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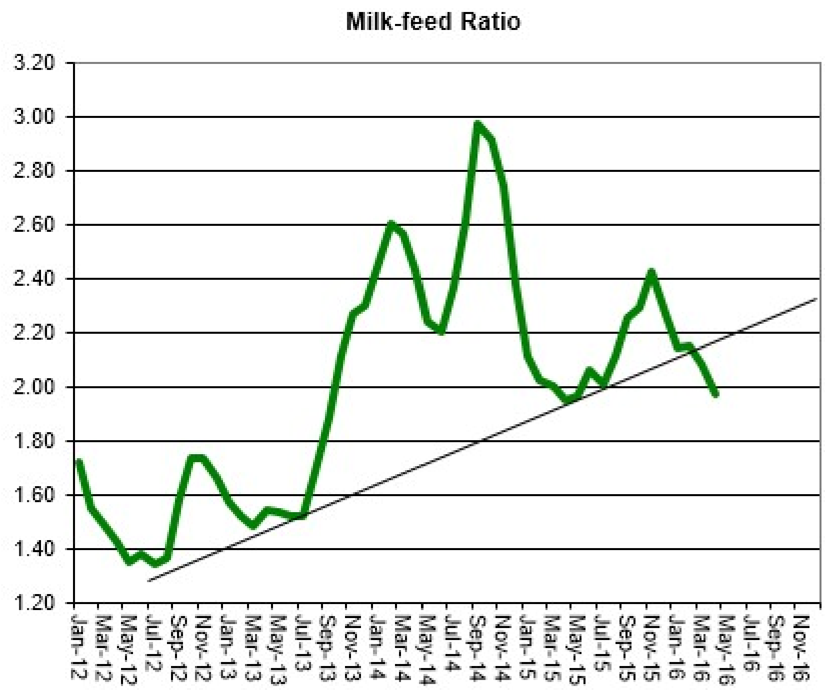
The KDM Dairy Report – June 3rd, 2016

What's Bullish:

Futures Month	Class III 06/03	Class III 05/27	Change	Dry Whey 06/03	Dry Whey 05/27	Change	Cheese 06/03	Cheese 05/27	Change
Jun-16	$13.16	$12.85	$0.31	25.475¢	25.250¢	0.23¢	$1.445	$1.416	$0.029
Jul-16	$13.91	$13.15	$0.76	25.725¢	26.250¢	(0.52¢)	$1.517	$1.440	$0.077
Aug-16	$14.56	$13.85	$0.71	27.550¢	27.250¢	0.30¢	$1.574	$1.509	$0.065
Sep-16	$15.00	$14.56	$0.44	28.300¢	28.000¢	0.30¢	$1.611	$1.573	$0.038
Oct-16	$15.21	$14.85	$0.36	29.250¢	28.875¢	0.38¢	$1.626	$1.600	$0.026
Nov-16	$15.32	$14.96	$0.36	30.050¢	29.500¢	0.55¢	$1.631	$1.607	$0.024
Dec-16	$15.30	$15.03	$0.27	30.350¢	29.750¢	0.60¢	$1.632	$1.615	$0.017
Jan-17	$15.28	$15.10	$0.18	31.225¢	30.375¢	0.85¢	$1.638	$1.617	$0.021
Feb-17	$15.42	$15.19	$0.23	31.250¢	30.000¢	1.25¢	$1.639	$1.629	$0.010
Mar-17	$15.50	$15.35	$0.15	31.250¢	30.025¢	1.23¢	$1.657	$1.638	$0.019
Apr-17	$15.60	$15.43	$0.17	31.425¢	30.025¢	1.40¢	$1.667	$1.638	$0.029
May-17	$15.60	$15.45	$0.15	31.425¢	30.025¢	1.40¢	$1.668	$1.642	$0.026
12 Mo Avg	**$14.99**	**$14.65**	**$0.34**	**29.440¢**	**28.777¢**	**0.66¢**	**$1.609**	**$1.577**	**$0.032**

