

The KDM Dairy Report – August 5th, 2016

What's Bullish:

- Spot Market: Block cheese gained 8¼¢ for the week on 9 trades, to settle at \$1.81½/lb. Barrels jumped 10½¢ on 20 trades to close at \$1.88/lb. Grade A NDM gave up 1¼¢ on 16 trades to settle at \$0.83¼/lb, but butter shot 13¼¢ higher to close at \$2.27/lb on 16 trades.
- Dairy Products Report: Butter output in June was up 6.4% vs. a year ago, but cheddar cheese output fell 3.5% and American-types declined 0.2%. Total cheese output increased 1.1% over last June, but much of that occurred in Italian types. Dry whey output for human consumption was down 8.2% vs. a year ago and down 3.8% from May. Dry whey stocks declined 2.3% YOY and fell 14.9% vs. the prior month.

Futures Month	Class III 08/05	Class III 07/29	Change	Dry Whey 08/05	Dry Whey 07/29	Change	Cheese 08/05	Cheese 07/29	Change
Aug-16	\$17.10	\$16.84	\$0.26	28.150¢	27.550¢	0.60¢	\$1.830	\$1.810	\$0.020
Sep-16	\$17.16	\$16.79	\$0.37	30.750¢	30.000¢	0.75¢	\$1.820	\$1.788	\$0.032
Oct-16	\$16.92	\$16.72	\$0.20	33.000¢	31.150¢	1.85¢	\$1.785	\$1.775	\$0.010
Nov-16	\$16.47	\$16.39	\$0.08	34.000¢	32.525¢	1.48¢	\$1.732	\$1.737	(\$0.005)
Dec-16	\$16.08	\$16.08	\$0.00	35.000¢	33.750¢	1.25¢	\$1.693	\$1.703	(\$0.010)
Jan-17	\$15.99	\$16.00	(\$0.01)	35.500¢	34.500¢	1.00¢	\$1.683	\$1.692	(\$0.009)
Feb-17	\$16.00	\$16.00	\$0.00	36.100¢	35.500¢	0.60¢	\$1.684	\$1.685	(\$0.001)
Mar-17	\$16.08	\$16.08	\$0.00	36.000¢	36.000¢	0.00¢	\$1.692	\$1.694	(\$0.002)
Apr-17	\$16.13	\$16.24	(\$0.11)	36.000¢	36.000¢	0.00¢	\$1.696	\$1.700	(\$0.004)
May-17	\$16.26	\$16.39	(\$0.13)	36.000¢	36.000¢	0.00¢	\$1.706	\$1.710	(\$0.004)
Jun-17	\$16.46	\$16.49	(\$0.03)	37.150¢	37.250¢	(0.10¢)	\$1.724	\$1.728	(\$0.004)
Jul-17	\$16.63	\$16.60	\$0.03	37.000¢	36.250¢	0.75¢	\$1.739	\$1.732	\$0.007
12 Mo Avg	\$16.44	\$16.39	\$0.06	34.554¢	33.873¢	0.68¢	\$1.732	\$1.730	\$0.003

