

The KDM Dairy Report – August 26th, 2016

What's Bullish:

- Outlook for U.S. Ag Trade Report: USDA expects U.S. ag exports to jump \$6 billion in 2017, according to the quarterly report. Beef exports were highlighted as making a big recovery, while China is projected to return as the top destination. Dairy product exports are forecast to increase by \$300 million to \$4.8 billion as competitors' supplies tighten.
- Cheese stocks at USDA-selected storage centers fell 4% (3.5 million lbs) over the period 08/01 through 08/24).
- Fluid Milk Southeast: Mid-Atlantic milk production continues to seasonally decline. Milk supply in this area is tighter

Futures Month	Class III 08/26	Class III 08/19	Change	Dry Whey 08/26	Dry Whey 08/19	Change	Cheese 08/26	Cheese 08/19	Change
Aug-16	\$16.91	\$16.95	(\$0.04)	28.400c	28.450c	(0.05c)	\$1.812	\$1.816	(\$0.004)
Sep-16	\$16.60	\$17.88	(\$1.28)	30.625c	31.800c	(1.18c)	\$1.769	\$1.895	(\$0.126)
Oct-16	\$16.57	\$17.58	(\$1.01)	34.975c	35.250c	(0.27c)	\$1.740	\$1.842	(\$0.102)
Nov-16	\$16.24	\$17.07	(\$0.83)	36.350c	37.000c	(0.65c)	\$1.697	\$1.780	(\$0.083)
Dec-16	\$15.94	\$16.60	(\$0.66)	37.500c	38.525c	(1.03c)	\$1.663	\$1.730	(\$0.067)
Jan-17	\$15.78	\$16.35	(\$0.57)	38.875c	39.750c	(0.88c)	\$1.650	\$1.693	(\$0.043)
Feb-17	\$15.90	\$16.20	(\$0.30)	38.500c	39.500c	(1.00c)	\$1.657	\$1.687	(\$0.030)
Mar-17	\$16.02	\$16.23	(\$0.21)	39.550c	40.000c	(0.45c)	\$1.669	\$1.682	(\$0.013)
Apr-17	\$16.20	\$16.27	(\$0.07)	39.975c	40.000c	(0.02c)	\$1.684	\$1.686	(\$0.002)
May-17	\$16.36	\$16.43	(\$0.07)	39.975c	39.750c	0.23c	\$1.697	\$1.700	(\$0.003)
Jun-17	\$16.57	\$16.59	(\$0.02)	40.000c	40.000c	0.00c	\$1.715	\$1.722	(\$0.007)
Jul-17	\$16.85	\$16.79	\$0.06	40.725c	39.750c	0.98c	\$1.740	\$1.737	\$0.003
12 Mo Avg	\$16.33	\$16.75	(\$0.42)	37.121c	37.481c	(0.36c)	\$1.708	\$1.748	(\$0.040)

