

The KDM Dairy Report – September 16th, 2016

What's Bullish:

- Weekly cold storage numbers show a seasonal drawdown has started in August. For the period 08/01 through 08/12, butter stocks at USDA-selected storage centers have declined 6% (1.6 million lbs) while cheese stocks are down 1% (1.1 million lbs).
- Fluid Milk Mid-Atlantic: Milk supplies are adequate, as production volumes move lower. Balancing plants are able to meet fluid contract commitments with very little remaining for manufacturing.
- Fluid Milk Southeast: Production continues to lose ground. Manufacturing supplies are held near contract minimums to

Futures Month	Class III 09/16	Class III 09/09	Change	Dry Whey 09/16	Dry Whey 09/09	Change	Cheese 09/16	Cheese 09/09	Change
Sep-16	\$16.36	\$16.51	(\$0.15)	30.350c	30.250c	0.10c	\$1.751	\$1.768	(\$0.017)
Oct-16	\$16.07	\$16.70	(\$0.63)	34.500c	35.000c	(0.50c)	\$1.698	\$1.756	(\$0.058)
Nov-16	\$16.24	\$16.59	(\$0.35)	36.500c	36.075c	0.42c	\$1.701	\$1.741	(\$0.040)
Dec-16	\$16.00	\$16.20	(\$0.20)	37.000c	37.000c	0.00c	\$1.680	\$1.697	(\$0.017)
Jan-17	\$15.86	\$15.96	(\$0.10)	37.800c	38.475c	(0.68c)	\$1.659	\$1.670	(\$0.011)
Feb-17	\$15.96	\$16.01	(\$0.05)	37.500c	39.475c	(1.98c)	\$1.672	\$1.670	\$0.002
Mar-17	\$16.05	\$16.04	\$0.01	38.000c	39.000c	(1.00c)	\$1.677	\$1.675	\$0.002
Apr-17	\$16.15	\$16.12	\$0.03	38.500c	39.325c	(0.83c)	\$1.681	\$1.678	\$0.003
May-17	\$16.23	\$16.26	(\$0.03)	38.500c	39.000c	(0.50c)	\$1.697	\$1.698	(\$0.001)
Jun-17	\$16.40	\$16.43	(\$0.03)	38.750c	39.500c	(0.75c)	\$1.715	\$1.716	(\$0.001)
Jul-17	\$16.60	\$16.66	(\$0.06)	38.800c	39.000c	(0.20c)	\$1.725	\$1.737	(\$0.012)
Aug-17	\$16.64	\$16.81	(\$0.17)	39.000c	39.250c	(0.25c)	\$1.738	\$1.740	(\$0.002)
12 Mo Avg	\$16.21	\$16.36	(\$0.14)	37.100c	37.613c	(0.51c)	\$1.700	\$1.712	(\$0.013)

