

**The KDM Dairy Report – September 23<sup>rd</sup>, 2016**

**What's Bullish:**

- Spot Market: Block cheese gave up 9¢ to settle at \$1.56/lb on 16 trades, but barrels gained 3¢ on 40 trades, to close at \$1.51/lb. Butter climbed 2¼¢ to reach \$2.02¼/lb on 26 trades and Grade A NDM picked up 2¼¢ on 25 trades to settle at \$0.93¼/lb.
- This week's GDT auction saw the dairy price index increase by 1.7% over the last event. Butter milk powder led the way up 7%, followed by AMF, up 4.6%. Cheddar cheese gained 2.2% to a U.S. equivalent \$1.60/lb.
- Livestock Slaughter Report: 244,600 dairy cows were removed from the milking herd in August, up 8.5% vs. a year ago, and the highest Aug total since 2013.

Futures Month	Class III 09/23	Class III 09/16	Change	Dry Whey 09/23	Dry Whey 09/16	Change	Cheese 09/23	Cheese 09/16	Change
Sep-16	\$16.38	\$16.36	\$0.02	30.700¢	30.350¢	0.35¢	\$1.751	\$1.751	\$0.000
Oct-16	\$15.56	\$16.07	(\$0.51)	33.850¢	34.500¢	(0.65¢)	\$1.648	\$1.698	(\$0.050)
Nov-16	\$15.78	\$16.24	(\$0.46)	34.900¢	36.500¢	(1.60¢)	\$1.663	\$1.701	(\$0.038)
Dec-16	\$15.73	\$16.00	(\$0.27)	35.750¢	37.000¢	(1.25¢)	\$1.656	\$1.680	(\$0.024)
Jan-17	\$15.62	\$15.86	(\$0.24)	35.850¢	37.800¢	(1.95¢)	\$1.642	\$1.659	(\$0.017)
Feb-17	\$15.73	\$15.96	(\$0.23)	36.500¢	37.500¢	(1.00¢)	\$1.650	\$1.672	(\$0.022)
Mar-17	\$15.79	\$16.05	(\$0.26)	37.000¢	38.000¢	(1.00¢)	\$1.661	\$1.677	(\$0.016)
Apr-17	\$15.86	\$16.15	(\$0.29)	37.250¢	38.500¢	(1.25¢)	\$1.666	\$1.681	(\$0.015)
May-17	\$16.05	\$16.23	(\$0.18)	37.500¢	38.500¢	(1.00¢)	\$1.682	\$1.697	(\$0.015)
Jun-17	\$16.25	\$16.40	(\$0.15)	38.000¢	38.750¢	(0.75¢)	\$1.700	\$1.715	(\$0.015)
Jul-17	\$16.49	\$16.60	(\$0.11)	38.025¢	38.800¢	(0.77¢)	\$1.724	\$1.725	(\$0.001)
Aug-17	\$16.63	\$16.64	(\$0.01)	39.000¢	39.000¢	0.00¢	\$1.735	\$1.738	(\$0.003)
<b>12 Mo Avg</b>	<b>\$15.99</b>	<b>\$16.21</b>	<b>(\$0.22)</b>	<b>36.194¢</b>	<b>37.100¢</b>	<b>(0.91¢)</b>	<b>\$1.682</b>	<b>\$1.700</b>	<b>(\$0.018)</b>

