

The KDM Dairy Report – April 29th, 2016

What's Bullish:

- Ag Prices Report: The milk-to-feed ratio for March came in at 2.08, the lowest level since last July. With recent gains in grain prices and further declines in milk prices, the ratio looks bound to head lower, at least in the near term. A ratio below 3.0 generally discourages expansion.
- CWT has accepted 12 requests for export assistance to sell 2.465 million pounds of Cheddar and Gouda cheese and 5.307 million pounds of whole milk powder to customers in Asia, the Middle East, North Africa and South America. The product has been contracted for delivery in the period from April through October 2016.

Futures Month	Class III 04/29	Class III 04/22	Change	Dry Whey 04/29	Dry Whey 04/22	Change	Cheese 04/29	Cheese 04/22	Change
Apr-16	\$13.62	\$13.65	(\$0.03)	24.300c	24.300c	0.00c	\$1.505	\$1.507	(\$0.002)
May-16	\$13.17	\$13.30	(\$0.13)	23.650c	24.000c	(0.35c)	\$1.458	\$1.478	(\$0.020)
Jun-16	\$13.26	\$13.48	(\$0.22)	24.100c	24.500c	(0.40c)	\$1.460	\$1.488	(\$0.028)
Jul-16	\$13.51	\$13.85	(\$0.34)	24.275c	25.250c	(0.98c)	\$1.490	\$1.520	(\$0.030)
Aug-16	\$14.16	\$14.46	(\$0.30)	24.900c	26.100c	(1.20c)	\$1.553	\$1.577	(\$0.024)
Sep-16	\$14.67	\$14.90	(\$0.23)	25.875c	27.200c	(1.33c)	\$1.600	\$1.614	(\$0.014)
Oct-16	\$14.83	\$15.14	(\$0.31)	26.600c	27.200c	(0.60c)	\$1.612	\$1.631	(\$0.019)
Nov-16	\$14.84	\$15.13	(\$0.29)	27.650c	27.950c	(0.30c)	\$1.611	\$1.629	(\$0.018)
Dec-16	\$14.88	\$15.12	(\$0.24)	28.050c	28.050c	0.00c	\$1.613	\$1.628	(\$0.015)
Jan-17	\$14.95	\$15.20	(\$0.25)	28.075c	28.050c	0.02c	\$1.620	\$1.640	(\$0.020)
Feb-17	\$15.13	\$15.35	(\$0.22)	28.525c	28.525c	0.00c	\$1.644	\$1.653	(\$0.009)
Mar-17	\$15.29	\$15.43	(\$0.14)	28.500c	28.800c	(0.30c)	\$1.654	\$1.668	(\$0.014)
12 Mo Avg	\$14.36	\$14.58	(\$0.23)	26.208c	26.660c	(0.45c)	\$1.568	\$1.586	(\$0.018)

- Fluid Milk West: In California, farm milk production reached the peak during the last few weeks. Consequently, milk yields are slightly lower at the present. Many balancing plants are busy clearing heavy manufacturing milk intakes, but bottling orders from restaurants and grocery stores are up. According to California Department of Food and Agriculture, March 2016 pool receipts of milk in the state were 2.9% lower compared to the same month a year ago. In Arizona, high daytime temperatures, around 98 degrees, are taking a toll on milk yields. Bottlers are requesting moderate milk volumes to fill pipelines from various educational institutions. Bottled milk requests from retailers and food service are steady to higher this week.
- NDM East: Prices moved higher this week, as the market undertone varies. Some market participants suggest a strengthening market based on domestic and global perceptions. Producer stocks are moderate to heavy, but supplies are notably held with confidence. Domestic demand is light to fair, but export demand has improved. Loads clearing to international markets have eased growing inventories at some plants.
- NDM Central: Prices for low/medium heat nonfat dry milk in the Central region adjusted higher this week. The market tone is mixed. From an historical perspective, current Central NDM pricing is trending below prices of the last several years. That circumstance may be enough to encourage some NDM to buyers willing to build stocks.
- NDM West: Prices for low/medium heat nonfat dry milk shifted higher, following upward trends in various indices. The strengthening in prices has taken some industry participants by surprise. Some buyers/end users are taking a wait and see approach. On the other hand, some manufacturers believe that the market is firming.
- International: February 2016 milk production was down from one year earlier in a most Eastern European countries, including the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Slovenia, and Slovakia. Production was up in Bulgaria and Romania.
- International: Australia is experiencing contracting milk output as the production season moves through the second half. Two primary factors often cited are feed tightness and high priced water for irrigation of pastures. Expectations are for milk output this season to fall below the last season.
- International: New Zealand March milk production as reported by DCANZ was down 11.7% from February. March 2016 milk solids (the sum of total milk protein and fat) decreased 5.4% vs. February 2016 and down 1.7% from a year ago.
- International: A Rabobank dairy analyst this week suggested that global dairy prices will pick up by year's end. A drop in EU milk prices has dairy operations running at close to cash cost levels, which is starting to put the brakes on milk output. Producers are thinking more about survival than expansion.
- International: Fonterra said this week that it was seeing strong growth in imports. Imports into China, the world's top dairy buyer, jumped by 14% year-on-year, with demand for infant formula up 38%. Imports to China over 12 months to February were up 6%. And demand from other key areas is strong as well, with imports to Latin America up 10% in 2015, and imports to Asia, excluding China, up 8%. 85% of New Zealand dairy farmers have been operating at a loss since milk prices have been cut by more than half since 2014. But purchases by these countries have recently picked up as domestic stockpiles are finally beginning to drop.

