

The KDM Dairy Report – March 4th, 2016

What's Bullish:

- Spot Market: Blocks finished the week up 4¢ to settle at \$1.52/lb and barrels gained 3¢ to close at \$1.46/lb. Trading was heavy on the block side, with 30 loads exchanging hands (15 alone on Friday), but there were just 4 barrel trades. Grade A NDM was down 2¢ to \$0.74/lb on 13 trades, but butter moved 6¼¢ higher to \$2.04/lb on 17 trades.
- Ag Prices Report: The Jan milk-feed ratio came out at 2.14, down from 2.27 the prior month and the lowest level since August. The lower the ratio, the more milk production and herd size tend to contract.
- CWT has accepted 6 requests for export assistance to sell 747,367 pounds of Cheddar and Monterey Jack cheese, and 1,102 million pounds of whole milk powder to customers in Asia and South America. The product has been contracted for delivery in the period from February through July 2016.
- NDM West: According to some industry participants, NDM supplies are committed to contracts. As a result, there is some tightness in the f.o.b. spot market. Low/medium heat NDM production is less active as moderate volumes of condensed skim are moving into ice cream manufacturing plants.
- The GDT dairy price index increased 1.4% vs. the last auction, the first increase since Dec. Gains were led by Rennet Casein up 14.9%, and WMP up 5.5%. Cheddar cheese, however, declined 0.7% to a U.S. equivalent \$1.15/lb.
- International: Australian milk production during the 2015-16 production season is now estimated by Dairy Australia to be lower than the previous season. A decrease of 1.4% is now forecast. The good start to the milk season did not hold. Growth slowed beginning in October as rains declined and margins increased, partly due to the need to supplement grazing with feed. Those factors were also coincident with higher water prices for irrigation. All of these factors led many Australian dairy producers to cut back on feeding to maintain herd size, leading to the current lower milk output. Dairy officials in Australia are not confident that in the remaining months of the season, through June, lost production can be recovered for the seasonal totals.
- International: New Zealand milk production in January was nearly flat with December. For the milk production season to date, which is about 2/3 completed, production is down from the previous season. Estimates at this point are down a couple of percent, or so. During February weather conditions were extremely and unusually dry in much of New Zealand, which adversely affected pasture growth. With the New Zealand dairy industry very pasture grazing focused, this has caused producers to struggle to maintain milk output volumes. In this final stage of the milk season, it is uncertain whether weather and rain will or can lead to pasture improvements sufficient to pull even, or ahead of last year milk volumes.

Futures Month	Class III 03/04	Class III 02/26	Change	Dry Whey 03/04	Dry Whey 02/26	Change	Cheese 03/04	Cheese 02/26	Change
Mar-16	\$13.78	\$13.66	\$0.12	25.500¢	24.250¢	1.25¢	\$1.517	\$1.510	\$0.007
Apr-16	\$13.53	\$13.50	\$0.03	25.575¢	24.000¢	1.58¢	\$1.489	\$1.490	(\$0.001)
May-16	\$13.53	\$13.53	\$0.00	25.700¢	24.000¢	1.70¢	\$1.491	\$1.498	(\$0.007)
Jun-16	\$13.63	\$13.84	(\$0.21)	25.625¢	25.175¢	0.45¢	\$1.494	\$1.529	(\$0.035)
Jul-16	\$14.04	\$14.21	(\$0.17)	26.025¢	25.475¢	0.55¢	\$1.534	\$1.552	(\$0.018)
Aug-16	\$14.50	\$14.60	(\$0.10)	26.250¢	25.000¢	1.25¢	\$1.580	\$1.596	(\$0.016)
Sep-16	\$14.77	\$14.94	(\$0.17)	26.100¢	26.250¢	(0.15¢)	\$1.607	\$1.622	(\$0.015)
Oct-16	\$15.00	\$15.20	(\$0.20)	27.000¢	26.275¢	0.73¢	\$1.623	\$1.648	(\$0.025)
Nov-16	\$15.00	\$15.20	(\$0.20)	27.700¢	26.775¢	0.93¢	\$1.624	\$1.653	(\$0.029)
Dec-16	\$15.00	\$15.19	(\$0.19)	27.700¢	27.500¢	0.20¢	\$1.626	\$1.647	(\$0.021)
Jan-17	\$15.02	\$15.25	(\$0.23)	29.600¢	29.600¢	0.00¢	\$1.629	\$1.658	(\$0.029)
Feb-17	\$15.05	\$15.25	(\$0.20)	30.500¢	30.500¢	0.00¢	\$1.641	\$1.658	(\$0.017)
12 Mo Avg	\$14.40	\$14.53	(\$0.13)	26.940¢	26.233¢	0.71¢	\$1.571	\$1.588	(\$0.017)