- ensure bottling plant needs are met. Florida is still seeing hot weather but nights are cooler. Rain is a daily occurrence. Production declines continue with expectations of bottoming out soon.
- Fluid Milk Pacific Northwest: Milk intakes have fallen off a bit, while bottling demand is steady. Manufacturers are processing available milk easily within their own facilities with minimal need to move loads around. Milk production in the mountain states of Colorado, Idaho and Utah is steady to lower. Single serve fluid milk sales are strong with schools, hospitals and other institutions pulling good volumes. Interest to process NDM, SMP and MPC is strong.
- Butter Northeast: Some butter manufacturers continue to draw down bulk butter inventories and microfix to cover their existing needs. Currently, active demand results from retail markets. Q4 needs are at the forefront of some production runs, as manufacturers look to increase stocks for year-end customer orders. Bulk butter prices range 4-8 over the market of the CME Group.
- Butter Central: Manufacturing is uneven throughout the region. The churning activity is lower in a few processing plants as cream supplies fluctuate. Processors are expecting to increase butter production in order to meet the anticipated high demand for Q4. Some manufacturers are reducing bulk butter inventories as they microfix existing stocks to fill current print butter orders. Print butter inventories are steady to building. Demands from many retail channels and restaurants are strong.
- Butter West: Butter is moving well through existing contracts and buyers are placing orders for their Q4 holiday butter needs. Some industry contacts say they are starting to see a little seasonal uptick in retail butter sales. Butter inventories across the industry vary from long to committed.
- Dry Whey Northeast: Tighter inventories are a result of seasonal milk clearing to Class I, and summer's heat impact on milk production. Some sources hint that whey solids are clearing to higher protein production, suggesting economics favor higher protein products over whey powder. Availability is random for purchases in the cash markets. Hence, active trading, at premiums, is occurring in the resale market. The dry whey undertone is firm.
- Dry Whey Central: Industry contacts describe consistent demand and steady inquiries. Inventories are generally tighter and some contacts feel manufacturers are more willing to hold stocks as a cushion. Resellers are active and making trades at the upper end of the range. Dry whey production is steady, but may be hampered a little by increased manufacturing of higher protein concentrations.
- Dry Whey West: Prices moved higher this week, at the top end of both the range and mostly price series. A few manufacturers report being committed through the end of the quarter or end of the year. Resales are active. Demand is steady. A few contacts note a production shift to higher protein concentrations may be reducing the amount of dry whey being made.
- NDM Northeast: Some sources report declines in low/medium heat NDM shipments this week. There are manufacturers who project that customer orders could reflect a bump in pricing, while they suggest current NDM inventories are "practically sold out" due to end-of-year and the 2017 Q1 sales volumes moving higher. The NDM market undertone is unsettled as prices continue to firm.
- NDM Central: Prices are higher in the mostly series, as f.o.b. spot transactions adjusted the pricing series. NDM production is ongoing, as Class I needs continue to pull available milk supplies. Production is well below capacity for most plants. Interest in contracting is active, with sales reducing the availability of inventories. Resale market transactions are increasing for buyers needing smaller loads. The market undertone remains firm.
- NDM West: The market undertone is firmer. Compared to the previous week, sales volumes in the spot market are slightly higher. According to industry participants, some buyers/end users want to settle Q4 contracts in anticipation of prices going higher. Some NDM manufacturers are not hesitant to hold stocks, expecting better prices in the next few weeks. NDM sales into cheese plants for fortification purposes are active. In addition, demand from bakers is improving as the fall baking season approaches.
- Cheese Northeast: Manufacturing schedules are somewhat active where milk supplies permit. Reports indicate that milk volumes, in general, are mostly steady while components are marginally improving but remain at lower seasonal levels. Mozzarella cheese production and cheddar for aging programs remain steady. Contract orders are expediting most transactions. Process cheese interest is seasonally lighter. Cream cheese producers note typical strong fall orders.
- Cheese Midwest: Cheese makers are seeing decent demand for commodity cheese in both retail and food service markets. Most varieties of cheese are moving well through regular contracts. However, cheese with any irregularity or age is a lot harder to move. Manufacturers are running their facilities at or just below capacity. Some manufacturers are looking for additional loads of milk to round out cheese production. Spot loads of milk are a little harder to find and cheese makers need to reach further out of the region to find the extra milk.

- International: In Europe, sliced cheese availability continues to be tight. Many manufacturers have allocated or reduced deliveries. There are low stocks in aging programs. This tight supply situation is expected to continue in the immediate future. Prices continue to rise. With significant overcharges, it is possible for buyers to obtain short-run quantities. Domestic demand in Europe remains strong.
- International: Late August to early September milk deliveries to dairy processors in Germany are reported to be a bit lower than expected. Hotter late summer weather is cited. Butter prices in Western Europe firmed at each end of the price range. Stocks of fresh butter are lower than desired levels and retail demand is increasing. With cream prices firming, upward pressure on packaged butter pricing is expected to continue. Skim milk and whole milk powder prices in Western Europe increased at each end of the price range. There is a declining supply available to buyers following shrinking milk supplies. Manufacturers are increasingly cautious about sales terms due to uncertainty as to what production volumes will be possible moving forward. There is good buying from the European food industry, which is supporting price strength. Contracts for first quarter 2017 are being developed. Export interest is also helping to support prices.
- International: Hay prices in Australia have been elevated, with low stocks and inconsistent demand. While recent rainfall has been average, heavy rains during recent months have helped replenish reservoir levels, easing water prices paid by producers using irrigation. Pricing for cull cows remains strong, as does interest by cash strapped dairy producers in reducing herd size as a way to raise cash and reduce ongoing costs. Butter prices increased significantly at each end of the price range. Several factors are mentioned by dairy market participants. Expectations of slightly less milk being available to make butter in Oceania, a growing domestic consumer market in Australia, plus a market adjustment moving prices closer to EU prices. Cheddar prices increased to a U.S. equivalent \$1.60/lb. Reduced early season milk availability for making cheddar left lower cheese production while exports increased. Cheese production in Australia during July was down 9.5% from July 2015.

