

The KDM Dairy Report – July 29th, 2016

What's Bullish:

- Spot Market: Block cheese gained 2½¢ for the week, settling at \$1.73¼/lb on just 4 trades. The settlement price was a new high for the year and highest since October, 2015. Barrel cheese was unchanged at \$1.77¼ on 4 trades. Grade A NDM made up ground for losses early in the week, to settle up ¾¢ to \$0.85/lb on 16 trades. Butter, however, gave up 15¼¢ to close at \$2.13½/lb on 14 trades.

Futures Month	Class III 07/29	Class III 07/22	Change	Dry Whey 07/29	Dry Whey 07/22	Change	Cheese 07/29	Cheese 07/22	Change
Jul-16	\$15.26	\$15.27	(\$0.01)	27.500¢	27.500¢	0.00¢	\$1.644	\$1.644	\$0.000
Aug-16	\$16.84	\$16.72	\$0.12	27.550¢	28.175¢	(0.63¢)	\$1.810	\$1.784	\$0.026
Sep-16	\$16.79	\$16.68	\$0.11	30.000¢	30.750¢	(0.75¢)	\$1.788	\$1.770	\$0.018
Oct-16	\$16.72	\$16.63	\$0.09	31.150¢	31.950¢	(0.80¢)	\$1.775	\$1.750	\$0.025
Nov-16	\$16.39	\$16.38	\$0.01	32.525¢	33.250¢	(0.73¢)	\$1.737	\$1.717	\$0.020
Dec-16	\$16.08	\$16.05	\$0.03	33.750¢	33.500¢	0.25¢	\$1.703	\$1.689	\$0.014
Jan-17	\$16.00	\$15.94	\$0.06	34.500¢	34.000¢	0.50¢	\$1.692	\$1.680	\$0.012
Feb-17	\$16.00	\$16.07	(\$0.07)	35.500¢	35.350¢	0.15¢	\$1.685	\$1.683	\$0.002
Mar-17	\$16.08	\$16.16	(\$0.08)	36.000¢	35.500¢	0.50¢	\$1.694	\$1.698	(\$0.004)
Apr-17	\$16.24	\$16.16	\$0.08	36.000¢	35.550¢	0.45¢	\$1.700	\$1.700	\$0.000
May-17	\$16.39	\$16.31	\$0.08	36.000¢	35.475¢	0.52¢	\$1.710	\$1.716	(\$0.006)
Jun-17	\$16.49	\$16.45	\$0.04	37.250¢	36.000¢	1.25¢	\$1.728	\$1.725	\$0.003
12 Mo Avg	\$16.27	\$16.24	\$0.04	33.144¢	33.083¢	0.06¢	\$1.722	\$1.713	\$0.009

- Fluid Milk Northeast: Southern portions of the Northeast, along with the Mid-Atlantic are suffering cow distress due to the heat wave, which has simultaneously lowered milk production. Manufacturing milk supplies, as well, are lower from the production declines and increased draws from Class I plants.
- Fluid Milk Southeast: The region is very low on fluid milk as area heat and humidity significantly reduce milk production volumes. Manufacturing is seeing heavier pulls on milk supplies, as loads move in from New Mexico to support area Class I demand. Florida weather is hot with little rain. July is on pace to record, on average, the hottest month in history. Consequently, milk production at the farm continues to fall and expects to maintain the trend. Just 13 loads of milk were exported this week, down from 50 last week. The cream market appears better balanced than in previous weeks, with sufficient supplies and steady demand. Cream demand, prompted by the regions' seasonally high temperatures, is generating high-volume ice cream utilization.
- Fluid Milk Central: Milk production in the region is trending downward as summer advances. The South Central area has witnessed large week to week declines as continuing hot daytime temperatures add to the discomfort of dairy herds. North Central dairy operators report milk production is tapering off after the recent hot spell. Class I sales crept higher into bottling plants, as some areas start to refill the school pipeline ahead of the first day of instruction. Bottlers anticipate orders for single serve containers will build over the next few weeks.
- Fluid Milk Southwest: In California, the high daytime temperatures are raising heat stress on dairy cows. Consequently, milk yields are lower this week. Bottled milk sales to the retail sector are slightly up this week as buyers' interest for flavored milk is active. Demand for Class 2 is even. Sales into Class 3 (ice cream/frozen desserts) continue trending up. June 2016 pool receipts of milk in the state total 3.21 billion pounds. This is 1.3% lower compared to the same month a year ago. Farm milk production is trending lower in Arizona. The hot weather and high humidity are taking a toll on dairy cows' comfort. Some balancing plants are helping to clear milk surpluses from nearby states. Bottled milk orders from retailers and food service are steady. However, according to some processors, requests for Class I will increase very soon as most public K-12 schools will reopen during the second week of August. Demand for Class II is seasonally strong. Condensed skim sales into NDM and ice cream production are steady this week. Milk production is lower in New Mexico due to the warmer climate. Class I sales are slightly up this week. Significant milk loads are moving to the Southeast region to meet production shortfalls there.
- Cream West: Supplies are tight in many processing plants. Demands from ice/cream and cream cheese manufacturers are strong. Some western cream loads are moving to Mexico. The market undertone is firm.
- Dry Whey Northeast: Production is balanced, to somewhat lower, as farm milk clearing to cheese processing declines seasonally. Demand from end users is mostly steady. The market undertone is generally steady, but seasonal indicators show some strengthening.
- Dry Whey Central: Production is steady to slightly lower. Because milk intakes are dropping, some cheese production is decreasing, therefore slowing the whey stream. Several industry contacts report resistance from buyers as they raise prices. However, other contacts continue to move loads at or above market pricing.
- Dry Whey West: Domestic interest for whey is fair to good. Demand from Mexico is active. Dry whey production is ongoing in line with the regional cheese manufacturing. Inventories are tight in some processing facilities.
- Cheese Northeast: Milk supplies to cheese plants are decreasing seasonally with some areas noting stronger declines due to recent spells of heat and humidity. Cheddar programs for aging are maintaining mostly steady production schedules. Mozzarella demand from pizza is fair to good.
- Cheese Midwest: Some manufacturers report falling milk intakes and are running one to two less vats a week. Other processors are seeking out additional spot loads of milk to maintain full production schedules. Sales are strong for many market participants. Several manufacturers of specialty cheese varieties report difficulty keeping up with demand and are sold out. American and processed varieties of cheese are also doing well. Industry contacts attribute this to the grilling and fair season. Due to high levels of sales, contacts report having to turn away buyers interested in fresh loads of cheese due to lack of stocks.
- Cheese West: Cheese production is steady as the producers look to balance the market's demand. Domestic demand is good for most types of cheese. Retail cut and wrap cheese sales are solid. As demand for cheese is steady, especially in fresh cheese barrels, the remaining cheese in cold storage remains stable with some age. While the cheese in cold storage are getting some age, other cheese in inventories are expecting to be moved due to prior contractual orders.
- CWT has accepted three requests for export assistance to sell 90,390 pounds of Cheddar and Gouda cheese, and 881,849 pounds of whole milk powder to customers in Asia. The product has been contracted for delivery in the period from August through October 2016.
- International: Milk output in Australia is falling, and at an accelerating rate. June output was down 8.8% vs. a year ago, by far their biggest YOY decline in 12 months, and a sharper drop than the 5.5% decline in May, or 1.1% decline in April.

