

The KDM Dairy Report – May 13th, 2016

What's Bullish:

- Spot Market: Blocks finished the week down 2½¢ to \$1.28/lb, but came off its low of \$1.27 on Thursday and settled with a 10-lot bid at the close on Friday. Just 5 loads exchanged hands all week. Barrels settled at \$1.32/lb, up 2¢ for the week on decent volume of 22 loads. Buyers were the aggressors in NDM, snatching up 36 loads and pushing the price up 3¼¢ to \$0.81¼/lb, but butter gave up 1¼¢ to settle at \$2.03¼/lb on 13 trades.
- World Ag Supply & Demand Report: USDA upped their 2017 milk production forecast based on favorable feed availability and costs. However, they also increased their

Futures Month	Class III 05/13	Class III 05/06	Change	Dry Whey 05/13	Dry Whey 05/06	Change	Cheese 05/13	Cheese 05/06	Change
May-16	\$12.73	\$12.87	(\$0.14)	24.750¢	23.900¢	0.85¢	\$1.409	\$1.428	(\$0.019)
Jun-16	\$12.26	\$12.92	(\$0.66)	24.775¢	24.000¢	0.77¢	\$1.363	\$1.431	(\$0.068)
Jul-16	\$12.84	\$13.34	(\$0.50)	25.750¢	23.800¢	1.95¢	\$1.417	\$1.471	(\$0.054)
Aug-16	\$13.60	\$14.00	(\$0.40)	26.500¢	24.275¢	2.23¢	\$1.489	\$1.540	(\$0.051)
Sep-16	\$14.36	\$14.65	(\$0.29)	26.850¢	25.025¢	1.83¢	\$1.558	\$1.600	(\$0.042)
Oct-16	\$14.72	\$14.81	(\$0.09)	28.000¢	26.000¢	2.00¢	\$1.591	\$1.615	(\$0.024)
Nov-16	\$14.81	\$14.84	(\$0.03)	28.075¢	26.775¢	1.30¢	\$1.596	\$1.610	(\$0.014)
Dec-16	\$14.85	\$14.89	(\$0.04)	28.750¢	27.125¢	1.63¢	\$1.602	\$1.613	(\$0.011)
Jan-17	\$14.95	\$15.03	(\$0.08)	29.475¢	28.000¢	1.48¢	\$1.612	\$1.628	(\$0.016)
Feb-17	\$15.10	\$15.13	(\$0.03)	29.000¢	28.525¢	0.48¢	\$1.626	\$1.642	(\$0.016)
Mar-17	\$15.21	\$15.28	(\$0.07)	29.000¢	28.500¢	0.50¢	\$1.637	\$1.653	(\$0.016)
Apr-17	\$15.26	\$15.28	(\$0.02)	29.000¢	27.025¢	1.98¢	\$1.632	\$1.656	(\$0.024)
12 Mo Avg	\$14.22	\$14.42	(\$0.20)	27.494¢	26.079¢	1.41¢	\$1.544	\$1.574	(\$0.030)