What's Bearish:

- Spot Market: Barrel cheese fell 12½¢ for the week, settling at \$1.48 on heavy trading of 43 loads. Blocks lost 6¢ to close at \$1.65/lb on 14 trades. Grade A NDM managed a ½¢ increase to settle at \$0.91/lb on 12 trades, but butter was down 3¼¢ to close at \$2.00/lb on 12 trades.
- Fluid Milk Northeast: Milk output in the region is mostly steady. Cooler temperatures have moved into parts of the area and are expected to progress through the week. Active pulls from Class I orders appear to be settling, as milk pipelines continue to be filled. Some manufacturers note higher than normal intakes for this time of the year.
- Fluid Milk Central: Protein and butterfat milk components are rising. Milk handlers note farm milk pickups are trending higher and there is evidence of expansions taking place. Feed availability within the region is ample to support herd growth. Sales into Class I are mixed from area to area. The draw on milk supplies to refill the school pipeline stabilized as of this week. Class II sales are generally lower as frozen dessert manufacturers realign production schedules with fall demand.
- Fluid Milk Southwest: Farm milk intakes are steady to higher in California as daytime temperatures continue dropping. Milk components are slowly improving. Manufacturers report having sufficient milk supplies for processing. Requests from bottlers have plateaued as school milk pipelines are filled. Class 1 sales to restaurants and grocery stores are slightly lower. Ice cream sales are seasonally down. In Arizona, milk production is slightly higher. The cooler morning temperatures, below 100 degrees, are supporting cows' comfort. Demands for Class II products, especially ice cream, are weakening. Milk production is even in New Mexico. Manufacturers have adequate milk supplies for most processing needs. Class I sales to retailers, food service and educational institutions are slightly down. Sales into Class II are seasonally lower. Sales to cheese processing plants are active. Dairy operators' interest for high quality alfalfa hay is light as supplies are readily available.
- Cheese West: Cheese makers report no problems finding milk available for processing needs. Cheese production is steady and facilities are running at or near full capacity. Cheese marketers suggest inventories are a bit long for American and Italian cheeses. However, industry contacts feel these stocks will be drawn down in the next few months. A few industry contacts note a growing buyer interest for retail cheese. Domestic cheese demand is stable for most cheese varieties.

Recommendation:

A large, relentless, Western barrel seller continued to control the spot market this week. After hitting a high of \$1.88 on August 10th, the barrel price has plunged 40¢, to its lowest price since May. There is a lot of speculation out there as to who, why and how long this will go on. Blocks fell in sympathy but not nearly as much, sitting at a 17¢ premium. The big question is who will this spread be fixed; will block fall, barrels go up or a bit of both. With cheese being tight in the EU and Oceania prices hovering around \$1.60/lb, without adding shipping costs, the U.S. suddenly has some of the cheapest cheese on the planet. That should mean further downside is limited, but we thought that a while ago. Domestic demand continues to be strong, though it has shifted from process to mozzarella with the change in seasons. Both the dry whey and NDM markets appear to be firming, while holiday demand is around the corner. We think the market is a bit oversold, but it will do what it wants, not what we want. Another 43 loads of barrels traded this week, and one wonders when that supply and seller will slow down. Once it does, expect the market to pop. On the negative side, feed remains cheap and there are some signs of expansions, especially in the Midwest. With tighter global milk supplies, the U.S. is in an ideal position to increase exports. It will need to if herd expansions are the direction we're headed. We would continue to look at getting come 2017 milk hedged in Q1 at \$16.20 or higher, and some Q2 at \$16.30 or higher. Wait for that rebound in the market to do any further Q4 '16 sales.

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