

The KDM Dairy Report – August 19th, 2016

What's Bullish:

- Spot Market: Blocks gained 8½¢ on the week to close at \$1.86½/lb on 27 trades. Barrels were unchanged at the same price with no trades. Grade A NDM inched 1¼¢ higher to close at \$0.85½/lb on 9 trades, but butter declined 6¢ to \$2.19/lb on 15 trades.
- Weekly cold storage numbers indicate cheese stocks at USDA-selected storage centers have declined 2% (1.9 million lbs) over the first 15 days of August.
- Fluid Milk Northeast: Hot and humid weather, with frequent rainfall, affects milk production throughout the East region. Producers' milk continues its seasonal decline. Several manufacturers scheduled downtime for maintenance activities as milk intakes ease behind stronger Class I sales. Farm-level milk production in the Mid-Atlantic is lower. Manufacturing milk supplies in the area are reduced as increased Class I demand in the Southeast pulls supplies out of processing venues. Some balancing plants report significant falloff in milk intakes.

Futures Month	Class III 08/19	Class III 08/12	Change	Dry Whey 08/19	Dry Whey 08/12	Change	Cheese 08/19	Cheese 08/12	Change
Aug-16	\$16.95	\$16.97	(\$0.02)	28.450¢	28.400¢	0.05¢	\$1.816	\$1.819	(\$0.003)
Sep-16	\$17.88	\$17.10	\$0.78	31.800¢	31.200¢	0.60¢	\$1.895	\$1.809	\$0.086
Oct-16	\$17.58	\$16.77	\$0.81	35.250¢	32.250¢	3.00¢	\$1.842	\$1.769	\$0.073
Nov-16	\$17.07	\$16.46	\$0.61	37.000¢	34.000¢	3.00¢	\$1.780	\$1.726	\$0.054
Dec-16	\$16.60	\$16.14	\$0.46	38.525¢	35.000¢	3.53¢	\$1.730	\$1.697	\$0.033
Jan-17	\$16.35	\$16.03	\$0.32	39.750¢	35.700¢	4.05¢	\$1.693	\$1.681	\$0.012
Feb-17	\$16.20	\$16.03	\$0.17	39.500¢	36.200¢	3.30¢	\$1.687	\$1.677	\$0.010
Mar-17	\$16.23	\$16.04	\$0.19	40.000¢	36.500¢	3.50¢	\$1.682	\$1.681	\$0.001
Apr-17	\$16.27	\$16.11	\$0.16	40.000¢	36.000¢	4.00¢	\$1.686	\$1.696	(\$0.010)
May-17	\$16.43	\$16.32	\$0.11	39.750¢	36.100¢	3.65¢	\$1.700	\$1.706	(\$0.006)
Jun-17	\$16.59	\$16.45	\$0.14	40.000¢	37.150¢	2.85¢	\$1.722	\$1.730	(\$0.008)
Jul-17	\$16.79	\$16.60	\$0.19	39.750¢	37.000¢	2.75¢	\$1.737	\$1.739	(\$0.002)
12 Mo Avg	\$16.75	\$16.42	\$0.33	37.481¢	34.625¢	2.86¢	\$1.748	\$1.728	\$0.020

