Change
Dec-15	\$14.48	\$14.52	(\$0.04)	23.600c	23.875c	(0.27c)	\$1.572	\$1.573	(\$0.001)
Jan-16	\$13.34	\$13.59	(\$0.25)	23.300c	24.000c	(0.70c)	\$1.481	\$1.499	(\$0.018)
Feb-16	\$13.41	\$13.75	(\$0.34)	23.000c	24.225c	(1.23c)	\$1.490	\$1.521	(\$0.031)
Mar-16	\$13.86	\$14.22	(\$0.36)	23.025c	24.000c	(0.98c)	\$1.537	\$1.566	(\$0.029)
Apr-16	\$14.25	\$14.64	(\$0.39)	23.775c	24.850c	(1.08c)	\$1.575	\$1.611	(\$0.036)
May-16	\$14.53	\$14.95	(\$0.42)	24.500c	25.800c	(1.30c)	\$1.600	\$1.638	(\$0.038)
Jun-16	\$14.98	\$15.35	(\$0.37)	24.750c	26.775c	(2.03c)	\$1.635	\$1.670	(\$0.035)
Jul-16	\$15.50	\$15.85	(\$0.35)	25.325c	28.025c	(2.70c)	\$1.686	\$1.715	(\$0.029)
Aug-16	\$15.90	\$16.14	(\$0.24)	26.500c	28.825c	(2.33c)	\$1.726	\$1.744	(\$0.018)
Sep-16	\$16.17	\$16.36	(\$0.19)	27.600c	30.000c	(2.40c)	\$1.740	\$1.760	(\$0.020)
Oct-16	\$16.04	\$16.36	(\$0.32)	26.800c	30.675c	(3.88c)	\$1.736	\$1.755	(\$0.019)
Nov-16	\$15.95	\$16.25	(\$0.30)	27.500c	31.000c	(3.50c)	\$1.728	\$1.738	(\$0.010)
12 Mo Avg	\$14.87	\$15.17	(\$0.30)	24.973c	26.838c	(1.86c)	\$1.626	\$1.649	(\$0.024)



- Fluid Milk Pacific Northwest: Milk production is steady and components are improving. Some milk is shifting back into manufactured products as bottling slows over the holidays. Weather damage created a few delays for milk shipping, but Utah and Idaho milk processors have not seen any drop off in milk production. Milk is readily available and additional spots loads are available as well.
- Butter: Manufacturers are ambivalent about churning during this unsettled market. Multiples are lower on cream loads, which benefits cost of production. However, with weak domestic demand and comparatively lower world prices, butter producers are hesitant to add to already sizeable butter inventories. At the end of November, butter stocks were at their highest level since November, 2009.
- Cheese Northeast: Production is steady to heavier as fluid milk demand slows with school closings for the holidays. Some smaller add-on orders are being shipped, as buyers hold back on sizeable purchases until the yearend holiday period concludes. Most packagers and processors will operate on holiday shortened schedules over the next two weeks, limiting the need for bulk cheese.
- Cheese Midwest: Cheese makers report good movement of cheese leading up to the winter holidays. Domestic specialty cheese, food service and retail demand have been good, but are slowing slightly. Cheese production is vigorous and cheese makers expect to run full schedules over the holidays. Inventories are building and adding to already heavy cheese supplies.
- Cheese West: Production is steady to higher. Domestic retail and food service sales have been good, but have slackened slightly as the holidays draw near. A few manufacturers are trying to get remaining annual contracts in place before the end of the year. Milk is readily available for processing and many cheesemakers expect to run at full production over the next two weeks. Industry contacts report a lot of cheese is available, especially cheese used for further processing.
- International: The US Dairy Export Council released a report this week stating that growing EU milk production is weighing on the dairy markets. Output is up 3% since milk quotes came off last April, while October output was up 4.7%. The extra output will put competitive pressure on US exports in 2016.
- International: Milk production in the E.U. has been stronger overall than previously expected during the final three months of the year. Higher than expected milk production during the final quarter of the year, ahead of the same period the previous year, is considered indicative of the potential for higher production during the first part of 2016. Typically milk production increases from January into May in the E.U. Caution is being voiced that beginning 2016 with atypically higher milk volumes could lead to keeping processing facilities very busy. There is concern about potential production bottlenecks next year. This is viewed as keeping pressure on prices next year, particularly skim milk powder leading to continuing intervention purchases, as well as whole milk powder. This view of 2016 suggests a challenge for a market recovery. Some of the increased milk production this year has gone into cheese manufacturing, where pre-Christmas sales have been especially strong. The European food industry is believed to be adequately stocked. This leaves potential buyers cautious and price sensitive. Particularly with skim milk powder being sold into intervention, for the first time since 2009, expectations are for pricing to remain near current levels for a while which lessens pressure to finalize transactions. Pricing for whole milk powder and skim milk powder have trended lower throughout 2015.

Recommendation:

In a holiday-shortened week, spot cheese continued to see pressure with prices sliding further by the end of the week. There really isn't much out there to cheer about. Production in the EU is strong, while domestically, east of the Rockies output continues to outpace demand as well. American cheese stocks remain elevated, just like last month and even increased slightly from October. With fluid demand sharply lower while schools are out, processors will be running on extended schedules to clear the milk over the coming two weeks. That means more manufactured dairy goods, including cheese, are going to get made. Orders are slowing and barrel cheese supplies, in particular, are long throughout the country. Low prices cure low prices, and it appears we will be heading through a tough stretch. But also remember, when everyone is convinced the market will be bearish for months on end, is usually the time something happens to shake the market. Just like we can't pick the top, nor can we pick the bottom. Producers with fixed contracts should be jumping on call options July-Dec to protect their upside. Current spot prices work out to about \$12.90/cwt milk. With more of the writing on the wall and prices approaching or lower than breakeven for most of 2016, we saw some aggressive selling in all Class III contracts this week, in what we would describe as panic selling by producers. Fear is a powerful motivator, as is the local banker. It remains to be seen how this aggressive hedging will ultimately pan out, but oftentimes, operations end up selling near the low. All that said as just another reminder to try to get that upside protection in place before the market reverses.

Note: We will be closed on 12/25 in observance of Christmas day, as well as on 1/1 for New Year's Day. There will be no report next week. On behalf of KDM Trading, Inc., we wish all of you a very Merry Christmas and Happy New Year. We appreciate your business!

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