

The KDM Dairy Report – February 19th, 2016

What's Bullish:

- Fluid Milk Southeast: Milk production volumes are steady in the region. Only a few shipments cleared into manufacturing as the region saw an increase in Class I sales, prompted by a run on retail ahead of the region's wintery forecast. Sources report an overall increase in Florida milk production. But above average rainfall equates to reductions in tanker loads in some areas, as conditions distress cow comfort.
- Butter: Ample cream supplies continue to inspire active production at butter operations throughout the regions. However, demand for domestic holiday butter needs is increasing, and expected to advance through the remainder of Q1. This week, retail butter promotions doubled, compared to the previous week's advertisements. Export butter demand is reasonably active, with some additional forward sales receiving price assistance.
- CWT has accepted 11 requests for export assistance to sell 1.613 million pounds of Cheddar cheese and 2.315 million pounds of butter (82% milkfat) to customers in Asia, the Middle East and Oceania. The product has been contracted for delivery in the period from February through August 2016.
- Cheese stocks at USDA-selected storage centers increased just 1% over the first 15 days of February.
- Dry Whey Northeast: Prices for dry whey moved higher on both ends of the range. The bulk of dry whey production is tied to contract needs. Availability in the Northeast is limited with those looking for additional product having to look outside the region. The switching of some production from whey to WPC has reduced spot offerings. The current undertone conveys a firming market.
- Dry Whey Central: Prices are unchanged to higher on the range and mostly price series. The market undertone is steady. End users indicate f.o.b. offers are less frequent, potentially signaling more comfortable inventories on hand at manufacturers.
- Dry Whey West: Prices moved slightly higher on the bottom end of the range series. A few processors responded to various market signals and pushed for higher prices. Some manufacturers are reporting committed or comfortable inventories, while others in the industry say inventories are building. Whey production is active. A few manufacturers made block sales into export markets.
- Cheese Northeast: The cheese market is mixed, though the weekly average price adjusted higher for both blocks and barrels. Major cheese manufacturers are running full schedules, but inventories in general are seeing only marginal increases, due to the volume of committed cheese moving through production.
- International: Australian milk production through December 2015 was down 0.2% for the current season and down 4.6% for the month. Lower production is attributed to dry conditions as well as tighter margins that affected feeding. Queensland is experiencing industry exits while in contrast, Western Australia milk volumes are growing with higher farmgate prices there. Cull cow numbers are higher, due to higher beef prices, relatively less expensive replacement stock, and margin pressures for producers. Hay fodder prices are higher and not expected to decline until winter.
- International: New Zealand pasture growth had been slowing, adversely affecting milk production. Rains within the past week are offering hope of improvement in pastures and production. However, more cow culling is occurring, as producers seek to generate cash.

Futures Month	Class III 02/19	Class III 02/12	Change	Dry Whey 02/19	Dry Whey 02/12	Change	Cheese 02/19	Cheese 02/12	Change
Feb-16	\$13.82	\$13.87	(\$0.05)	24.500c	24.700c	(0.20c)	\$1.520	\$1.525	(\$0.005)
Mar-16	\$13.85	\$14.06	(\$0.21)	24.750c	24.475c	0.27c	\$1.527	\$1.540	(\$0.013)
Apr-16	\$13.81	\$14.11	(\$0.30)	25.000c	25.400c	(0.40c)	\$1.523	\$1.541	(\$0.018)
May-16	\$13.93	\$14.19	(\$0.26)	25.000c	25.900c	(0.90c)	\$1.531	\$1.547	(\$0.016)
Jun-16	\$14.34	\$14.50	(\$0.16)	25.750c	25.575c	0.18c	\$1.571	\$1.585	(\$0.014)
Jul-16	\$14.75	\$14.95	(\$0.20)	25.650c	26.025c	(0.38c)	\$1.613	\$1.624	(\$0.011)
Aug-16	\$15.12	\$15.29	(\$0.17)	26.000c	26.125c	(0.13c)	\$1.653	\$1.664	(\$0.011)
Sep-16	\$15.50	\$15.64	(\$0.14)	27.000c	27.000c	0.00c	\$1.684	\$1.690	(\$0.006)
Oct-16	\$15.79	\$15.80	(\$0.01)	28.000c	28.000c	0.00c	\$1.700	\$1.703	(\$0.003)
Nov-16	\$15.84	\$15.81	\$0.03	28.625c	28.525c	0.10c	\$1.700	\$1.701	(\$0.001)
Dec-16	\$15.82	\$15.82	\$0.00	29.500c	29.500c	0.00c	\$1.699	\$1.700	(\$0.001)
Jan-17	\$15.70	\$15.60	\$0.10	29.775c	29.775c	0.00c	\$1.684	\$1.682	\$0.002
12 Mo Avg	\$14.86	\$14.97	(\$0.11)	26.629c	26.750c	(0.12c)	\$1.617	\$1.625	(\$0.008)

What's Bearish:

- Spot Market: Blocks finished the week down ½c to \$1.48/lb on just 2 trades, while barrels were unchanged at \$1.48/lb on 5 trades. NDM inched ¼c higher to \$0.74/lb, but butter gave up 5½c to close at \$2.05/lb on heavy volume of 25 trades.
- Milk Production Report: Milk output in January increased 0.3%, despite a late-December blizzard that decimated some dairies NM and TX. Indeed, cow numbers declined 10,000 head from Dec, but nearly 20,000 head were lost in the storm, meaning other parts of the country saw increases. Output in NM fell 12%, and was down 6.7% in TX, but SD was up 12.2%, MI was up 5.9% and WI saw a solid 4.1% increase.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic are seeing year over year increases. Manufacturers report ample, but not burdensome, milk volumes moving into production. Bottling sales increased for the week, but are expected to level off in both regions. Demand for condensed skim is slow to moderate, as existing supplies exceed demand. Cream supplies are plentiful. Loads that some consider burdensome, are being shopped in other regions.
- Fluid Milk Central: Milk production in the region is steady to seasonally higher. As calving progresses, milk handlers and processors are bracing for increasing milk intake volumes in the coming weeks. According to milk processors in the North Central area, dairy producers have maintained herd sizes throughout the winter. With strong dairy replacement numbers in the North Central, some expansion in milk cow numbers is expected. Cheese makers are hesitant to take in more milk as commodity cheese orders trend lower, unless spot milk pricing offers an advantage. Spot milk prices for the week range from \$2.50 under to flat Class. Cream availability is unchanged from last week, with ample volumes clearing through the spot market. A few market participants noted that Class II buyers tended to contract lower cream volumes for Q1, compared to the previous year.
- Fluid Milk Southwest: In California, farm milk production is increasing, though milk processors indicate the rate of increase is slower than what was expected. Processors in Arizona indicate milk intakes are increasing both on week to week and on year to year bases. Several dairy operators within the state have expanded incrementally throughout the last year through purchases of dairy animals and through internal herd growth.

- Fluid Milk Pacific Northwest: Some milk processors in the region are noting a slight uptick in milk intakes. The recent warm temperatures have improved cow comfort. In addition, rains over the last month have eased drought conditions in some parts of the region. Pastures are starting to grow and green up.
- Over the first 15 days of February, butter stocks at USDA-selected storage centers increased 26% (3.8 million lbs).
- Cheese Midwest: Manufacturers are running full schedules with available milk. Some cheese makers are buying the occasional load of milk if they can get it at or below Class. While others say they would be willing to sell off an extra load of milk here and there to ease up a little on cheese making, they would rather make cheese in their own plants than sell the milk below Class. Domestic retail sales continue to be good, but demand for cheese used in manufacturing is a little slow. Inventories continue to be long, especially for cheese barrels and, to a lesser extent, for cheese blocks.
- Cheese West: Cheese production continues to move along at a steady pace. Domestic consumer demand has been good and has not dropped off much since the Super Bowl, but cheese inventories are tending to be long for barrels at both the manufacturers' and secondary markets' warehouses. Cheese blocks are moving, but the market for cheese barrels is still soft. Cheese export opportunities are still sluggish.
- International: In a Reuters news article this week, Arla Food's CEO said the global milk market was in crisis due to oversupply, and didn't expect demand to recover until the end of the year. Rising European milk production following the scrapping of EU milk quotas combined with China's slowdown in demand and a Russian embargo on European foods have put downwards pressure on milk prices.
- International: Increased milk production in the EU continues to be a challenge in terms of pricing and returns. Higher volumes are currently tending to move into butter, processed cheese and skim milk powder. The fact of skim milk powder being a top option, considering the factor of intervention pricing, reflects the struggle to market increased milk production in a global market with higher milk volumes in other regions as well. That also contributes to the overall lower prices prevailing for most dairy commodities within the EU. Eastern European milk production increases has resulted moving excess milk to other EU countries. This adds transportation costs, so some Eastern European processors are evaluating expansion and equipment upgrades.
- International: This week's GDT auction saw the dairy price index fall 2.8% from the last event, and the 4th consecutive drop. Declines were led by rennet casein, down 11.5%, and cheddar cheese, down 5.6%. Cheddar cheese settled at a U.S. equivalent \$1.15/lb.

Recommendation:

We're starting 2016 in an eerily similar place as we started 2015. The milking herd is just 2,000 head more than last Jan. Milk prices are well off their highs. World output, especially in the EU, is high. A year ago we heard talks of a wall of milk coming in the spring that would crush milk prices, but strong domestic demand in combination with processor capacity constraints kept that from happening. Are we in for a repeat? Domestic demand has held up better than expected post Super Bowl, while new interest in butter over margarine is sustaining butter prices above historical norms. Yes, a lot of milk will be produced this spring, but processors will still be limited by capacity. Class III's settle modestly lower this week, but the spot cheese market pretty much refused to budge, after weeks now of hearing how long barrels are. A large, private cheese plant we spoke to this week said they are sold out into Q2. With international fundamentals still mostly bearish EU, neutral Oceania, there seems little potential for prices to increase substantially in the near term, but we wouldn't rule out a mini rally, as prices just don't seem to want to move lower. Longer term, demand from China and the potential drop by Russia of its dairy import ban could go a long way to support prices later this year. Producers should be protecting existing hedges in the second half of the year with call options. Those with milk yet to market should consider buying "courage calls" to sell in to. The market is calm for now, but on edge. Everyone is waiting for the first move, whether it be a news event, weather event or economic event that will clarify market direction.

This material has been prepared by a sales or trading employee or agent of KDM Trading, Inc. and is, or is in the nature of, a solicitation. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that KDM Trading, Inc. believes are reliable. We do not guarantee that such information is accurate or complete and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades.

© Copyright 2016 - KDM Trading, Inc. All Rights Reserved – www.kdmtrading.com