What's Bearish:

- Dairy Products Report: Cheddar cheese output in Jan was up 1.4% vs. a year ago and up 1.4% from Dec. Total cheese output was 2.6% higher than Jan '15, but down 2.6% from the prior month. Butter output declined 2.1% YOY.
- Butter stocks at USDA selected storage centers jumped 44% (6.44 million lbs) over the month of February. Cheese stocks increased 2% (1.5 million lbs) over the same period.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic is increasing at seasonal levels. Fluid milk into balancing is heavy.
- Fluid Milk Southeast: Milk output in the region is steady to higher. Redirection of milk shipments by handlers is continuing, as orders from bottling exhibit notable declines. In addition, some backup processing plants are offline, thereby producing burdensome milk receipts for other supporting plants. Milk production in Florida is still on the rise and expected to sustain moderate increases through March.
- Fluid Milk Central: Farm milk production is following seasonal trends throughout the region. Steady upticks in on-farm pickup volumes are occurring, especially in the South Central area. North Central haulers report regular pickups are also inching higher. Bottler interest is steady to lower throughout the region as school districts enter/exit spring break status.
- Fluid Milk Southwest: This week, a warm climate pattern is stimulating the milk yields in California. In Arizona, milk production continues to increase from week to week as the weather remains advantageous for the milking cows. Many processing plants in the state are busy trying to clear regular intakes. Farm level milk output is increasing in New Mexico. Manufacturing volumes moving into Class III are steady to higher. Alfalfa fields are starting to green in most parts of New Mexico. Cream supplies are higher throughout the West. Most of the cream volumes continue to move into butter manufacturing. According to some butter processors, demand for cream is slightly lower as the spring holiday orders have been filled.
- Fluid Milk Pacific Northwest: Favorable weather in the region is inching on-farm milk production upward. The warming temperatures are promoting pasture grasses to grow earlier than normal. In many areas of the region, ample precipitation and a good snow pack have filled water reservoirs and given farmers confidence of good water availability to start the growing season. Dairy farmers have good carryover of hay and other feedstocks as they enter the growing season.
- Butter: Manufacturing is strong in the East and West coasts as heavy cream volumes continue to clear into churns. In the Central region, butter churning is steady to lower as some processors are not buying cream volumes outside of contracts. In the East, print demand is fairly lackluster, but processors are anticipating a holiday spurt. In the Central region, butter sales related to the upcoming spring holidays are picking up. In the West, the domestic demand for print butter has waned as the spring holiday orders get filled. Butter inventories are seasonally building in all regions.

