

The KDM Dairy Report – January 29th, 2016

What's Bullish:

- Spot Market: Both block and barrel cheese were unchanged for the week at \$1.46 and \$1.43, respectively, with no trades. NDM gained ¾¢ to \$0.71¾ on heavy volume of 24 trades, while butter notched a 5¢ increase to settle at \$2.22 on 13 trades.
- Cheese stocks at USDA-selected warehouses declined 3% (2.7 million lbs) over the period 01/01 through 01/25.
- Butter West: Churning operations say cream supplies are fairly well balanced. Although additional spot loads of cream are available, many processors are content to use the cream they have rather than seek out additional loads. Western

Futures Month	Class III 01/29	Class III 01/22	Change	Dry Whey 01/29	Dry Whey 01/22	Change	Cheese 01/29	Cheese 01/22	Change
Jan-16	\$13.73	\$13.72	\$0.01	23.650¢	23.650¢	0.00¢	\$1.519	\$1.517	\$0.002
Feb-16	\$13.89	\$13.78	\$0.11	24.225¢	23.475¢	0.75¢	\$1.527	\$1.517	\$0.010
Mar-16	\$13.88	\$13.75	\$0.13	23.750¢	23.325¢	0.43¢	\$1.525	\$1.512	\$0.013
Apr-16	\$14.00	\$13.93	\$0.07	23.875¢	23.925¢	(0.05¢)	\$1.534	\$1.528	\$0.006
May-16	\$14.25	\$14.27	(\$0.02)	23.875¢	23.575¢	0.30¢	\$1.561	\$1.561	\$0.000
Jun-16	\$14.65	\$14.65	\$0.00	24.500¢	24.275¢	0.23¢	\$1.600	\$1.597	\$0.003
Jul-16	\$15.04	\$15.07	(\$0.03)	24.850¢	24.250¢	0.60¢	\$1.639	\$1.640	(\$0.001)
Aug-16	\$15.50	\$15.55	(\$0.05)	25.500¢	24.750¢	0.75¢	\$1.679	\$1.686	(\$0.007)
Sep-16	\$15.74	\$15.85	(\$0.11)	26.500¢	25.050¢	1.45¢	\$1.699	\$1.714	(\$0.015)
Oct-16	\$15.92	\$15.95	(\$0.03)	26.500¢	26.475¢	0.02¢	\$1.715	\$1.728	(\$0.013)
Nov-16	\$15.88	\$15.92	(\$0.04)	26.775¢	26.500¢	0.27¢	\$1.711	\$1.719	(\$0.008)
Dec-16	\$15.85	\$15.90	(\$0.05)	28.000¢	27.000¢	1.00¢	\$1.710	\$1.715	(\$0.005)
12 Mo Avg	\$14.86	\$14.86	(\$0.00)	25.167¢	24.688¢	0.48¢	\$1.618	\$1.620	(\$0.001)

butter production is active. Most processors are busy fulfilling Q1 commitments. Manufacturers report domestic demand has been decent ahead of the upcoming spring holidays. Inventories are building, but manufacturers are not overly concerned and feel they are manageable. The new grading standards announced last week by the American Butter Institute will take effect at the CME Group next week. Sellers may be able to provide a Certificate of Analysis as an acceptable document for loads of butter traded on that exchange.

- Dry Whey Central: Prices were unchanged to higher this week, as some variably priced contracts factor in changes on indices. Buyers report they continue to search for well-priced loads from all sources. Spot load availability is light to moderate, as many manufacturers broadened the number of agreements in place with brokers/traders, thus decreasing the need to regularly sell via the spot market. Manufacturers report inventories are comfortable. Export sales to the Far East helped moderate end of month inventories, and those sales made recent active production trends less problematic as far as building holdings.
- Dry Whey West: Prices were steady to higher this week. Dry whey production is stable and inventories are balanced. Industry contacts say information requests for whey exports have increased.
- International: Cash flow issues continue to grow for many New Zealand dairy farmers as dairy prices have tumbled by more than half since early 2014. Dairy-related debt has ballooned to such an extent that banks are being downgraded by ratings agencies. It estimated that 80% of NZ farmers are operating below break-evens, with their debt representing 10% of total lending by banks. More heavily indebted New Zealand dairy farmers may be asked to sell out, as non-performing loans increase with lower forecast payouts.
- International: England's dairy farmers are set to see their income decrease by nearly half, due to a global oversupply of milk and slowing demand in China. The price paid for milk is the lowest in 9 years.