- Fluid Milk Southeast: Milk output continues to decline in the region along the seasonal trends. Nearly all milk supplies are used to fill fluid needs as sales surge with the replenishing of school pipelines. Sources report some loads shifting to the Midwest bottling. Hence, area manufacturing milk supplies, if available, are moderated to contract minimums. Nearly all schools are back in session, thus, Class I demand is very strong. Seasonally hot temperatures continue to boost strong cream pulls from ice cream production. Condensed skim supplies are declining in most of the regions' markets as Class I pulls increase with the reopening of schools. Demand from ice cream, cream cheese and yogurt manufacturing is moderate to good.
- Fluid Milk Central: Excessive heat in the region has tightened up the Midwest milk supply. Milk marketers report consistent calls from processors seeking spot loads but are rarely able to meet their requests fully. Spot loads are reported at \$1.50 to \$2.00 over class. A few market participants speculate that spot loads are moving at even higher premiums towards the end of the week and into the weekend. The pull for fluid milk into Class I is picking up in the Central region. Bottlers report a strong increase in orders for single serve containers from educational institutions. Cream slightly tightened this week.
- Fluid Milk Southwest: California milk production is flat to lower as high temperatures return. Manufacturers are seeking additional loads to round out production. Demand from bottlers is strong with the beginning of school terms. Class 2 demand is steady. Class 3 sales are strong with good demand from ice cream manufacturers. Milk production continues to drop in Arizona. It is hot and dry. The high temperatures are also driving milk components lower. Class I demand is up as bottling for schools keep pulling more fluid milk to fill the seasonal increase. Ice cream demand continues to be strong.
- Butter: Across the nation, butter production has slowed. Most manufacturers notice a reduction in available milk supply, slowing production schedules for some processors. Lower cream availability has pushed many butter makers to slow down butter churning rates, creating a tight market for near term butter needs.
- Dry Whey Northeast: Production is below plant capacity at many locations. Drops in farm milk and increased fluid milk needs limit output. Sources note few spot offers. Domestically, demand for whey is steady and at seasonal norms. However, international interest is good, with heavy dry whey volumes clearing to China.
- Dry Whey Central: Prices in the region are mostly higher this week. Demand from the bakery sector is increasing as educational institutions go back into session. Several market participants note upticks in sales this week. Manufacturers report increased calls from buyers. Some industry contacts speculate that buyers are entering the market now and making large purchases because they anticipate the market will continue to firm. Some manufacturers attribute tightening stocks to high levels of exports. The market undertone is firming.
- Dry Whey West: The general market tone is strengthening. In some cases, buyers are finding limited availability of spot loads. Inventories are snug, or at very least comfortable. Some manufacturers are more willing to hold onto supplies to wait and see if prices will rise in the near future.
- NDM Northeast: Manufacturing milk supplies have decreased significantly. Some producers see slight reductions in inventories as they focus managing inventory volumes based on future sale considerations. In some instances, producers prefer to hold stocks and only offer spots at the high end of the range. Domestic demand is active, with a number of transactions occurring this week through various buying channels. As well, sales to Mexico are good. The market undertone is seeing some firmness.
- Cheese Northeast: Some area cheese plants are operating at levels less than capacity as milk supplies continue to move lower due to falloffs in availability. Milk supplies are being rerouted to increase cheese production, to meet near term customer requirements. Surplus milk is limited in the spot market. Customer cheese orders for mozzarella and provolone are strong into the fall period. In general, the Northeast market realizes good demand and developing interest from various food service outlets. Manufacturers' cheese stocks remain balanced. The market maintains a firm undertone.
- Cheese Midwest: As Class I demand grows, some cheese manufacturers are facing dwindling milk supplies. Several manufacturers continue to fortify to offset falling milk intakes. Spot loads of milk are increasingly difficult to come by and few manufacturers report purchasing additional loads of fluid milk. Industry contacts feel that overall demand for cheese continues to grow in the Central region. Buyers are requesting additional loads outside of contracts. Some suppliers report numerous calls from new buyers looking for a variety of cheeses. Market participants seem

