

**The KDM Dairy Report – January 8<sup>th</sup>, 2016**

**What's Bullish:**

- Fluid Milk Northeast: Milk production in the region is at seasonal levels. Milk sales for Class I usage are active with the re-opening of most of the regions' educational institutions. As bottlers work on refilling the school pipelines, orders are expected to steadily improve.
- Fluid Milk Southeast: Milk production in the Southeast is even to increasing, but the region notes a significant rise in Class I sales, causing the bulk of milk targeted for manufacturing to re-distribute to bottling. Handlers continue to look to Mid-Atlantic to help support the surge in bottling additions. Cream supplies which were harder to clear last week are finding homes this week.

Futures Month	Class III 01/08	Class III 12/31	Change	Dry Whey 01/08	Dry Whey 12/31	Change	Cheese 01/08	Cheese 12/31	Change
Jan-16	\$13.68	\$13.56	\$0.12	24.075¢	23.700¢	0.38¢	\$1.509	\$1.505	\$0.004
Feb-16	\$13.55	\$13.75	(\$0.20)	23.000¢	22.750¢	0.25¢	\$1.501	\$1.528	(\$0.027)
Mar-16	\$13.86	\$14.18	(\$0.32)	23.250¢	24.475¢	(1.23¢)	\$1.530	\$1.562	(\$0.032)
Apr-16	\$14.30	\$14.54	(\$0.24)	24.000¢	25.025¢	(1.03¢)	\$1.573	\$1.594	(\$0.021)
May-16	\$14.66	\$14.85	(\$0.19)	24.500¢	26.125¢	(1.63¢)	\$1.606	\$1.623	(\$0.017)
Jun-16	\$14.90	\$15.20	(\$0.30)	24.525¢	26.800¢	(2.28¢)	\$1.633	\$1.650	(\$0.017)
Jul-16	\$15.15	\$15.65	(\$0.50)	25.250¢	28.000¢	(2.75¢)	\$1.660	\$1.698	(\$0.038)
Aug-16	\$15.54	\$16.11	(\$0.57)	25.975¢	28.975¢	(3.00¢)	\$1.697	\$1.738	(\$0.041)
Sep-16	\$15.82	\$16.35	(\$0.53)	26.250¢	29.950¢	(3.70¢)	\$1.725	\$1.764	(\$0.039)
Oct-16	\$15.93	\$16.40	(\$0.47)	27.250¢	29.850¢	(2.60¢)	\$1.734	\$1.766	(\$0.032)
Nov-16	\$15.86	\$16.29	(\$0.43)	27.500¢	30.000¢	(2.50¢)	\$1.719	\$1.758	(\$0.039)
Dec-16	\$15.75	\$16.21	(\$0.46)	28.250¢	30.250¢	(2.00¢)	\$1.705	\$1.749	(\$0.044)
<b>12 Mo Avg</b>	<b>\$14.92</b>	<b>\$15.26</b>	<b>(\$0.34)</b>	<b>25.319¢</b>	<b>27.158¢</b>	<b>(1.84¢)</b>	<b>\$1.633</b>	<b>\$1.661</b>	<b>(\$0.029)</b>

- Fluid Milk Southwest: Rainy conditions have been present throughout the week in the Central Valley. As a result, California farm level milk production is steady to lower. Heavy milk volumes are clearing into butter/powder processing plants. Condensed skim demand from yogurt manufacturers is increasing. Some dairy operators are stretching feed supplies until the new alfalfa hay crop becomes available in late Q1. At this point, dairy operators are importing hay from nearby states. Numerous rain showers are marginally lowering milk yields in Arizona. Class I sales are increasing as schools are back in session. Farm level milk output is lower in New Mexico. A significant number of dairy cows died last week due to the adverse impact of winter storm Goliath. Producers expect more deaths during this week and in the short term. Consequently, manufacturing milk volumes are down.
- Cheese Midwest: Manufacturers are resuming regular schedules following the winter holidays. Production is active with discounted milk available into next week. Although having Christmas and New Years on Friday this year cut into restaurant sales, cheese makers say food service demand has been relatively good. Domestic retail demand is also strong. Mozzarella demand is picking up as pizza companies resume production and push a little more in advance of the football playoffs and Superbowl.
- International: The view in Australia is that El Nino is near its peak and that leaves uncertainty as to whether summer rainfall will be below average or above. Irrigation water allocations and water remain expensive and the quality of feed grains remains variable. Some Victoria growers are putting more hay into storage, reducing currently available volumes, in expectation of a dry season ahead. Some crops and stored hay were destroyed by fires in central South Australia. High cull cow prices continue to induce some producers to reduce herd sizes to more easily cope with dry conditions. October 2015 New Zealand milk production as reported by DCANZ was 3,211 million MT, down 2.67% from October 2014.

