

**The KDM Dairy Report – June 10<sup>th</sup>, 2016**

**What's Bullish:**

- Spot Market: Barrel cheese settled up 6½¢ to \$1.51/lb, its highest price since January. Blocks closed the week up 3½¢ to \$1.47½/lb, a price not seen since April. Just 4 loads of blocks and 5 loads of barrels exchanged hands. Grade A NDM gained 1¼¢ on 25 trades to settle at \$0.83/lb, its highest price since October, and butter shot up 10¢ on just 2 trades to \$2.20/lb, its highest price since January.
- Fluid Milk Southeast: Milk production is down as hot and rainy weather decreases cow comfort levels. Bottling sales are up, with add-ons increasing orders. Auxiliary manufacturing plants are seeing milk intakes decline as handlers redistribute milk supplies to accommodate developing fluid sales. In Florida, tropical storm Colin dumped quite a bit of rain throughout the state. With temperature also hovering in the 90s, milk production is expected to trend lower. Ahead of this week's storm, milk sales took a slight upturn. As a result, export milk shipments fell to 160 loads this week, down from 200 loads last week. Cream supplies are adequate for most manufacturing needs, but surplus loads are not easily accessible, as demand outweighs supplies in some areas. Buyers are more willing to purchase loads at higher multiples. The timing of sales and stronger demand primarily from ice cream both increased and widened the range.

Futures Month	Class III 06/10	Class III 06/03	Change	Dry Whey 06/10	Dry Whey 06/03	Change	Cheese 06/10	Cheese 06/03	Change
Jun-16	\$13.25	\$13.16	\$0.09	25.550¢	25.475¢	0.07¢	\$1.454	\$1.445	\$0.009
Jul-16	\$14.54	\$13.91	\$0.63	27.250¢	25.725¢	1.53¢	\$1.575	\$1.517	\$0.058
Aug-16	\$15.33	\$14.56	\$0.77	28.750¢	27.550¢	1.20¢	\$1.650	\$1.574	\$0.076
Sep-16	\$15.68	\$15.00	\$0.68	30.250¢	28.300¢	1.95¢	\$1.670	\$1.611	\$0.059
Oct-16	\$15.67	\$15.21	\$0.46	31.250¢	29.250¢	2.00¢	\$1.664	\$1.626	\$0.038
Nov-16	\$15.60	\$15.32	\$0.28	31.750¢	30.050¢	1.70¢	\$1.648	\$1.631	\$0.017
Dec-16	\$15.43	\$15.30	\$0.13	32.375¢	30.350¢	2.03¢	\$1.639	\$1.632	\$0.007
Jan-17	\$15.40	\$15.28	\$0.12	32.375¢	31.225¢	1.15¢	\$1.639	\$1.638	\$0.001
Feb-17	\$15.45	\$15.42	\$0.03	32.000¢	31.250¢	0.75¢	\$1.637	\$1.639	(\$0.002)
Mar-17	\$15.64	\$15.50	\$0.14	32.500¢	31.250¢	1.25¢	\$1.662	\$1.657	\$0.005
Apr-17	\$15.68	\$15.60	\$0.08	33.000¢	31.425¢	1.58¢	\$1.667	\$1.667	\$0.000
May-17	\$15.58	\$15.60	(\$0.02)	34.000¢	31.425¢	2.58¢	\$1.668	\$1.668	\$0.000
<b>12 Mo Avg</b>	<b>\$15.27</b>	<b>\$14.99</b>	<b>\$0.28</b>	<b>30.921¢</b>	<b>29.440¢</b>	<b>1.48¢</b>	<b>\$1.631</b>	<b>\$1.609</b>	<b>\$0.022</b>