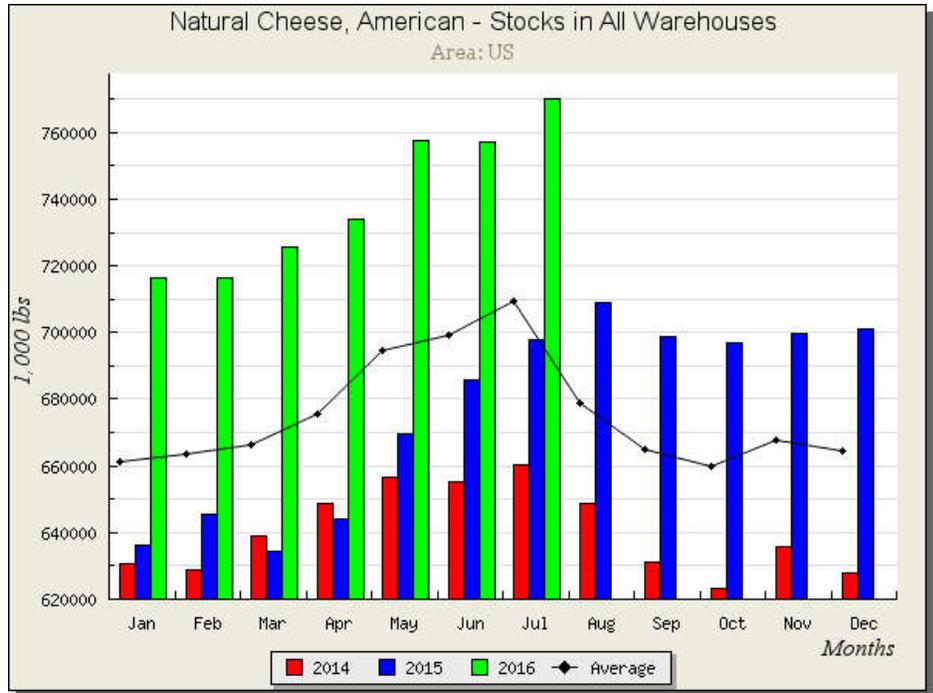
- as demand for milk in the Southeast grows. Class I demand is strong in the Southeast as many schools are back in session. Milk production continues to fall as hot, humid weather prevails. Florida milk production is steady to slightly lower this week. Milk marketers anticipate production will continue to fall in the upcoming weeks. Class I demand remains strong and bottlers report continual demand for single serve containers. The state milk imports totaled 40 loads this week. Cream cheese manufacturers are gearing up for the beginning of their busy season and anticipate pulling more cream into production in the upcoming weeks. Ice cream manufacturers continue to utilize large volumes of cream for production purposes. Condensed skim supplies are dwindling as orders for bottlers pick up.
- Fluid Milk Central: Temperatures overnight dipped down into the 50s in the North Central area, aiding cow comfort. However, spot loads of milk continue to be difficult to come by. Spot loads are reported at \$1.50 to \$2.00 over Class. Bottlers are busy filling orders from schools as many educational institutions in the region reopen their doors. North Central milk marketers are turning to other areas of the region for additional milk to meet demands.
- Fluid Milk Southwest: In California, many dairy operators are seeing a slight uptick on milk yields. However, the butterfat component in the milk continues to be low. Sales into Class 1 balancing plants are up as bottlers are filling many K-12 pipelines. Demand for alfalfa hay is moderate, but supplies are tight. Milk production is lower in Arizona. Although the effects of monsoon season are less active, temperatures remain high at 110 degrees. Class I orders from the retail sector are up as some grocery stores are restocking shelves. Interest for ice cream is active. In New Mexico farm milk output is slightly lower this week. Some sporadic rain showers are unsettling cows' comfort. Bottled milk sales into educational institutions are up. Class I milk demands from retailers and food service are mostly steady, but manufacturing milk volumes moving into cheese processing facilities are flat.
- Fluid Milk Pacific Northwest: Recent hot spells have suppressed milk production a little, but intakes rebound as temperatures moderate. Good volumes of milk continue to flow into bottling for school milk programs. Some processors are looking for a little extra milk to fill up manufacturing schedules.
- Butter Northeast: As students head back to school, an increasing amount of fluid milk has been going towards their demand and away from the production of other dairy products. In response, the Northeastern butter market has seen significant reduction in butter churning rates. In response to increased fluid milk sales and low cream availability, butter has been tight in the market.
- Butter Central: Industry contacts feel spot loads of cream are still available, but less obtainable than in recent weeks. A few manufacturers who were previously selling loads of cream are now holding on and processing all contracted cream loads in order to keep churns full. Demand is strong. Market participants report growing demand from food service and retail outlets. Some contacts speculate some of the recent spark in demand can be attributed to schools going back into session. Bulk butter prices reported ranged from market to 7.5 cents over the market. The market undertone is firm.
- Butter West: Domestic print butter demand remains solid. Cream availability is mixed, with some areas being tight and other areas having cream readily available. U.S. butter inventories are large, but industry contacts question how much of the stockpile is bulk or print butter, and how much is committed versus not committed to buyers.
- Dry Whey Northeast: Industry contacts describe domestic whey demand as steady and product is moving well through contracts. International demand is good. Inventories are getting tighter and supplies for spot sales are not as readily available.
- Dry Whey Central: Prices are mostly higher this week. Many buyers agree whey is more difficult to come by than in recent weeks and availability is tight. Buyers seeking specific brands or quality specifications are willing to pay premiums unseen in previous weeks. Several market participants feel both domestic and international demand is strong. Some manufacturers have slowed dryers in reaction to decreased cheese production rates. Inventories are comfortable to light. The market undertone is firming.
- Dry Whey West: Domestic demand is increasing and export demand has provided good support for prices. Inventories are comfortable to tight. A few buyers are finding limited availability of western whey outside of contracts, especially for some specific brands.
- Cheese Northeast: The market is tight around this time of year with fluid milk tightening and supplies down. Some cheese plants are operating as best they can with the given milk levels. While students return to school, it has been difficult to fill cheese orders that have been coming in. Suppliers have been routing milk to areas of the nation with low supplies, like the Southeast, moving more to fluid and less to cheese vats. Manufacturers' cheese stocks remain balanced to tight.
- Cheese Midwest: A few industry contacts report being short on milk, but are able to find spot loads when needed. Demand is mixed. Some market participants feel sales slowed some this week following several weeks of active orders outside of contracts. Other manufacturers feel demand