**What's Bearish:**

- Spot Market: Barrel cheese gained a penny on the week with 9 loads trading, setline at \$1.54/lb. However, blocks gave up 4¼¢ on 2 trades to close at \$1.46/lb, NDM lost 2¼¢ on 13 trades to close at \$0.73¼/lb and butter shed 4½¢ on 21 trades to settle at \$2.03½/lb.
- Dairy Products Report: Cheddar cheese production in November was 2% higher than a year ago, according to USDA. Total cheese output was just 0.6% higher. The gain was led by Gouda, up 129%! Butter output was 4.4% higher than Nov '14.
- Fluid Milk Central: Handlers indicate milk production notched some increases in the north Central area while the south Central area noted some declines. The full effect of Goliath has yet to be determined in the south Central area as producers are still assessing damage to dairy livestock, feed, equipment, and buildings. Milk marketers indicate the tempo of sales is slower than during the holiday weeks as smaller operations resume accepting milk deliveries. Spot milk prices range from flat Class to \$4.00 under.
- Fluid Milk Pacific Northwest: Processors report plenty of milk for immediate needs. With many schools resuming sessions after winter break, bottling demand has increased. Utah and Idaho milk production is steady. Dairy contacts say the snowpack in the mountains exceeds the snowpack of last year. Many farmers are optimistic the snow will provide the water needed for next year's irrigation needs. Bottled processing is making cream more available in the West. Cream volumes are readily clearing into churns. Some ice cream plants are also taking some cream loads to restart production. Interest from sour cream and aerated cream makers is weakening.
- Butter: After the New Year's holiday, butter production is still strong throughout the country. Bottling processing is making cream more available for churning. Butter demand from retailers is seasonally light. In the Central region, there is some concern that Q1 needs were prefilled when prices were lower in December. As a result, new butter sales may lag in early 2016. In the Northeast, moderate shipments of unsalted butter are clearing into international markets. With supply above immediate needs, salted butter loads are clearing into cold storage.
- Dry Whey Northeast: Inventories are building due to robust production and sluggish domestic demand. Buyers are content with restricting purchases while gathering a clearer picture of the existing market.
- Dry Whey Central: Trading is light to moderate. While larger buyers have some contracts in place for early 2016, a portion of buyers are content to shop only to fulfill near-term needs. Dry whey production is active. Volumes of milk clearing through cheese are somewhat lower than during the holiday weeks, but some discounted milk loads are available and cheese manufacturers are taking advantage of those offers.
- Dry Whey West: End users note product is readily available. Demand has been light and spot sales are limited. Dry whey production is steady to higher. The general market tone is weak.
- NDM Central: Prices for nonfat dry milk are unchanged to lower on a weak market. With prices shifting lower on some U.S. and global indices, and strong U.S. currencies, market participants indicate this market is facing many challenges to regain footing. Although some larger end users have

annual or multiyear contracts in place, there are many mid and small size end users who are content to shop on a week to week schedule. Low/medium heat NDM production in the Central region is active. Inventories are building steadily.

- NDM Northeast: Prices are lower in a downward trending market. Drying operations in the region ran at capacity over the holiday weekend into the first half of this week. Resale price inquiries are frequent, however, little product is moving, as is the case in the f.o.b. spot market. Buyers are making purchases of low/medium NDM around their immediate needs, while searching out better price incentives, as a fairly competitive market develops. Producers' stocks are building. Sources report that interest is growing for Q2 needs, while describing Q1 as somewhat sluggish. The market undertone is weak.
- NDM West: Prices for low/medium heat nonfat dry milk are steady to lower, following movement on various pricing bases. The market tone continues to be weak. Sales in the f.o.b. spot market are light. Most buyers are purchasing low/medium heat NDM based on immediate needs. Some manufacturers are trying to clear up inventories at discount prices. Production is very active as heavy volumes of condensed skim continue clearing into NDM. Inventories are building.
- Cheese Northeast: Cheese production has been active during the final 2015 holiday weekend into the first week of 2016. Some larger plants operated heavier production schedules, while taking advantage of the increased milk availability and associated price discounts. Demand for cheddar is steady to higher. Best interest is for shreds and natural. Interest in Swiss is steady to lower. In general, new cheese interest is relaxed in its development as buyers assess stock levels and measure holiday sale volumes prior to placing orders. Wholesalers and retailers are projecting increased sales for the next few weeks leading up to the Super Bowl.
- Cheese West: Milk is still readily available for processing. Manufacturers are choosing to make cheese with the extra milk. Cheese production is active. Although domestic cheese demand has remained relatively good, inventories are building.
- International: Northern Europe continues to have a mild winter, which is helping to keep milk production higher. Many areas have experienced no frost. In fact, production has been so strong that some proposals to incentivize producers to lower milk output are circulating. Many expect milk production in 2016 to increase 1.3%. In Eastern Europe, milk production in Poland during 2015 was particularly strong. For the period January-November, production increased 2.4%.
- International: The first GDT auction of the year registered a 1.6% decline in the Dairy Price Index, led by WMP down 4.4%. Cheddar cheese gained 3.5% to a U.S.-equivalent \$1.34/lb.
- Dairy exports in November fell a sharp 24% vs. a year ago, according to the U.S. Dairy Export Council. Losses were led by WMP down 73% and butterfat down 59%. Cheese exports were down 7%. Total dairy exports were equivalent to 12.7% of domestic milk solids production, down from over 15% earlier in the year.

#### **Recommendation:**

The stock market just had its worst opening week after New Year, ever. The Dow and S&P 500 averages ended down more than 5%, while the tech-heavy Nasdaq shed more than 6.5%. Fears over the Chinese economy have renewed concerns about how much it will affect growth. Oil prices hit a 12-year low before recovering slightly by the end of the week. With these pressures, commodities in general were flat to lower for the week. Class III finished mostly in the red, despite a double-digit rally Jan-Jun on Friday. This could have been profit-taking by short-sellers, or the fact that we are seeing some stronger domestic demand for cheese leading into the football playoffs and Super Bowl. The freak blizzard in TX and NM definitely did some damage, but to put things in perspective, our weekly dairy cow cull averages about 50,000 per week. While the cattle losses there are horrific, we don't think there will be a major disruption to the milk supply at this point. In the short term, the inventory of cheese hanging over the market should continue to limit gains in both the spot market and Class III. If the market rallies further next week, we would see it as a selling opportunity for Q1 and Q2. We continue to recommend getting upside risk covered in the second half of the year via call options.

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