What's Bearish:

- Spot Market: 39 loads of blocks and 13 loads of barrels exchanged hands this week, an indication that cheese inventories are increasing. Blocks finished the week down 5¼c to settle at \$1.37/lb, with barrels down 1¼c to \$1.41¼/lb.
- Weekly cold storage numbers indicate butter stocks at USDA-selected storage centers have increased 7% (1.8 million lbs) over the period 04/01 through 04/25. Cheese stocks over the same period are up just slightly (360,000 lbs).
- Fluid Milk East: Milk production is increasing as the spring flush continues to strengthen in most areas of the East. In the Northeast and Mid-Atlantic regions, milk output is adding to heavy milk supplies. Southeast milk production also notes increases, with milk volumes closer to the peak. Auxiliary cheese plants are aiding with the increased volumes. In Florida, temperatures have been unseasonably warm with highs in the 80s to low 90s, with very little rain. However, milk production made a slight climb. Spot export milk totaled 180 truckloads this week, up 50 loads from last week and 100 loads higher than a year ago. Condensed skim volumes clearing to Class IV production are substantial. Many manufacturers are running 7 day dryer schedules. Manufacturing cream supplies are readily available.
- Fluid Milk Central: Across the region milk production is at spring flush levels. Bottling demand is steady although plants are preparing for a slow down as educational institutions approach the end of the school year. Cream is readily available and is also being brought in from the East and West regions. Milk spot load availability is steady to higher and is reported at \$3.00 to \$5.00 under Class. There has been mention of milk disposal

in the Central region as plant operators run up against holding times on some loads. Processors are separating the cream and trying to find responsible outlets for the remaining skim solids, such as digesters.