What's Bearish:

- Butter holdings in USDA-selected warehouses increased a whopping 80% (6.15 million lbs) over the period 01/01 through 01/25.
- Fluid Milk Northeast: As it stands, areas of the Eastern region are slowly recovering from the impact of the snow storm Jonas. The storm dropped 24-40 inches of snow in areas from the Gulf Coast to New England. There are reports of hauler accidents but no spilled milk involved. Missed pickups by haulers are being evaluated as milk handlers look for things to soon return to normal. In the Northeast and Mid-Atlantic regions, milk production is up slightly. Bottling orders are mixed following the heavy demand prior to the storm. Deliveries that were delayed over the weekend are being filled. Otherwise, bottling cuts have occurred this week, due to limited delivery routes caused by snow storm clean-up activity. Balancing milk supplies are moderate to heavy.
- Fluid Milk Southeast: Milk output is mostly steady. Some handlers are still digging out from the snow storm. Class I add-ons are being cut as shipments to some bottling facilities remain difficult. Thus, milk loads are being shifted to auxiliary manufacturing outlets. In Florida, milk production is moderately increasing. Sales are currently flat. Export shipments of milk moved higher. Sources report 40 spot loads moving out of the state this week, compared to 25 loads last week. East cream multiples range 1.10-1.25. Churning is heavy and butter makers are being offered a lot of cream.
- Fluid Milk Central: South Central milk production is trending gradually higher at conventional operations as the calendar advances and weather conditions improve. Although there is less milk in the area, because of recent dairy cow losses, many plants are once again receiving close-to-normal milk volumes for processing. In the North Central region, conventional operations report milk is trending higher along with steady advances in component levels. Some Central cheese plant operators reported they've lost some pizza cheese sales recently due to sluggish demand along the East coast.
- Fluid Milk West: Milk output is steady to higher in California. At this point of the season, the weather conditions are favorable to dairy herds. Manufacturing milk volumes are sufficient. Comfortable temperatures for milking cows are helping to rise the milk yields in Arizona. In addition, fair/good feed is readily available. Manufacturing milk volumes moving into processing plants are stepping higher. Sales into bottling plants are flat as the pipeline for K-12 schools is full. Condensed skim volumes moving into NDM dryers are steady to higher. Throughout the week, the climate has been advantageous for dairy herds in New Mexico. As a result, farm level milk output is higher than last week. Cream supplies are readily available in the West. Cream volumes continue to be clear into butter churns as regional demand for butter is inching up. In addition, some cream supplies have been used to make ice cream, cream cheese and sour cream.
- Fluid Milk Pacific Northwest: Utah and Idaho milk production is steady to slightly higher. Relatively mild winter temperatures are aiding in cow comfort. There is plenty of milk to meet processing needs.