- Spot Market: All Class III components were higher in this week's cash market. Blocks surged 6¢ to settle at $1.44/lb on 16 trades, while barrels gained ½¢ to close at $1.44½/lb on 17 trades. Grade A NDM increased 1¾¢ to settle at $0.81¼/lb on 13 trades, and butter was up 3½¢ to close at $2.10/lb on just 3 trades.
- Ag Prices Report: The decline in milk prices, combined with an increase in grain prices, put the April milk-feed ratio at 1.97, the lowest level since May '15. That milk-feed ratio has now broken its upward trend going back to 2012 (see graph).
- Fluid Milk Southwest: In California, farm milk output is steady to lower. Daytime temperatures above 100 degrees are lowering cows' productivity. Milk components are steadily decreasing. After the holiday weekend, Class I orders from grocery stores and restaurants are improving. Interest for flavored milk is active. Demands for Class II and Class III dairy products are higher, following seasonal trends. Moderate to heavy condensed skim loads are moving into NDM processing. Daytime temperatures are reaching 115 degrees in Arizona. Consequently, milk yields are trending lower. However, manufacturing milk intakes are sufficient to keep balancing plants busy. In addition, some processing plant operators are helping to clear milk surplus from the Central region. Milk production is slightly lower in New Mexico after reaching the seasonal peak in the past few weeks. Higher temperatures and humidity are promoting stress in cows. Class I requests are lower as K-12 schools finished terms during last week. However, orders from retailers and food service remain steady. Cream is readily available, especially for butter churning. However, less milk volumes are moving for standardization. Thus, cream supplies are slightly tight in some areas. Cream sales to ice cream/frozen dessert manufacturers are active.



- Fluid Milk Pacific Northwest: Dairy contacts say a lot of milk is available for processing. Milk production is at, near or just past spring flush. A few manufacturers are noting milk intakes are beginning to tighten in some areas. Bottling demand is slowing slightly as schools begin their summer breaks. Although milk intakes were a little sloppy over the recent holiday weekend, Utah and Idaho milk production is in generally good balance with processing needs.
- Butter: Churning remains active as cream volumes are generally plentiful throughout the nation. Inventories are generally increasing, however, some manufacturers are making print butter to stay current on immediate customer needs. Demands from retailers and food service are fair to good. In the Central region, several manufacturers are microfixing to cover short-term orders and also to meet Q3 needs. Overall, domestic demand remains good as buyers continue to seek coverage for Q3 and Q4 butter needs.
- Dry Whey Northeast: Prices are steady to higher on adjustments to contracts based on various pricing indices. As ice cream accounts begin to increase production, dry whey demand is seeing an uptick.
- Dry Whey Central: Recent growth in dry whey interest has allowed some market participants to alleviate inventory pressures. A few manufacturers report only light domestic interest. However, other contacts report strong spot sales domestically. In addition, at the current price point, U.S. whey is competitive in the international market. International interest is strong. Many sellers report exporting a large portion of their sales. The market undertone is firming.
- NDM: Prices are mixed on the range, but moved up on the mostly series. Higher international prices are helping to push up domestic prices. The market undertone is stronger. Demands from cheese and dry mix processors are active. In some cases, manufacturers' stocks are committed through the end of the year.
- Cheese Northeast: Milk supplies continue to encourage overall strong cheese production. However, extra supplies are not an issue at most plants as inventories build. In some instances, inventory volumes are heavily committed. Sources note good demand.
- Cheese Midwest: Vats are running at or near full capacity in the Midwest, and manufacturers forecast full schedules in June, as milk production shows little to no sign of slowing. However, several recent promotions have prompted increases in sales. A few manufacturers note sales for

provolone, specifically, have taken large strides. As June begins, industry contacts are optimistic for continual growth in sales and promotions. Buyers are showing interest in additional loads of cheese outside of contracts.

- Cheese West: Production remains strong as milk is readily available for processing. However, domestic cheese demand is firm and contracted commitments are taking a steady pull on cheese stocks. Inventories for almost all varieties of cheese continue to trend upwards, but retail and food service demand has been solid.
- CWT has accepted 2 requests for export assistance to sell 259,043 pounds (118 metric tons) of Cheddar cheese and 41,888 pounds (19 metric tons) of butter to customers in Asia and the Middle East. The product has been contracted for delivery in the period from June through November 2016.
- International: GDT prices firmed in this week's auction, with the dairy price index climbing 3.4%. Gains were led by butter milk powder up 14.2% and skim milk powder up 12.1%. Cheddar cheese had a strong showing as well, up 7.8%.

