

The KDM Dairy Report – April 1st, 2016

What's Bullish:

- CWT has accepted 11 requests for export assistance to sell 2.216 million pounds of Cheddar and Monterey Jack cheese, and 3.948 million pounds of whole milk powder to customers in Asia, the Middle East and South America. The product has been contracted for delivery in the period from March-September 2016.
- Grains: While there was a bearish acreage surprise for corn, there was a bullish surprise for wheat acres (the lowest since 1970) and soybeans continued a 3-week rally. Further gains going forward will increase the cost of production at dairy operations.

Futures Month	Class III 04/01	Class III 03/24	Change	Dry Whey 04/01	Dry Whey 03/24	Change	Cheese 04/01	Cheese 03/24	Change
Apr-16	\$13.81	\$13.86	(\$0.05)	24.250¢	25.175¢	(0.93¢)	\$1.526	\$1.526	\$0.000
May-16	\$13.98	\$13.78	\$0.20	24.500¢	25.500¢	(1.00¢)	\$1.540	\$1.519	\$0.021
Jun-16	\$14.05	\$13.78	\$0.27	24.750¢	26.000¢	(1.25¢)	\$1.542	\$1.513	\$0.029
Jul-16	\$14.29	\$13.95	\$0.34	24.750¢	26.050¢	(1.30¢)	\$1.570	\$1.527	\$0.043
Aug-16	\$14.63	\$14.32	\$0.31	24.975¢	26.275¢	(1.30¢)	\$1.604	\$1.563	\$0.041
Sep-16	\$14.85	\$14.57	\$0.28	25.250¢	26.500¢	(1.25¢)	\$1.622	\$1.584	\$0.038
Oct-16	\$14.95	\$14.69	\$0.26	25.750¢	27.075¢	(1.33¢)	\$1.634	\$1.598	\$0.036
Nov-16	\$14.95	\$14.73	\$0.22	26.000¢	27.250¢	(1.25¢)	\$1.628	\$1.598	\$0.030
Dec-16	\$14.90	\$14.73	\$0.17	26.500¢	28.500¢	(2.00¢)	\$1.625	\$1.597	\$0.028
Jan-17	\$14.76	\$14.66	\$0.10	27.700¢	29.225¢	(1.53¢)	\$1.614	\$1.587	\$0.027
Feb-17	\$14.70	\$14.65	\$0.05	28.425¢	30.225¢	(1.80¢)	\$1.601	\$1.586	\$0.015
Mar-17	\$14.72	\$14.77	(\$0.05)	28.025¢	28.025¢	0.00¢	\$1.607	\$1.586	\$0.021
12 Mo Avg	\$14.55	\$14.37	\$0.17	25.906¢	27.150¢	(1.24¢)	\$1.593	\$1.565	\$0.027

- International: In Australia, spells of rain in Northern Australia have helped pasture growth in coastal regions, but supplies of hay remain tight in parts of Southern Australia. Dairy Australia also reported production of various dairy commodities for July 2015-January 2016, showing the following cumulative seasonal percentage changes compared to 2014-2015: butter, -4.5%; whole milk powder, -16.2%; buttermilk powder, -4.5%; cheese, -0.3%; and whey powder, -19.4%.
- International: New Zealand February 2016 milk production as reported by DCANZ, was 1.97 million MT, down 18.9% from January. There is significant discussion among dairy producers in New Zealand, expressing anxiety over recent reduction in the previously forecast payout for milk. While specific outcomes will vary by farm size, some estimates for the average New Zealand dairy producer milking 414 cows, will lead to a six figure revenue deficit over earlier payout projections.