- Dry Whey Northeast: As strong cheese production promotes dry whey output, processors are easily meeting committed orders. However, uncertainty prevails amongst market participants as to the actual level of dry whey holdings in the region.
- Dry Whey Central: The market tone is mixed. Participants indicate offers from some manufacturers and many brokers/traders emerged this week. Offers include some dry whey loads from 2015 that are still within the one year storage life. Buyers are finding good value in those loads, as long as their plans are to use the loads in the near term. However, sellers indicate buyers are price conscious and ready to pass on offers that seem too costly.
- Dry Whey West: Manufacturers report a good amount of inquiries, but also some push back on prices at the high end of the range. Inventories are mixed. A few manufacturers report stocks are committed to tight, while others suggest their inventories are a little long. Some industry contacts say supplies are building, but not to the point of being problematic. A handful of processors are working to clear out any whey that may have some age in order to make room for new production.
- NDM Northeast: The region continues to see active production of low/medium nonfat dry milk. Low/medium NDM holdings extend beyond contracted volumes, as those inventories continue to build. Some East producers are displaying uneasiness with current inventory levels.
- NDM Central: Brokers/traders report end users were loath to finalize purchases before the upward price movement. With the advent of spring flush and upcoming active NDM production season, buyers are not rushing to purchase NDM at higher prices. Low/medium heat NDM production is active in the Central region. Demand from Class II has yet to fully emerge, so balancing plants are running hard to keep up with intakes. A few plants are finding opportunities to build NDM inventories through the purchase of spot condensed skim loads. Low/medium heat NDM inventories are building.
- Cheese Northeast: Cheese prices are showing a little weakness, in an unsettled market. Cheese production remains steady with milk output above a year ago levels. Packagers and processors are operating seasonally heavy schedules. Mozzarella manufacturers are seeing adequate customer interest from retail and foodservice accounts. Buyers are inclined to show some hesitancy, while timing purchases, as market prices fall.
- Cheese Midwest: As on-farm milk production increases through the spring, manufacturers are starting to face an oversupply. Some processors report slowing cheese production and turning away loads of milk as monthly supply agreements end. At the same time, a few other plant managers are encouraged to keep the vats full in order to meet the solid retail demand. Processors say domestic consumer demand has not subsided much after the winter holidays and Super Bowl. Although cheese sold through cut and wrap and food service markets is moving, there is still some concern about the long inventories of cheddar blocks and barrels growing further.
- Cheese West: Although inventories, especially for cheese barrels and blocks, are heavy and trending longer, western cheese production remains active. Most cheese makers have not been compelled to alter their annual cheese production plans for their facilities. Domestic cheese demand continues to be solid, while export opportunities are limited. Retail and food service leads the way for cheese sales activity. Manufacturers are making a lot of offers to end users to try to clear inventories.
- International: With seasonal milk production in the EU moving toward the flush, dealing with milk volumes will become even more challenging. Observers in Germany believe milk production for the first two weeks of February 2016 were 5% higher than the same weeks of 2015. Some dairy manufacturers are concerned that continuing year over year increases could tax the capacity of existing processing/manufacturing plants. Milk production in Eastern Europe remains strong overall.

Recommendation:

Bidders in the spot market were more aggressive this week, grabbing 30 loads of blocks and moving the prices of all but NDM higher. One would think there is a “disconnect” somewhere what with the spring flush period directly ahead of us. But if you’ll recall, this is exactly where we were a year ago with many warning of the wall of milk that was coming. Indeed, it came, but a combination of strong domestic demand and processor constraints (they simply could not run plants any harder) put a floor under prices. The crash never came. But neither did we rally. For all of 2015, monthly settlement prices only ranged \$2.28/cwt from high to low. In other words, there was price stability in a fairly narrow range. This is atypical for the dairy complex, which usually reacts violently (up or down) to supply or demand shocks. That fact was, there were none. And so we start 2016. Private cheese plants we have spoken to in the Midwest comment on large commercial cheese inventories, but state that demand is strong and most production is committed. We are beginning the year in a lower range (in the \$13’s), but still supported. Activity in the spot market is surprisingly aggressive. Who needs this product? When, if at all, will it all come crashing down? We certainly don’t know, but the report from the plants seems to suggest that domestic demand is still strong. We probably wouldn’t sell anything starting with a \$13, but would look to market some milk up front if prices recover to the mid to upper \$14’s. And of course weather could play a significant role this year as well. The spot market looks like it could still find a bid next week. Hedgers might want to consider buying some cheap call options up front, then selling in to them. Or, just put in target orders as described earlier, in the mid to upper \$14’s.

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