- Fluid Milk East: Milk production continues to taper off in the southernmost areas of the Northeast and Mid-Atlantic areas. Southeast milk marketers are bringing in loads of fluid milk from other areas of the country to supplement production losses. Draws from Class I plants are anticipated to pick up towards the end of this week as educational institutions prepare to begin the school year. Bottlers report growing orders for single serve containers. Florida milk production is steady to slightly lower. Milk marketers in the area believe that drops in milk production will continue throughout the month of August. There were no export milk shipments this week but five milk shipments were imported. As high temperatures prevail, farm level milk production is falling and decreasing the overall supply. Many Southeast schools begin the school year next week and have milk marketers prepared for the condensed skim supply to tighten. Ice cream and frozen dessert manufacturers continue to utilize a large portion of the cream supply.
- Fluid Milk Central: Milk production continues to fall in the region. Several North Central area milk marketers report a stronger fall off in production than in previous weeks. Some processors are seeking additional loads of milk from out of state and regional suppliers. Spot load availability is decreasing. Market participants report little to no spot loads being offered at discounts. Spot load prices reported this week ranged from class to \$1.50 over class. Bottlers report steady demand from retail and food service outlets and are preparing for educational institutions to reopen their doors in the upcoming weeks. Ice cream and frozen dessert processors continue to pull large amounts of Class II cream off the spot market and into production.
- Fluid Milk Southwest: Farm level milk production is trending lower in California. Daytime temperatures are reaching 109 degrees in the Central Valley. Consequently, cows' stress is increasing. Orders from bottlers are steadily improving as most educational institutions are reopening in the next few weeks. Demands for ice cream and frozen desserts are strong, which is usual for this time of the year. Dairy operators' demand for high quality alfalfa hay is moderate to high, but supplies are tight. The monsoon activity and high humidity are negatively affecting milk yields in Arizona. A few hauling issues have been reported due to flooding along highways. Class I orders from educational institutions are ramping up as most K-12 schools are reopening this week. Requests from retailers are higher as some supermarkets are restocking shelves. The rains have delayed alfalfa hay harvesting in some areas of the state. In New Mexico, the warm and rainy weather conditions are dropping farm milk intakes. Bottled milk demands from retailers and food service are even this week. However, many processors are anticipating higher Class I sales as K-12 schools are reopening soon. Class II sales are higher as interest for ice cream is strong.
- Cream West: Cream supplies continue to narrow. Cream volumes moving into butter churning are steady. However, ice cream makers continue pulling significant amounts of cream. The market undertone is firm.
- Butter East: Butter plants are focusing production efforts on filling current orders. Industry contacts note milk intakes are marginally lower. Manufacturers are looking to sell cream for the production of Class II products rather than produce butter. In some parts of the East, the market might expect falloff in availability due to the effect of heat waves covering the Eastern region.
- Butter Central: Cream remains available and manufacturers are running full schedules. However, demand for butter remains strong. Brokers and manufacturers both report calls from buyers seeking loads of butter. However, industry contacts with butter stocks remain reluctant to make a spot sale. Bulk butter prices reported ranged from market to 7.5 cents over the market.
- Butter West: Industry contacts say domestic butter demand is good with a lot of interest coming from retailers. Buyers have a fair amount of pent-up demand as they want to assure Q4 coverage of their butter needs. A number of market participants see this as the quiet time before baking season moves into top gear.
- Dry Whey Northeast: Prices are steady to higher this week. Manufacturers report getting sporadic inquiries from buyers. In some cases, buyers are looking to lock in Q4 deals. Dry whey production is down a little due to more interest by manufacturers to make WPC and lactose in lieu of dry whey and seasonal declines in farm milk production.
- Dry Whey Central: Prices in the Central region are mostly higher this week. Milk intakes are seasonally decreasing for manufacturers and some contacts are seeing the whey stream slow down slightly because of this. Demand is steady to higher. Several industry contacts report more difficulty finding whey on the spot market than in recent weeks. Market participants note buyers showing little to no resistance to rising prices. Inventories in the Central region are tightening. Many manufacturers report decreasing spot load availability. Some contacts are choosing not to offer any dry whey on the spot market for the time being. The market undertone is firming.
- Dry Whey West: Prices are mostly higher this week. A few end users are finding specific brands of dry whey to be a little harder to find, but dry whey in general is available.

- Cheese Midwest: Production is steady to slightly lower this week. Milk production continues to fall in the region. Several cheese manufacturers are choosing not to seek out additional spot loads of milk to make up for drops in fluid milk intakes. Manufacturers currently utilizing spot loads of milk are preparing for spot load availability to disappear and production slow-downs as educational institutions begin to reopen. Fresh cheese, processed cheese and cheese curds are all up in sales and manufacturers report little to no inventories. Manufacturers and brokers both continue to receive calls from buyers seeking loads of several varieties of cheese. Inquiries for cheddar and Italian cheeses have grown this week. Several industry contacts report increases in sales this week.
- Cheese West: Although food service demand has eased a bit, buyers are making regular orders. Retail demand is solid while export markets continue to be weak. Some manufacturers are eager to move into the fall football/pizza season and are anticipating the increased demand will help reduce inventories of mozzarella and other cheeses used on pizzas.
- International: This week's GDT auction saw the Dairy Price Index jump 6.6%, the largest increase since October, 2015. Gains were led by rennet casein up 16.3%, WMP up 9.9% and butter milk powder up 7.7%.
- International: Expectations in the EU are for second half milk production to be below year ago volumes. EU dairy producers have increased culling and feeding of concentrates has been reduced. Semi hard cheese stocks are described as barely sufficient to meet demand. Declining milk production and components are factors limiting cheese production. Cheese in aging programs has been drawn down. Manufacturers are being cautious before entering into contracts for future cheese sales to be certain that there will be cheese available to deliver, as well as because expectations are for pricing to increase and thus, not wanting to leave too much money on the table by locking in a price too early. Packaged butter supplies are tightening and finding offerings for immediate delivery is challenging. A recent uptick in orders for packaged butter for future delivery within the EU is believed to have been motivated by retailers stocking up in advance of expected price increases. Production volumes are lower, in part due to increased prices for industrial cream.
- International: Parts of Argentina were ravaged by floods earlier this year, resulting in a loss of milk production in those regions. In addition, processors have switched to making cheese which is more profitable. As a result, Argentina is looking at a butter shortage. Increased consumption of butter is also contributing to the tight supply.