- Fluid Milk Southwest: In Arizona, farm milk output continues declining. Higher temperatures averaging 117 degrees are increasing stress on cows. However, manufacturing milk volumes are sufficient, keeping many balancing plants busy. Bottled milk requests from retailers are higher as many grocery stores are restocking shelves. Demand for flavored milk is active. Condensed skim volumes moving into NDM manufacturing are steady to higher. In New Mexico, milk output is trending lower. Higher temperatures are taking a toll on dairy herds' comfort. Milk components are steadily declining.
- Fluid Milk Pacific Northwest: Milk production has been a little suppressed by the recent hot weather. However, milk is generally available for most processing needs. Some manufacturers are adjusting internal production schedules to balance out intakes with processing runs. Milk intakes remain in good balance with processing needs, and industry contacts say there is not much milk moving into or out of the region. Cream volumes continue moving into butter churning. Demands from ice cream, frozen dessert and cream cheese manufacturers are steady to slightly higher. Cream is mostly available in the region. However, a few processors are reporting some tightness in supplies.
- Butter Northeast: Manufacturers in the Northeast are seeing active butter production. However, cream in general is not as available at times outside of processors' normal production. The region is likely to see a marginal decline in churning rates as some area operations reduce production. Some sources expect prices to move higher and are not surprised by what they consider a bullish market. The northeastern price for bulk butter is reported 6 to 8 over the market, based on the CME Group with various time frames and averages used. Retail trading is active, with good print demand. The undertone is steady to firm.
- Butter Central: Manufacturing facilities are running at or near full schedules. Bulk butter is being pulled out of freezers and some manufacturers are microfixing for upcoming contracts and anticipated spot sales. Other contacts report producing print butter now in lieu of microfixing, as they predict the cream market will tighten in the upcoming months. Overall, market participants feel butter stocks are at comfortable levels for this time of year. Sales into foodservice are strong.
- Butter West: Many butter makers are actively producing butter. However, a few manufacturers are backing off production a little as milk production begins to decline seasonally and as more cream is pulled into other cream products. Although much of the butter production is focused on bulk butter, some manufacturers are also making print to stay current with immediate retail needs. Manufacturers report domestic demand remains solid and regular customers are consistently taking shipments.
- Dry Whey Northeast: Prices are showing some uptick based on f.o.b. spot sales activity this week. Production in the region is fairly stable. Most inventories are adequate for contract customer needs. Sources suggest a shrinking of some dry whey holdings. Global interest is good, with shipments noted moving to China.
- Dry Whey Central: Prices are higher this week. Midwest whey manufacturers are running full schedules to work through the steady whey stream from active cheese making. However, many market participants report strong sales. Several suppliers are reportedly requesting additional loads outside of commitments. International interest is strong. Reportedly, revenue for China hog producers is large and they are turning to the U.S. for dry whey. Several industry contacts report exporting large quantities of whey to international outlets. Steady domestic interest and active and rapidly growing international interest is thinning out Central whey stocks. A few manufacturers report having comfortable inventory levels, while others report little to no whey stocks. The market undertone is firming.
- Dry Whey West: Prices moved up on the lower end of price range, but otherwise held steady. Industry contacts note the market tone may be firming slightly, mostly due to a little stronger demand from export markets. A few manufacturers have been able to clear significant stocks into international markets and now describe their inventories as much more comfortable.

- Cheese Midwest: Cheese production in the region is active. Manufacturers are keeping vats full and bringing in spot loads of milk when their schedules allow. However, several market participants report strong sales to end users and are moving additional loads outside of contracts with ease. Promotions for June Dairy Month are reportedly boosting sales for a large group of manufacturers.
- Cheese West: Cheese makers report good domestic demand in retail and food service sectors. In addition, some contacts are seeing a decent seasonal pull for process cheese. Any domestic demand is welcome in light of the limited export opportunities for U.S. cheese. Western cheese production remains active with ample supplies of milk finding their way into the vats. In a few cases, however, manufacturers are trying to control their cheese inventories by limiting the amount of milk they take in for production.
- International: Preliminary observations from some milk producing regions of the EU find signs of seasonal declines beginning. Cream supplies are tighter and buyers face increasing prices. Domestic cheese prices are firming in the EU. Stocks in aging programs are being drawn down. Some sellers are not accepting new orders. Prices for future delivery periods have increased above recent pricing. Many buyers are moving ahead to secure sales commitments for delivery in the coming months. Butter and butteroil prices strengthened. Bulk butter demand has recently increased, primarily due to EU customers. Prices for delivery in coming months have firming. Whey prices have strengthened as markets are viewed as recovering. Lower cheese production is a factor leading to buyer awareness of potentially declining inventories. Whole milk powder prices have increased at each end of the price range. WMP demand for EU consumption has been strengthening. Pricing for near term and future delivery commitments is higher, as buyers in the EU food industry move to assure supplies for use in coming months.
- International: In Australia the end phase of the 2015-16 milk producing season persists in being more hot and dry than had been expected earlier in the season. This has led to unexpectedly higher costs to dairy producers for irrigation, hay and grain. Rainfall in Australia this season has generally been below average. Previous hopes that April would provide more rainfall proved incorrect. The continuation of dry conditions further constrained pasture growth, which tightened markets for hay. Costs for acquiring water to irrigate increased to margin squeezing levels, even assuming any give producer could secure a water allocation. Looking ahead, there are concerns that the financial stresses of the current dairy season will result in producer adjustments that will result in lower milk output for the coming 2016-17 milk season in Australia.
- International: Dairy producers in New Zealand have suffered poor margins as the milk production season is nearing an end. There is more culling of cows than had been expected earlier in the season, as producers strive to adapt to lower than expected returns. A number of producers find pay prices to be below their costs of production. A large processor in New Zealand has recently announced opening prices for the 2016-17 season disapprovingly lower than many producers had hoped for. Unlike in Australia where a larger population generating increasing domestic demand for dairy products has helped weather weaker export markets, New Zealand has been more subject to prevailing global export markets.
- International: Oceania butter prices are up slightly, due to strong demand for orders as well as price strength in futures trading. The declining milk production volumes in Australia and New Zealand have also been accompanied by lower butterfat content. As a result, buyers are motivated to secure sale commitments, and demand for butter is increasing.