- optimistic that cheese demand will continue to grow throughout the month. Inventories are mixed in the Central region. Cheddar cheese stocks are a little heavy, but have seen some relief over the past few weeks. Inventories for curds, fresh cheeses, and provolone are all reportedly light.
- Cheese West: Although plenty of milk is available for processing across much of the West, cheese makers in parts of the region are scrambling to get a few extra loads of milk due to seasonal declines in milk production and the increased draw of fluid milk for school startups. Cheese inventories are long, but holding relatively steady. A few industry contacts suggest manufacturers are able to rotate cheese stocks held in their warehouses. Supplies of young cheese, blocks and barrels, are still somewhat limited and continue to push cheese prices at auction markets. Domestic retail demand is solid and manufacturers report cheese is moving well.
 - This week's GDT auction saw the dairy price index jump 12.7%. Gains were led by WMP up 18.9%, BMP up 18.1% and butter up 14.1%. Cheddar cheese was up 8.9%.
 - International: In Western Europe, seasonal declines in milk production have accelerated as a result of summer heat in some areas. Informal estimates from German processors have some intakes down nearly 2% from a week ago. Components are also dropping. EU milk deliveries during June were 1.9% below June last year, according to Eurostat. This is the first monthly decline since the 1.7% decline during March 2015. Cow culling was up in some areas. In Germany, January-June 2016, 9.1% more cows were sent to slaughter than the prior year, another way producers sought to reduce operational costs and raise revenue. Butter prices are stronger. Firming is expected to continue, at least in the near term. Current demand for new bulk butter transactions is quiet. Supplies available for new sales are limited. Much current production has been previously contracted. Sellers are inflexible in pricing. Whey prices have firmed in Western Europe. In part this reflects cheese production that is below what manufacturers would like to achieve. With milk production declining, buyers do not expect much supply relief in coming months. This is helping to strengthen markets due to increased demand.
 - International: In the EU, demand for sliced cheese is strong with limited supplies. Semi hard cheese demand is robust. Manufacturers are attempting to increase cheese production but with seasonally declining milk production, this is difficult to achieve. Thus, cheese continues to be taken out of aging programs to meet current demand. Many dairy product manufacturers have determined that making cheese currently is more profitable than making skim milk powder or butter, so what extra milk there is frequently goes into cheese. Nevertheless, the lower milk availability is straining existing cheese stocks.
 - International: Many dairy producers in Australia recently had their milk prices retroactively reduced for the final two months of the 2015/16 season, leaving many owing a debt to the processor. Prices for the new season are lower than many expected. This leaves many dairy producers in a very tough financial situation. Many producers are culling herds and/or seeking other processors.

What's Bearish:

- Fluid Milk Pacific Northwest: Although some manufacturers are reaching a little further to find additional loads due to the start of schools, milk is still readily available for most processing needs. In the mountain states of Colorado, Idaho and Utah, farm milk production is steady. Plenty of milk is available for manufacturing facilities. Some milk is moving within the region and to neighboring states at prices just above Class III. Schools opening this week are creating an increase in Class I demand. Industry contacts report good crop conditions. Feedstock supply will be solid for the remainder of the year.
- NDM Central: Some industry contacts moved loads of low/medium heat NDM at prices at the low end of the range in an effort to relieve some inventory pressures. Falling milk production in the Central region has slowed low/medium heat NDM production, but domestic demand is described as lackluster. International interest is strong, but inventories are mostly long.

Recommendation:

July milk output in the U.S. was up 1.4%, down from a 1.6% increase the prior month. In addition, cow numbers stayed relatively flat, up just 2,000 head from June. Temperatures and humidity increased during July, which started to limit output. Fresh barrels continue to be tight, with no trades at all in this week's spot market. Blocks, on the other hand, finally closed the spread, but buyers took on 27 loads to do it. Fresh cheese across the country continues to be on the tighter side. With schools now open in parts of the country and opening soon in other regions, Class I demand has surged, further limiting manufacturing abilities. Block cheese has not been this high since Nov, 2014, but we don't see any reason for a market collapse over the coming 3-6 weeks. Heat continues in many parts of the country, while football season is also around the corner. Mozzarella cheese demand is on the rise as both school and the sports activities spur demand. Dry whey exports are strong and output is declining with the drop in cheese production. On the international side, low prices are doing their job. Curing low prices. Milk output in the EU is falling, while culling is way up in some areas. Hard cheese in the EU is tight, while demand is very strong. We've said it before, but this should limit imports into the U.S. Both Australian and New Zealand dairy operations continue to operate under major financial distress. As global dairy demand recovers, the U.S. is uniquely positioned to meet that demand. Producers with milk still to market in 2016 should look at ever cheaper PUT options, to get a basic floor price in place, but leave your upside open. While we think prices are also headed higher in 2017, producers wishing to get started on hedging could consider targeting \$16.85 average or higher on a small percentage of their output. The current 2017 average is \$16.58.

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