What's Bearish:

- Fluid Milk Pacific Northwest: Dairies have experienced a stretch of relatively good milk production weather. With the occasional touch of summer heat, milk production is steady to lower and following typical seasonal trends. Sufficient supplies of milk are available for most processing needs. Bottling demand is stable, but processors are anticipating the start of school terms over the next few weeks will increase bottling draws. Milk production is stable in the mountain states of Colorado, Idaho and Utah. Recent higher temperatures may have taken milk intakes down a notch, but there is still plenty of milk for most processing needs. Hay making is ongoing and feedstocks are in good supply.
- NDM: Prices for eastern low/medium nonfat dry milk (NDM) shifted lower on the range and mostly series. Trading activity has been light to moderate throughout the week. At this point, the market undertone is unsettled, according to industry participants. In the Central region, prices are lower this week. Several industry contacts report six month or older low/medium heat NDM being offered on the spot market at prices towards the lower end of the range. Inventories are long in the Central region. Some manufacturers faced with large stocks are using low/medium heat NDM to fortify other dairy products as a way of managing stock levels. Several market participants report inventory pressures and the need to make sales in order to free up space in warehouses for new production. Industry contacts feel many buyers are content with their current low/medium heat NDM stocks and are choosing to sit on the sidelines for the time being. In the West, spot sales in the domestic market are light to moderate. Some buyers/end users continue pushing manufacturers to drop prices. Trades to Mexico are less active compared to the past two weeks. Inventories are steady to building.
- Cheese Northeast: Milk supplies to cheese manufacturers have been adequate, even with some heat and humidity waves in certain parts of the East. Cheese producers are maintaining mostly steady production schedules with demand for cheese remaining constant. Manufacturing inventories are adequate with short-term orders filled. The market undertone is steady to firm.
- International: Most of northern Australia is experiencing good rainfall and crop growth. This is adding to a positive outlook for supplemental feeding when needed. A leading dairy cooperative in New Zealand recently announced that for the present, it will hold its previously projected milk pay price. This is welcome to dairy producers. With cooler weather and recent rain in New Zealand, hopes are increasing for production improvements. The rain is welcome in replenishing areas which have been dry.

Recommendation:

After a quiet week last week, where spot prices barely nudged in what we thought might have been resistance, they exploded to the upside this week. Blocks and barrels reached a new, multi-year high going back to Nov 2014. Class III futures responded with Aug and Sep pushing in to new contract highs. It appears the market is finally becoming aware the global milk supply is beginning to decline. Semi hard cheese is tight in the EU. That should keep it from coming to the U.S. Milk output in Oceania is starting their new season at levels far below last year. Butter is tight in Argentina as milk output there has slipped. Heat in the U.S. has taken output down from peak levels, while demand remains strong. Fresh cheese is still tight, with buyers looking, and failing, to procure product beyond commitments. Spot butter prices were also very strong this week, while the GDT auction saw it's steepest increase since Oct 2015. Schools will be opening shortly in parts of the country, with the remainder around Labor Day. Fluid orders are on the rise, taking milk away from processing. We still don't think \$20 milk is headed our way in the short term, but the current market looks well supported over the next 4-6 weeks. That should greatly benefit the Sep/Oct Class III contracts. Current spot prices work out to about \$17.55 Class III. Add in the premium we've been seeing all year in the weekly NDPSR survey numbers and it takes us at or even slightly above \$18/cwt. With the Sep contract beginning its pricing period in another week, should spot cheese prices hold or go even higher, Class III will have to respond to the upside. Producers should be watching Q4 prices and look for an opportunity to buy cheap floor price protection in the form of PUT options. Currently the 16.00 PUT over those months averages 47¢ each. Enter target orders at 25-30¢ to buy them.

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