#### What's Bearish:

- Fluid Milk Northeast: Farm milk production is steady, with near peak volumes. Sources indicate that temperatures rising into the 90s in some areas will likely suppress cow comfort and milk production. But for now, milk supplies are heavy into most manufacturing facilities. Farm-level milk volumes eased slightly in the Mid-Atlantic region. Class I demand continues to decrease, as area schools end.
- Fluid Milk Central: Milk production in the region is strong. The North Central area has yet to face weather hot and humid enough to affect cow comfort and drop production. Industry contacts in this area feel North Central milk production has peaked, but the cool weather has prolonged the flush. Pockets of the South Central area are hot enough to drop farm level milk production, but milk is still readily available. Spot loads are actively moving both in and out of the region and can be found at \$1.25 to \$4.00 under Class. A handful of spot loads moved at \$5.00 to \$6.00 under class when manufacturers found themselves in a pinch.
- Fluid Milk West: In the Central Valley of California, an unusual decrease in temperatures is slightly enhancing milk production. Some bottlers are lowering orders, as most K-12 schools will close next week. Consumer demands for flavored milk, ice cream and frozen dessert is inching up, but condensed skim prices remain low. Consequently, many processors are opting to drying instead of selling.
- NDM: As stocks build and market participants face inventory pressures, some sellers are willing to move one to six month old NDM at lower price points. Several industry contacts show little to no interest in purchasing additional loads outside of commitment unless offered an exceptional discount.
- Cheese Northeast: Cheese production is steady with the previous week's pace. Seasonally strong farm milk output continues to add to Class III milk receipts. Inventories are adequate according to most cheese manufacturers in the region. Cyclical factors affects the declining demand for mozzarella in the food service sector, however, interest in the provolone variety shows some uptick. In general, the market maintains a mixed undertone.

#### Recommendation:

Class III's finished the week solidly in the green in a week that saw some wild volatility. On Thursday, spot cheese saw blocks lose ½¢. While futures were briefly lower, they relentlessly pushed higher until July-Sep were locked limit up 75¢ at the close. When the overnight session started an hour later, prices climbed again, only to see double-digit losses by the end of day on Friday. We've fielded a lot of calls in the past couple days. No one seems to know what is causing the market to react like it has. We don't know for certain either, BUT, we have been recommending call coverage for quite some time. Here's our take. It appears the international market is picking up. Large quantities of dry whey are leaving our shores and heading to China, specifically. Maybe China is finally back as a buyer. Cheese is tightening up in the EU. It would seem that there is little chance of them dumping cheap cheese on our market going forward. Operations in Oceania are in terrible financial shape. They are culling cows aggressively. Milk output at the start of the new milking season in July/Aug is most likely going to be below last year's levels. Heat has arrived in much of the U.S. Remember also that our spot cheese spec is for under 30-day aged cheddar. Our warehouses can have cheese coming out the windows, yet if 30-day cheddar tightens, the spot pride will go up. Volatility is likely to continue going forward, but we still see the trend as heading higher. The low is in and done. Producers should continue to look at upside coverage Aug-Dec in the form of bull-call spreads. Target to sell July at 15.10 or higher.

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