- Class III price forecast due to predicted gains in both cheese and whey prices. USDA expects stronger domestic and export demand for cheese, NDM and whey will provide the necessary lift. Class III is forecast to average \$14.55/cwt next year.
- Despite the highest cheese inventories since 1984, a senior Rabobank analyst concludes that rising consumer demand and increased exports will eventually take care of it. Americans increased their annual cheese consumption by 2 lbs in 2015, to 34.5 lbs per person, and the trend is expected to continue. As views continue to change towards being more favorable to cheese and butter, companies are reformulating their foods to incorporate more dairy fat in them.
- Fluid Milk Southeast: The region's milk production is moving lower after hitting peak levels. Class I sales strengthened, with bottlers adding to orders. Fewer supporting manufacturing plants are operating full this week as milk supplies fall off. Farm-level milk output in Florida continues to decline. Export milk shipments totaled 160 loads, down 20 loads from last week.
- Fluid Milk Southwest: Farm milk production in California is flat to lower this week according to dairy processors. Wet conditions were present by the end of the previous week, shrinking dairy herds' comfort. Orders from grocery stores are up and steady from food service. Sales into Class 2 are steady to higher. Higher daytime temperatures, above 100 degrees, are taking a toll on milk yields in Arizona. Milk output is still increasing in New Mexico, but at a slower pace. According to some industry participants, milk output is near to hitting the seasonal peak and leveling off. Some out-of-state processing plants are helping to clear moderate to heavy manufacturing milk intakes.
- Fluid Milk Pacific Northwest: Milk production in the region is rising along seasonal trends, but most processors say they have capacity available to absorb the extra milk. Demand from bottling is steady. In addition, pulls from ice cream and other seasonal dairy products are increasing. Manufacturers report milk intakes are well balanced with processing needs. Cream supplies are mixed throughout the West. In some processing plants, cream is slightly tight as ice cream/frozen dessert and cream cheese makers are steadily pulling moderate cream loads. In addition, the butterfat component in the milk is seasonally trending lower.
- Butter Northeast: Most area churns are operating at a steady to higher rate and cream supplies are heavy. However, the majority of inventory is committed for near term customer utilization. Retail demand is good for private labels. Loads moving through export channels are fair.
- Butter Central: Churns across the region are active. However, several manufacturers are microfixing butter to meet upcoming customer needs. As temperatures rise in the South Central area, the demand for cream clearing to Class II is increasing. Many butter manufacturers have contracted cream through Q2 and Q3 and feel comfortable entering the warm season. Retail interest is strong. Overall, many industry contacts believe interest in butter is increasing. A large amount of butter makers feel well balanced with their inventories.
- Butter West: With plenty of cream available, butter making remains active. Most manufacturers are focused on bulk butter production, but are also making some print butter to meet immediate retail needs or co-pack obligations. Processors describe retail and food service demand as relatively good. Industry contacts say butter is moving fairly easily through existing contracts and through further buyer inquiries. Some buyers are working hard to maintain a stable level of butter stocks and to assure coverage for late year butter needs.
- Dry Whey East: Prices were steady to higher this week. F.O.B. spot sales prompted movement that increased prices at the bottom of the range. Production is active as supplies build, but decent domestic demand and improved export interest is moving the bulk of dry whey.
- Dry Whey Central: Production continues to be strong in reaction to active cheese making in the Midwest. However, several industry participants report an increase in sales. With long stocks, manufacturers are alleviating some inventory pressure by moving product at a lower price. However, specific needs for a handful of buyers are keeping particular brands of whey moving at higher prices. There is some report of international interest in the domestic whey market. The feeling is that there could be growth in exports if whey prices continue to be steady.
- Dry Whey West: Prices are unchanged this week and production is steady. Inventories are building a little, but manufacturers report their stocks are still comfortable and have not become burdensome.
- NDM East: Prices for low/medium nonfat dry milk (NDM) increased this week. Sources note that most manufacturers are firm on prices, as they feel confident in their position. Some market participants noted pressure to lock up bids as NDM prices moved unexpectedly higher.
- NDM West: Low/medium heat nonfat dry milk (NDM) prices moved higher. Sales outside contracts are active this week. Some industry participants are puzzled by the recent price strength at the CME Group, as supplies are readily available in the market. However, according to some processors, NDM supplies are tight and the market is getting stronger.
- Cheese Midwest: Cheese manufacturers continue running full schedules to handle strong milk production. However, contracts continue to be filled and a handful of manufacturers report increases in sales. There is still a considerable amount of cheese stocks in the region, but the recent

upturn in sales has returned some inventories to comfortable levels. Some cheese makers are limiting their output and seem determined to work through inventories to avoid rebuilding stocks.

- International: March 2016 milk production in Australia was -4.6% below March 2015. Financial stress on farmers is increasingly a matter of concern. The end of the milk season in New Zealand is approaching. Although milk production is not down as much as had been expected earlier in the season, production in New Zealand is weaker this year by several measures. March 2016 milk production is down 0.8% from March 2015, down 1.64% from March 2014, and down 11.75% from February this year. Lower milk volumes are affecting profitability as well as weaker milk prices are a factor. Expectations remain that milk production will weaken more than usual as the season nears an end, due to poor pasture conditions and lingering dryness.