- Weekly cold storage numbers are showing a strong drawdown in butter. Stocks at USDA-selected storage centers declined 10% (2.7 million lbs) over just the first 19 days of September. Cheese stocks over the same period fell 1% (1.3 million lbs).
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic is mostly flat, but in some areas milk volumes continue to move marginally lower. Milk haulers point out load volumes have stabilized somewhat after the most recent declines. Sales are good across the Classes in the Northeast.
- Fluid Milk Southeast: Farm milk output is steady, but milk supplies continue to circumvent a few manufacturing operations. Bottling is receiving support from Southwest and Mideast milk. Milk production in Florida dipped once again. The state's fluid demand is mostly flat. However, milk imports rose by 20 loads this week, to 70 f.o.b. spot shipments, in support of bottled milk sales.
- Fluid Milk Central: South Central milk production bobbled in some areas as rainstorms delivered challenging conditions to operators with dry lot housing. North Central operations fared a little better, despite frequent rainstorms. Demand for spot milk loads is active. Cheese plant operators are scouring the region looking for milk loads, but pricing and transportation costs are stalling some sales. Spot milk prices range from \$1.25-\$3.00 over class. Fluid milk demand is mixed throughout the region. A few plant operators indicated orders are lower as bottlers adjust for weekly features, but others are sending additional loads to their Class I customers.
- Butter Northeast: Butter production dipped slightly this week. Additionally, the level of seasonal milk supply into balancing restricts churning at some plants. Orders are steady as upcoming yearend needs continue to develop. As butter prices decline, feature activity supports an increase in retail butter orders.
- Butter West: Retail demand for butter is building. Production is active, yet processors seem willing to pull butter out of inventory to prepare it for retail market sales. Industry-wide butter inventories are still long, but many contacts are not concerned and feel Q4 demand will deflate stocks to more comfortable levels.
- Dry Whey Central: Manufacturers report dry whey inventories are a little tighter and spot availability has declined recently. Dry whey production is active, but some processors have switched to making higher proteins instead of dry whey.
- Dry Whey West: Prices moved higher at the top ends of both the range and mostly price series. Industry contacts say domestic demand is not great, but calls from Southeast Asian feed markets continue to support some export demand for dry whey. Production is steady to lower. Inventories are mixed. Some manufacturers report having committed stocks into the near future.
- NDM: Spot prices are higher, following upward movements of various indices. According to some market participants, the recent SMP pricing uptick at the GDT is helping to boost domestic NDM prices. The market undertone is firm. Some NDM processors are anticipating higher prices in the near future. Consequently, they are holding stocks in lieu of selling. Low/medium heat NDM demand from bakers is inching up as the fall baking season approaches.
- Cheese Northeast: Generally, limited volumes of milk are available for processing. Market demand for mozzarella cheese continues to be very good with strong orders from food service and pizza makers. Cheddar manufacturers are comfortable with their current inventories.
- Foreign Cheese: European cheese manufacturers continue to struggle to keep up with demand for cheese. Manufacturing volumes remain below desired levels, mostly due to lower milk supplies available for cheese making. This has resulted in aging stocks being below levels needed to meet projected future demand for aged cheese because cheese is being taken from aging to meet current demand. Customers seeking to obtain new orders of cheese in the near term are usually disappointed.

**What's Bearish:**

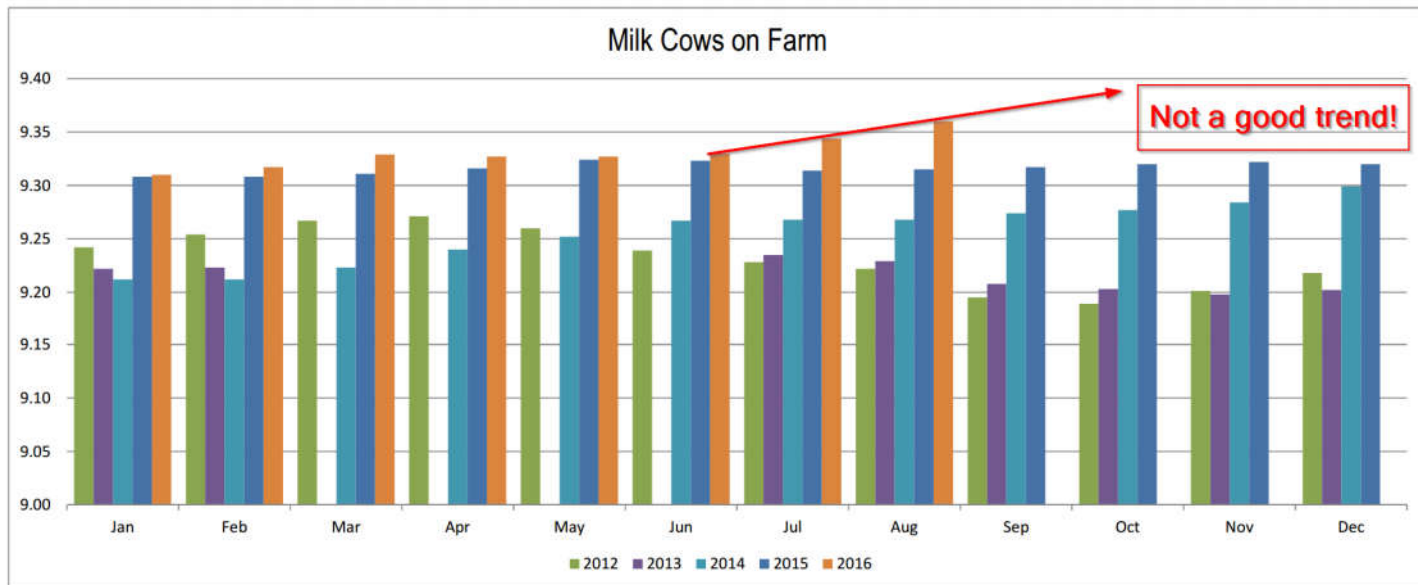
- Milk Production Report: USDA revised July cow numbers sharply higher and tacked on another big increase in August, to bring the milking herd up to 9.360 million head. That's a jump of 30,000 head since June and the largest milking herd since 1996! States showing the biggest gains in cow numbers were CO, ID, MI, SD and TX. Milk output in August was 1.9% higher than the prior year, led by TX up 11%, CO up 6.9% and MI up 6.6%.
- Cold Storage Report: Butter stocks at the end of August were 52% higher than a year ago. American cheese stocks were 5% higher than last year, but down 3% from July. Total cheese stocks were 6% higher than in Aug '15. At 1.243 billion lbs, it's the highest amount of cheese in storage on record (since 1917) for the month of Aug.
- Fluid Milk Southwest: Farm milk intakes in California are higher this week. The cooler temperatures in the Central Valley are conductive to cows' comfort. In addition, some dairy operators are adding more cows to the milking parlor. Milk protein and butterfat components are improving. Milk production is steady to slightly higher in Arizona. Lower temperatures and humidity are helping to support cows' comfort. Harvesting of good