What's Bearish:

- Butter stocks at CME-approved warehouses increased 14% over the period 03/01 through 03/28. Cheese stocks were flat.
- Dairy cow slaughter for the week ending 03/19 totaled 57,900 head, down 4.14% vs. the same period a year ago. YTD, the cull is slightly below last year.
- Fluid Milk Northeast: Class I demand has declined in all areas as many schools and colleges are on spring break. Mild spring weather has led to early stages of the spring flush in most areas of the East. The Mid-Atlantic region is enjoying mild weather conditions, encouraging greener pastures and milk production increases.
- Fluid Milk Southeast: Processing plants in the region are running full schedules to assist with the increased milk supplies. Milk production in Florida is ascending to the peak. Sales to bottling are lower than anticipated. Market sources are not expecting an increase in orders before fall. Milk shipments continue to climb as f.o.b. milk loads for export totaled 170 this week, 25 more than the previous week. Condensed skim supplies continue to strengthen as heavy volumes clear to Class IV production. Demand for skim solids remains weak. Trading on the spot market is being boosted by suppliers offering discounted loads to other regions in various Classes in order to lighten increasing milk volumes. Cream supplies remain strong, as holiday pulls are reasonably reduced.
- Fluid Milk Central: Milk production is trending higher throughout the region, with some southern areas getting closer to the peak. Milk processors indicate their plants are close to capacity with few opportunities for down time. Processors are working cooperatively to find room for all the milk volumes needing processing. In addition, Central manufacturers are also utilizing spot condensed skim loads from the East region. These loads, at discounted prices, are offering a break on input costs. Bottling demand is steady to higher. However, bottlers indicate there is some carryover in dairy cases after the holidays, so retail bottled milk orders are uneven. Spot cream loads are readily available within the region, as well as from the East and West regions, so buyers have ample choices on suppliers. Spot milk sales are active into Class III operations, especially into specialty cheese varieties. Milk load prices range from \$3.00 to \$1.50 under Class.
- Fluid Milk Southwest: Farm level milk output is steady to slightly higher in California. Daytime temperatures in the Central Valley, averaging 73 degrees, have been favorable to cows' comfort. Fair to good quality alfalfa hay is still growing in the state. Some alfalfa fields has been cut throughout the week. In Arizona, milk output is steady to higher, near to the spring flush. The butterfat component of the milk is steadily declining. Harvesting of good/excellent quality alfalfa hay continues in most parts of the state. A warm and dry weather climate is aiding to the milk yields in New Mexico. Fair to good quality alfalfa continues growing throughout the state. Cream supplies are readily available. Heavy cream volumes are moving into butter processing. At this point, most churns are running at full capacity.
- Fluid Milk Pacific Northwest: Milk production continues to increase seasonally. Some warmer temperatures and days without rain have promoted the onset of spring and cow comfort. Bottling demand is still in a bit of flux as various educational institutions start and end their spring breaks. Milk production is relatively steady in Utah and Idaho. Milk supplies remain in balance with processing needs. Farmers report silage, hay and normal water volumes should provide the foundation of decent milk production as spring begins.
- Butter: Increasing milk volumes clearing into bottling are making cream more available for churning. Production of butter is still strong throughout the country. Many butter manufacturing plants are running at full capacity. Butter processors are focusing on bulk production. Inventories are building ahead of summer. In the East, the butter market undertone is unsettled. In the Central region, butter demand from retailers is lower as shopping for the holidays was completed last week. Interest from food service is flat. In the West, demand is holding steady.
- Dry Whey: In the Northeast, output has increased on increased cheese production, with milk output levels in the early stages of spring flush. Stocks are building. The Central dry whey market undertone is weakening. Inventories are mixed as some plant managers indicate they only have dry whey loads for fulfilling contract needs. At other locations, inventories are building. With steady to higher milk production in the region,

manufacturers are sending increasing milk volumes into Class III production. The market tone for Western dry whey is flat to softening slightly. A few manufacturers have seen decent movement of dry whey, selling volumes of whey into export markets. However, some industry contacts suggest demand is a little light and buyers are taking a wait and see approach. Some industry contacts report stocks are a little long, while a few other processors have been able to aggressively work contract sales and stay ahead of their stocks. Production remains steady and active.