What's Bearish:

- Fluid Milk Pacific Northwest: Temperatures are conductive to dairy herds' comfort. Milk production is seasonally up. Manufacturing volumes are sufficient to keep balancing plants busy. Class I demands from restaurants and grocery stores are steady. However, processors are expecting an increase in orders as educational institutions will restart in the next few weeks. In the mountain states of Colorado, Idaho and Utah, farm milk yields are higher. Some processing plants from nearby states are helping to clear heavy milk volumes. Bottled milk demand is seasonally lower.
- Butter: Although cream supplies are tight across the nation, butter production remains active. Many manufacturers are running full schedules this week. However, a few processors have decided to slow their churns and opted to sell off the excess cream. Domestic demand for butter is fair to good. Orders from private labels are steady. Processors are comfortable with the volume of stocks for Q3 and Q4 buyers' needs. The NASS Cold Storage report noted U.S. butter stocks as of June 30, 2016, were 326.0 million pounds, unchanged from last month and up 27% from last year.
- NDM Northeast: Prices are higher as nonfat dry milk is seeing slight declines in output rates due to lower farm milk intakes and declining component levels caused by the existing seasonal conditions. However, market participants' interest is lukewarm. As a result, manufacturers' stocks are growing as mostly light market trading occurs. The NDM market does not show much confidence at this point, as the undertone remains unsettled.
- NDM Central: As milk seasonally tightens, more manufacturers are redirecting milk away from the dryer and into production of other commodities. Several producers are comfortable with this shift because it is an opportunity to manage inventory levels. Industry contacts speculate long inventories for end users and brokers alike. Domestic demand is light and buyers show little interest in loads outside of contractual commitments.
- NDM West: The market undertone is mostly unsettled. Many buyers/end users have been pushing manufacturers to drop prices for several weeks. However, a few processors are holding stocks anticipating higher prices in the near future. A few NDM manufacturers are clearing supplies from Q4 2015 at prices near to the bottom of the range.

Recommendation:

At a little over \$1.75/lb average, spot block and barrel cheese prices may have finally found some resistance this week. Gone are the daily 2-5¢ jumps of a couple weeks ago and frantic buying. Just 4 loads of blocks and 4 loads of barrels exchanged hands this week. The market seems to have found some price stability at current levels, with neither buyers nor sellers motivated to move prices in either direction. Fundamentally, domestic cheese demand is still strong and fresh cheese, particularly barrels, are tight. With the exception of the Pacific Northwest, most of the country has experienced some heat, or is currently. Milk production and components are headed lower, as they often do at this time of year. Some schools will be opening in 2-4 weeks, so fluid pipelines will soon be pulling milk from manufacturing. To be honest, we're not sure where prices will go from here. If demand stays strong and milk output continues to fall, we would see a push to \$1,80+ cheese. But as we mentioned last week, once it cools and grilling season ends, the barrel supply could catch up to demand. We still don't see that for another few weeks, however. While cheese demand remains hot, butter demand may be cooling off. Even though cream is tight and getting tighter, we have so much butter in storage that manufacturers believe they have sufficient product to meet Q3 and Q4 demand. Spot prices tumbled over 13 cents this week as buyers took a step back. Current spot prices work out to about \$16.55 Class III, basis September dry whey. Add in the premium we've been seeing in weekly NASS survey numbers and it gets us close to \$17/cwt. Front month Class III futures are trading a slight discount to that, so will be sensitive to any moves in next week's spot market. With the uncertainty facing us in the near term, producers should consider their cost of production, relative to current futures prices. For operations that still have little marketed in Q4, putting on a fence strategy might make some sense. For example, the Oct-Dec 1550 PUT averages 38¢, while the 1750 CALL averages 35¢. By selling the calls (collecting the premium) and buying the puts (paying the premium) this trade can be done for a net 3¢ (excluding transaction costs). The result would be a floor price of 15.50, with ability to ride the market higher to 17.50, at which point the price is capped. Doing up to 25% of your milk production with this strategy could be a good, inexpensive way to protect your milk price.

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