- Fluid Milk Southwest: Milk production is higher in New Mexico as good weather conditions are boosting cows' comfort. Bottled milk sales to food service, grocery stores, and K-12 schools are up this week. Class II sales are flat. Sales into Class III are lower. Cream is readily available for processing and butter manufacturers are actively churning.
- Fluid Milk Pacific Northwest: Milk production is following seasonal patterns. Manufacturers say intakes are high, but milk handlers are not having much trouble finding homes for the milk. Bottling is steady. Milk production in Idaho and Utah continues to slowly climb. Processors report adequate supplies of milk for almost all processing needs. Spring weather is promoting good forage and pasture grass growth.
- Butter Northeast: Internal cream volumes for butter manufacturers are usually more than adequate and limit the purchase of surplus cream even though those loads usually have an incentive attached. Overall, butter production is heavy. Retail orders are strong; however, new production contributes to moderate stock growth. With latest year over year stock indications from the Cold Storage report pointing to much stronger inventories, market participants are even more perplexed about the markets' higher than expected seasonal butter prices.
- Butter Central: Cream is available from sources within the Central region as well as from western and eastern sellers. Interest is moderate, though, as cream buyers indicate some plants are not looking for addition cream volumes. Retail demand for print butter is trailing lower as prices moved higher during the last few weeks. Inventories are steady to building.
- Butter West: Cream is readily available and churning is active, with much of the production focused on making bulk butter. A few manufacturers are making print butter to satisfy the decent demand from retail and from private label requests. However, inventories continue to build.
- Dry Whey Northeast: Heavy cheese production is driving whey output as inventories build. Demand is fairly relaxed, with product moving mainly over contracts. Transactions in the spot market typically occur at the bottom of the pricing range.
- Dry Whey Central: Prices are steady to lower in a weak market. One to two whey producers have experienced an increase in production due to the availability of milk spot loads and an active whey stream from high cheese production. Many manufacturers continue to fill whey contracts for the upcoming months and Q3 while inventories build. There is plentiful whey in the marketplace from variable sources. A few industry contacts feel that prices will continue to weaken before leveling out. Buyer interest for spot loads is only present when the price is right.
- Dry Whey West: Prices continue to soften slightly. Manufacturers say the domestic spot market is quiet, but some whey is clearing into export markets. Inventories have grown a little. Production continues to be steady and active.
- Cheese Northeast: Cheese vats are processing cheese relative to seasonally heavy milk supplies. Manufacturers' inventories are growing as interest is only fair. The market undertone is unsettled.
- Cheese Midwest: Vats remain full as manufacturers work hard to manage high fluid milk intakes. Storage facilities continue to fill and inventories are long. Central producers report steady to moderate increases in orders. However, some feel that prices are beginning to reflect the large supply of cheese available.
- Cheese West: Vats remain full and a steady supply of milk is available for processing. Demand, especially for natural cheese varieties destined for retail and food service, is good and is helping reduce some of the inventory pressures being faced by manufacturers. The question is, 'will it be enough?' Cheese makers are using the demand to rotate and shift stocks in an effort to make room for the growing inventories. Industry contacts report the availability of storage is starting to become a concern. Some manufacturers are regularly asking end users about available warehouse space in an effort to find temporary homes for cheese.
- International: The EU dairy market is heavily oversupplied by strong milk volumes from EU producers. This has exacerbated the global milk oversupply. EU dairy exports have been good but not enough to move as close to balance as is desired. According to Eucolait, February 2016 milk production in the EU-28 is 9.9% higher than February 2015. Milk price weakness is expected in coming weeks.

Recommendation:

With talk of commercial storage starting to fill up with cheese, sellers in this week's spot market didn't hesitate to offer product. What was surprising was the volume of blocks at 39 loads, with just 13 loads of barrels. One would have thought those numbers would be reversed, based on the country having more barrel cheese than block at the moment. And we have an inverted market with the barrel price above blocks. As milk output increases in cheese-making country in the Midwest, we would expect sellers to be the aggressors over the coming weeks in the cash market. Eventually the block/barrel spread will be corrected, and with current fundamentals as they are, it implies a correction involving barrels moving lower. It appears that the spread between the weekly NDPSR prices and the spot market is also narrowing. As a result, Class III saw significant losses by week's end. Current spot prices work out to about \$12.70 Class III, so continued weakness will likely push prices up front even lower. Cheese prices haven't been this low since 2011. Not all is gloom, however. Butter managed to gain 9¢ this week, despite large inventories. Holders of butter are anxious to ensure they have enough product on hand for Q3 and Q4. With Americans switching more and more from margarine to butter, the extra demand is warranting carrying larger supplies. Longer term, the global situation is improving. China's dairy imports are on the rise, as are several other countries. Milk output in the EU is likely to stabilize, while in Oceania, producers continue to struggle with red ink. We think milk prices could turn around by Q4, perhaps sooner if the USA experiences some significant heat. Producers with fixed contracts in the 2nd half of the year should protect those hedges with call options, to open them back up to upside forces. Aug-Dec 16.50 call options settled at an average 17¢/mo today. Why not put in an order at 15¢ and see if you can't get them purchased? Producers who are still open to the market could also purchase these calls to sell in to, should the market rally, thus having their upside already covered. With the grain markets surging and managed money moving back in to commodities, don't expect milk to stay low forever.

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