continues to grow ahead of the holiday season. Several manufacturers report high volumes of calls from buyers looking for cheese. However, only some manufacturers can meet their needs. Cheese curd sales continue to soar as the fair and carnival season continues. Inventories vary and widely depend on the variety of cheese. Cheddar and American cheese inventories are mostly long. Some manufacturers are blending cheese with some age on it with fresher cheese in an effort to manage aged cheese stocks. The market undertone is steady to firming.

- Cheese West: Cheese makers are trying to keep their production schedules full. Although milk is generally available within the immediate area, a few processors have had to reach a little further to get extra spot loads of milk needed to round out production. Some manufacturers note domestic retail and food service demand has eased back a little for American style cheeses, but mozzarella demand is picking up.
- Foreign cheese: The tight supply situation for cheese in the EU is not expected to significantly ease in the near term. Cheese manufacturers do not expect that increased milk supplies will become available for making cheese in the near term. This will keep supplies tight and put upward pressure on prices.
- This week the USDA announced plans to purchase approximately 11 million pounds of cheese from private inventories to assist food banks and pantries across the nation.
- International: Australia's new milk production season is getting off to a slow start. July milk output was down 10.3% vs. a year ago, according to Dairy Australia.

What's Bearish:

- Spot Market: Blocks finished the week down 11½¢ to \$1.74/lb on 18 trades. Barrels fell 18½¢ to \$1.68/lb on just 3 trades. Grade A NDM inched ¼¢ lower to \$0.85/lb on 16 trades, while butter lost 13¼¢ to \$2.05¼/lb on 9 trades.
- Cold Storage Report: Butter stocks at the end of July were 31% higher than a year ago, according to USDA. American cheese stocks and total cheese stocks were both 10% higher over the same period.
- Livestock Slaughter Report: Dairy cow slaughter in July totaled 213,300 head, down 10.6% vs. a year ago, and the lowest July total since 2011.
- Fluid Milk Northeast: Hot weather saw some relief this week in the Northeast. Evening temperatures dipped down into the 50s in some parts of the area, boosting cow comfort. Milk marketers report a smaller decrease in milk production than in recent weeks. As education institutions go back into session, bottlers report strong orders for single serve containers. Industry contacts report availability of discounted spot loads of milk on the weekends.



Recommendation:

Despite milk supplies continuing to decline seasonally, the start of schools competing with manufacturing milk and a tight fresh cheese and butter supply, the spot market was simply crushed this week. Apparently \$1.86+ cheese with record supplies in storage was enough to persuade buyers to step away for the time being. Offers fell over themselves in both blocks and barrels. From one week to the next, we shaved \$1.50/cwt off the Class III price, with the front month futures taking the brunt of the decline. After six trading days in a row with losses, we are technically very oversold. But fear is a strong motivator, so we wouldn't be surprised to see more selling to start the week, as producers begin seeing their margins evaporate, even with cheap feed. At some point, however, we believe the market will recover. Domestic demand is still very good, some cheese plants remain sold out through Q4 and internationally the milk supply has begun to contract. That won't stop. Producers with existing sold contracts should take advantage of this correction to purchase upside protection in the form of call options. We would not sell at current levels. Mentally, be prepared to watch price fall further, before sellers run out of momentum and buyers return. A correction like this was certainly due, after 6-8 weeks of steadily higher moves. Yet we believe we are still in the early stages of a longer term bullish move in milk.

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