- NDM Northeast: Production levels are trending higher as milk output flourishes seasonally. As such, marketing agents are clearing condensed skim, well below class, into other regions as loads to drying become burdensome. Domestically, low/medium NDM interest is light to moderate, and uneven. Prospective buyers typically purchase NDM product for immediate needs only. Stocks of low/medium heat nonfat dry milk are steadily building.
- NDM Central: Prices are unchanged to lower. Buyers are willing to press for discounts. Buyers report offers are available from brokers and traders as well as directly from manufacturers. With no shortage of offers, buyers are pushing for discounts. Low/medium heat NDM production is ongoing, with some plant managers stating operations are nearly continuous as milk intakes increase seasonally. With an influx of condensed skim spot loads from the East and West adding to Central intakes, there is growing attention focused on handling holding times. Wait times for unloading are also increasing.
- NDM West: The market undertone is still weak. Demand is sluggish. According to some industry participants, there are numerous offers from manufacturers to brokers. Sales in the f.o.b. spot market have been quiet throughout the week. Some buyers/end users are in a wait and see attitude, anticipating lower prices in the near future. In general, low/medium heat production is active in the West as heavy milk volumes continue clearing into dryers. At this point, inventories are steady to building.
- Cheese Northeast: Cheese production remains active, at capacity levels, prompted by heavy milk output and weak Class I demand. Inventories in the region continue to expand. Cheese makers with aging programs are building supplies. As well, mozzarella stocks are increasing. Those expanding inventories are prompting increased retail promotions. In general, interest has declined following the holiday.
- Cheese Midwest: Production is at or near full capacity. Milk is readily available and pushing into the vats. Some processors report trying to sell excess spot loads of milk to ease the pressure. A few manufacturers are willing to take on the milk at \$2 to \$3 under Class to keep the vats full. Inventories for commercial cheese types are generally long, but manufacturers are finding specialty cheeses are moving well and stocks of these varieties are tighter.
- Cheese West: Cheese production continues to be active and milk volumes are generally adequate for most processing needs. Domestic cheese demand is steady to lower. Retail and food service sales are strong, but have slowed slightly over the holiday weekend. Export deals continue to lag due to the strong U.S. dollar and robust international competition. Western commercial cheese stocks are heavy.
- International: European dairy production and processing is strong and volumes continue to weigh on prices. January 2016 milk production was 5.6% higher than January 2015 according to Eurostat. February production throughout EU milk producing countries is observed to have strong, perhaps even stronger, by observers. In Germany milk production through the first half of March continued to seasonally increase. Last week, the UK government launched an Eatwell guide. That guide contains government recommendations halving the amount of dairy products in people's diets, 15% down to 8%.

Recommendation:

April Fools may have come a day early in the dairy markets this week. With little movement in the spot market (blocks finished the week down 2¢ while barrels were up ½¢) and few trades taking place, on Thursday, bidders began aggressively hitting offers in cheese futures. Class III futures moved along with the strength, being tied to cheese from a correlation standpoint. In addition, there was a bout of short-covering as the market reversed. We, along with most of our contacts in the industry are scratching our heads a bit, as from a fundamental standpoint, we are long cheese across the country, with inventories building, while heading into peak milk production season. It just doesn't make sense. Further, there was minimal follow-through buying on Friday, with most contracts finishing the day lower. One explanation was that Thursday was quarter-end, with a higher cheese settlement helping the balance sheets of physical holders of said commodity. Most we talked to believe this to be a hedge opportunity for producers, and we concur. If prices continue to find a bid next week, be prepared to sell into the strength. Until milk production slows, we don't see much opportunity for a significant price rise. We would also comment, however, on our recommendations the past couple weeks, and reiterate them now. No one knows when the bottom will be put in. The weekly gains in Class III futures contracts was significant, and from a technical standpoint, could be added to next week. The opportunity to cover existing hedges in the second half of the year just got a little more expensive. It is still affordable, however. We encourage producers to buy call options July-Dec to open up sold futures or fixed contracts with a local plant. And like we mentioned last week, just when everyone thinks prices can't go anywhere but lower, they usually don't! Trade smart! Hedge smart!

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