What's Bearish:

- Dairy Products Report: Cheddar cheese output in April was up 3.3% vs. a year ago while total cheese output notched a 1.4% increase. Butter output was 6.4% higher than April 2015.
- Weekly cold storage numbers continue to reflect a seasonal build in both butter and cheese stocks. Butter holdings at USDA-selected storage centers increased 5% (1.3 million lbs) over the period 05/01 through 05/30. Cheese holding were up 3% (3.2 million lbs) over the same period.
- Fluid Milk Northeast: Milk production in the region is still seeing peak output. A few plant shutdowns over the holiday led to heavy manufacturing over the weekend. Mid-Atlantic milk production is beyond the peak, but output remains strong, with good cow comfort. Fluid milk sales are steady to lower in both the Northeast and Mid-Atlantic regions.
- Fluid Milk Southeast: Milk production in the region is holding, as output remains steady. Drops in bottling sales over last week extend into this post-holiday week. Most processing plants are full. Sources note heavy milk supplies to Class III operations. Florida's milk output varies with steady to declining levels of milk production reported. Limited rainfall is restricting forage growth in some pastures and creating adverse planting conditions. However, export milk shipments for the state totaled 200 spot loads this week, up from 190 last week and 120 a year ago.
- Fluid Milk Central: The holiday weekend left some milk marketers in a scramble to find processing facilities able to take on additional milk. Farm level milk production is still high in the North Central area. Other areas of the region are heating up and seeing decreases in milk production. Midwest milk handlers are turning to Southwest area processors to take on additional loads out of the Midwest. These loads, however, are moving at discounts. Spot loads are being reported at $2.00 to $4.00 under class. A few spot loads moved at $5.00 under class when processors found themselves in a pinch for time and space. Bottling interest is light as summer approaches and orders from educational institutions diminish. Some bottlers are now turning loads back to manufacturers. Cream is plentiful in the Central region. Spot loads are readily available. Demand for Class II cream going into ice cream is mixed.
- Fluid Milk Pacific Northwest: Dairy contacts say a lot of milk is available for processing. Milk production is at, near or just past spring flush. A few manufacturers are noting milk intakes are beginning to tighten in some areas. Bottling demand is slowing slightly as schools begin their summer breaks. Although milk intakes were a little sloppy over the recent holiday weekend, Utah and Idaho milk production is in generally good balance with processing needs. Because nighttime temperatures have remained cool, high daytime temperatures have yet to impact cow comfort or suppress milk production. Industry contacts say farmers are getting an early start on hay harvest. Many have completed first crop and are starting second crop. There is a strong carryover of hay into the new cropping season. Forages are readily available at reasonable prices.

Recommendation:

Bidders were relentless in this week's spot market, picking up a total of 33 loads of cheese. With the record amounts of cheese in storage, many are wondering why the aggressive buying. We think there are a few answers. Domestic demand is very strong. Despite cheese manufacturers running at or near capacity, much of that cheese is committed. Buyers are looking to get their Q3 and Q4 needs locked up, so are coming to the spot market. Fear is a motivator. Triple digit temps out West and the long-term forecast for a hot and dry summer in the grain belt states (due to a La Nina weather pattern) could put a crimp on production in many of the milk-producing states. Better to get ahead of the ball than try to buy if/when the market tightens. International demand appears to be picking up as well. Our dairy powders are competitively priced in the global market. Lastly, grain prices have been on a tear and continued higher this week. Feed costs are going up. The milk-feed ratio dropped below 2.0 and will likely fall further next month, before finally starting to rebound. More than likely there has been a fair amount of short-covering as the spec community was caught sleeping with so much bearish fundamental news. Trade volume in the July contract today nearly reached 1,000 contracts! In addition to short-covering, it appears there may be new longs getting in to the market as well. May Class III was announced this week at $12.76/cwt, the lowest settlement since Sep, 2009. That's nearly seven years, folks. When you reach multi-year lows like that, the risk to the upside tends to become greater than further risk to the downside. We think the May settlement will be the low of the year. While it was great to see prices rally this week, it doesn't mean we think $20 is headed our way. Those inventories are real, and will hamper price appreciation. However, if we do see some heat in the next 90 days, prices in the $16-18 range are possible this fall. Time will tell. We have been urging producers to buy call options to cover existing contracts, or to use to sell in to, for some time now. Those calls just got a whole lot more expensive this week. However, if we see some corrective price action next week, we would still try to get something done. The start of the price rally may have just begun.

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