What's Bearish:

- Fluid Milk Northeast: Milk production in the region has ramped up. Spring flush launched a few weeks ago; however, milk output has not been as aggressive as expected by some. However, current output is showing assertiveness, with significant surges observed across the region. Milk supplies into manufacturing are growing and slightly burdensome at some plants. The region is striving to manage heavy surpluses of condensed skim. Regional dryers are operating 7-day production schedules to process readily available volumes. Also, brokers are finding it necessary to heavily discount loads, while suffering substantial shipping costs as they trade to distant regions. Cream is ample with loads readily available from most suppliers.
- Fluid Milk Central: Weather has been conducive to high farm level milk outputs in the North Central area. Large amounts of milk are being trucked throughout the region to find a processing plant able to take on extra loads. There have been reports of some Central milk landing in the Western region for little to no cost over transportation. Some processors are at full capacity while others are welcoming extra loads of milk as resources allow. Regardless, manufacturers are running full schedules to manage milk intakes. Bottling demand is on a slow decline. Many universities have closed for the school year and other educational institutions are soon to follow. Spot prices are being reported at class price to \$4.00 under class. Some manufacturers report minor strengthening in cream interest in the South Central area. However, the majority of the Midwest has not seen an increase in cream demand just yet. Overall, there is still plentiful cream in the market.
- NDM Central: Low/medium heat nonfat dry milk prices are mostly higher. However, manufacturers report that spot interest is price sensitive. Resellers, too, note their buyers limit interest to offers carrying a discount to the current market. Buyers/end users view the current production trends as lending a bearish tone to the marketplace. Manufacturers indicate low/medium heat NDM production is ongoing and at peak output at most regional plants. Some milk intake volumes are clearing the separators, but after that, cream is moving on to further processing while some of the nonfat solids are shipping out for disposal.
- Cheese Northeast: Plants are maintaining full production schedules to manage heavy seasonal milk receipts. Producers' cheese stocks are building, particularly in cheddar-aging programs. Processors are seeing strong foodservice interest develop around provolone cheese. Overall, the market undertone is unsettled as prices trend lower.
- Cheese West: Milk is readily available and many western cheese plants are running at or near full schedules. Retail demand remains fairly good for most varieties of cheese, and a few manufacturers report sales of Italian cheese to be better than last week. However, some industry contacts suggest demand for American type cheese may have backed off a little. In addition, a few sources speculate there may be a lot of aged block and barrel cheese in storage. There are limited places to move these stocks with U.S. cheese still not fully competitive in international markets. The letup in demand, along with long inventories may be contributing to the downward pressure on cheese prices.
- International: Industry participants report that a plentiful supply of butter in other countries is being offered to American buyers. Reportedly, foreign butter manufacturers are pricing their product to compete with the U.S. market.
- International: The continuing high volumes of milk produced in the EU resulted in skim milk powder going into the EU intervention program last week. Additionally, 539 MT of skim milk powder entered the EU 365-day private storage program last week. Milk output increased in March, but at a slower pace than the prior month.

Recommendation:

Volatility finally showed up Class III futures this week as we saw both double-digit daily gains and losses. When markets behave like this, it's sometimes a sign that it's searching for direction and getting ready to make a move. Certainly we're still dealing with bearish fundamentals up front, but as we pointed out last week, there are some positive signs. Spot NDM gained 3¼¢ this week on heavy volume of 36 loads. When prices go higher on heavy volume, it might be indicating that buyers think a bottom is in and are getting more aggressive on their physical purchases. Likewise, barrel cheese increased 2¢ this week with 22 loads trading. Dairy Market News reports this week seem to imply that NDM manufacturers are holding inventory with confidence. Current spot prices work out to about \$11.85 Class III and \$13.70 Class IV. The last two big bullish moves in milk were led by Class IV. Should NDM and dry whey prices continue to inch higher, the spread between III and IV will increase and ultimately support Class III. Eating habits are changing and people are no longer shying away from real butter and other dairy fats. What looks like high dairy inventories could come under control more quickly with higher consumption. Time will tell, but we're leaning towards that scenario. While Class III and cheese futures finished the week in the red, dry whey futures settled higher across the board; more support in the powder complex. From a production standpoint, we are past the peak in the southern parts of the country, west to east. As warmer weather works its way north, milk production will eventually begin declining in the upper regions as well. Schools will let out across the country, freeing up more milk for manufacturing, but at the same time, demand for cream is on the rise as ice cream manufactures begin to ramp up production. Grilling season has begun and will improve in earnest over Memorial weekend. On the international side, we expect milk output in Oceania to struggle as farms struggle financially. Culling to raise cash is on the rise and should make for a weak start to their new milking season, come the end of our summer. Similar financial strain is hitting dairy operations in Europe and should limit further milk/herd increases. In summary, many have projected no milk price recovery until 2017, but we think it will come earlier, depending partly on how hot a summer we get in the Midwest. The bottom line though; we still think producers should be putting upside protection in place for milk they have already marketed, July-Dec. Call options got a little cheaper this week, so act on it.

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