- Butter Northeast: Northeast butter production is heavier for some, as churning surpasses demand. Cream supplies were readily available over the weekend into the early part of the week. This was relatively due to the winter snow storm, which increased Class I demand and immobilized cream distributions to cream user facilities in the region. Retail butter purchases dropped slightly this week. Retailers are assessing their needs, following the impact of the winter snow storm. Manufacturers are moderately clearing 82% unsalted into international outlets. Bulk butter stocks for both salted and unsalted butter are building.
- Butter Central: The market is described as steady to firm, although market participants find it difficult to reconcile the current prices and stocks on hand. At most plants in the Central region, butter production is active. Cream supply contracts are light to moderate for Class II usage as manufacturers finish sour cream and dip orders for Super Bowl-related shopping. Ice cream and ice cream mix production are steady, but manufacturers indicate the orders for summer-related sports activities have not started. Cream is available in the Central region, and butter plant managers also report they are receiving spot cream loads from outside the region.
- Dry Whey Northeast: Prices in the region were unchanged this week, even as production rates in the dipped slightly. Manufacturers have adequate supplies of dry whey on hand, with reports of surplus product being offered by some.
- NDM East: Prices moved higher this week, due to lighter milk receipts moving into butter and powder plants over the weekend and into the first of the week. However, buyers' interest still primarily entails near-term needs, and overall, interest is light. Stocks of low/medium are moderate to heavy and expected to build.
- NDM Central: Manufacturers report interest is sluggish. Buyers have multiple sourcing options and they are willing to compare offers, as necessary, before committing to purchases. Low/medium NDM production is active throughout the region, but generally below full capacity. Low/medium heat nonfat dry milk inventories are building incrementally.
- Cheese Northeast: The winter snow storm Jonas, which blanketed areas of the Northeast, hindered the movement of milk supplies to several area cheese plants. However, retail sales and food service orders were slowed by the snow storm as conditions continue to make deliveries to stores and restaurants difficult. With prices shifting lower this week, the market undertone remains unsettled. Wholesale cheese prices for blocks and barrels retreated after three weeks of continuous increases. In the Northeast, prices for cheddar and Muenster declined, \$0.0100, while processed cheese prices declined \$0.0475.
- Cheese Midwest: Most orders for retail or food service/frozen pizza cheese that will be consumed before or during the event have been filled. Cheese manufacturers are now looking forward into spring. Current Midwest milk supplies used for cheese are less impacted by extra spot milk this week than several weeks ago, but there are pockets where this remains a factor. Some milk from the East has been shopped around eastern portions of the Midwest. Some Midwest cheese manufactured for sales to eastern customers was not sold/shipped as a result of the substantial snowstorms over the weekend. This resulted in some increase in manufacturer inventories. Many manufacturers are now focused on fundamentals of supply looking forward. Strong domestic milk production seems to be a likely reality in coming months. Midwest weather quickly bounced back from a cold spell and now looks to remain mild in coming weeks, which will keep the milk flowing. The same is true in the EU. The outcome will be continuing strong cheese production on both continents. That will also maintain greater competition in cheese export markets. Growing inventories are a resulting reality more manufacturers expect to have to deal with.
- Cheese West: Cheese production is steady. Manufacturers say there is enough milk to meet their processing needs, but additional loads of milk are not as readily available as they were over the winter holidays. Cheese stocks have grown, albeit slower than in some other regions. Inventories of barrels continue to be heavy and blocks are long. Industry contacts say cheese with some age is definitely long and harder to place. However, a few manufacturers report a little tightness for fresh cheese supplies. Domestic retail cheese demand is steady to slightly lower.

Recommendation:

With USDA weekly survey numbers continuing to show a strong premium vs. spot for cheese prices, front month Class III futures found a bit of support. While current spot numbers work out only to about \$13.25/cwt, the nearly dime premium being consistently reported brings that number more to about \$14.20/cwt. Realistically, then, front month Class III's may be trading a slight discount to the spot market, depending upon where cheese heads from here, and if the premium spread continues to be maintained. We feel the writing is on the wall, however. Milk production in the West is now on the rise, heading into their peak period, while the East and Midwest will soon follow in the months ahead. Similar to last year, cheese plants and other milk processors are wondering how they will handle the increased supply. And on Monday, the CME Group is making it easier for butter sellers to bring their product to the spot market with more relaxed grading standards. It seems hard to imagine that butter prices will be able to be sustained at current levels. Large holdings of cheese in cold storage also continue to weigh on the market, while current orders are slowing as Super Bowl orders have now been filled. There was some chatter this week about a little tightness in fresh cheese, so in the near term, it's possible we could see spot prices increase. This week the cash cheese market was quiet Mon-Thr, until unchanged bids for both blocks and barrels appeared in Friday's session. In our opinion, however, a 30-50¢ rally in Class III, Mar-June, should be sold. EU countries will be warming up soon as well, with seasonal increases in their milk output. We believe there will be heavy competition for any exports, which will put pressure on prices. The Apr-Jun avg settled at \$14.30 today. If you can cash flow there, we would consider marketing some of your production at that level, or target 25-30¢ higher. In any event, the outlook is still bearish going forward.

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