to excellent quality alfalfa is active throughout the state. In New Mexico, the rainy conditions are slightly reducing milk yields at the farm level. However, there are enough milk supplies for processing. Moderate to heavy manufacturing milk volumes continue clearing into Class III processing plants.

- Fluid Milk Pacific Northwest: Seasonal temperatures are aiding cow comfort. Bottling demand continues to pull strong volumes of milk, while manufacturers start to gear up for the fall and winter holidays. Processors are not having any trouble finding milk for processing needs. In the mountain states of Colorado, Utah and Idaho milk production has only backed off slightly. Manufacturers report milk is still plentiful for most processing needs.
- Butter Central: Butter production is more active in the region as cream is more available. Bottled milk standardization is adding to cream supplies. In addition, the butterfat levels in the milk are improving. This week, there are more bulk butter supplies available in the spot market. Print butter inventories are steady to building.
- Dry Whey: Prices advanced at the top of the range. This week, dry whey production is steady to higher as additional milk supplies cleared to a few cheese manufacturers. Demand for dry whey is relatively steady, prompted by customers' obligations. Previously sold out suppliers made loads available in the spot market this week. Generally, inventories are light to adequate. Resale market trading continues to occur at a premium.
- Cheese Midwest: A few cheese makers report ramping up for fall cheese needs. Processors seem willing to take in a few extra loads of milk to bump up cheese production. Milk components are improving a little, but some cheese makers are still fortifying the cheese make process to bolster yields. Domestic cheese demand is mixed. Stocks are generally long for commercial varieties. Recent price decreases have allowed some manufacturers to clear inventories, however a few industry contacts suggest the price changes are giving some buyers pause. The buyers want to take a wait and see approach, buying only what is needed until the price settles.
- Cheese West: Cheese production is active. A few cheese manufacturers have had down days for repairs or maintenance, but facilities are mostly running near full capacity. Milk is in good supply. Export cheese markets remain soft, while domestic demand from retail and food service markets is firm.

**Recommendation:**

Big volumes continued to trade during this week's spot market, though all components but blocks finished the week higher, and barrels were quiet on Friday. Have we finally carved out a bottom? It's hard to say. A flurry of bearish USDA reports came out this week. The Milk Production report does not have as much immediate impact on the market as in years past, but the revision in cow numbers showing a sharp increase of 30,000 head from June certainly put a damper on the market (see graph below). Cow numbers are up 55,000 head YoY and at the highest level in 20 years. Feed is cheap and plentiful. Not a good combination for higher prices. The Cold Storage Report continued to reflect a record amount of cheese in warehouses, but the market knew this already. With current spot prices working out to about \$14.70/cwt, cheese prices are going to need to increase in a hurry in order for the front months to continue to carry the premium they are at this point. Futures finished solidly in the red as they continued to close the gap with spot prices. About the only encouraging factors are continued strong domestic demand and the international picture. In a little over a month, we've gone from the world's most expensive cheese, to the world's cheapest cheese. Hopefully these lower prices encourage buyers and move inventory. The short to medium term looks negative, with the surprise production report and jump in cow numbers. However, if international demand begins to recover, the U.S. could be ideally situated to meet that demand, considering the limited output potential in the EU and Oceania. We've exported as high as 16% of our milk supply in the past, but currently sit around the 14% level. An increase in exports to 16% or higher would certainly help support prices. Producers might want to consider buying call options Dec-Apr and holding them for a price rally. Should futures prices begin to recover in the medium term, they can then target selling their milk through their plant or broker, while already having their upside covered. It's hard to know what to do up front. If our featured barrel seller returns next week, prices will continue to fall in the Q4 months. However, the barrel market was silent on Friday, and we've traded 139 loads in 4 weeks. If the seller has run out of loads to sell, expect bidders to begin pushing prices up a bit. But at this point, it's anyone's guess.



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