

The KDM Dairy Report – October 7th, 2016

What's Bullish:

- Dairy Products Report: American cheese output in August was down 1.5% vs. a year ago and down 2.4% vs. July. However, Total cheese output, increased 1.2% vs. Aug '15. Butter output increased just 0.7% vs. last year, but was down 10.4% compared to the prior month.
- Fluid Milk Northeast: Farm milk production in the Northeast and Mid-Atlantic is generally steady, as output hovers near seasonal lows. Class I, II, and III demand is good.
- Fluid Milk Southeast: Milk production remains in good balance with only the occasional need to ship to manufacturing plants. Class I demand continues to be good, as bottlers add to orders. As Florida's milk production bottoms, temperatures are hot, with cooler nights and late afternoon showers. Import milk shipments totaled 110 spot loads this week, up from 90 last week.

Futures Month	Class III 10/07	Class III 09/30	Change	Dry Whey 10/07	Dry Whey 09/30	Change	Cheese 10/07	Cheese 09/30	Change
Oct-16	\$14.99	\$15.21	(\$0.22)	32.500¢	33.275¢	(0.77¢)	\$1.602	\$1.616	(\$0.014)
Nov-16	\$15.47	\$15.63	(\$0.16)	34.750¢	34.500¢	0.25¢	\$1.634	\$1.650	(\$0.016)
Dec-16	\$15.44	\$15.50	(\$0.06)	35.475¢	34.825¢	0.65¢	\$1.628	\$1.635	(\$0.007)
Jan-17	\$15.40	\$15.38	\$0.02	35.975¢	35.000¢	0.98¢	\$1.625	\$1.628	(\$0.003)
Feb-17	\$15.57	\$15.50	\$0.07	36.500¢	35.000¢	1.50¢	\$1.636	\$1.632	\$0.004
Mar-17	\$15.69	\$15.64	\$0.05	36.475¢	35.250¢	1.23¢	\$1.648	\$1.650	(\$0.002)
Apr-17	\$15.77	\$15.70	\$0.07	36.875¢	35.250¢	1.63¢	\$1.655	\$1.654	\$0.001
May-17	\$15.97	\$15.88	\$0.09	36.550¢	35.250¢	1.30¢	\$1.680	\$1.677	\$0.003
Jun-17	\$16.22	\$16.14	\$0.08	36.550¢	36.000¢	0.55¢	\$1.704	\$1.694	\$0.010
Jul-17	\$16.41	\$16.36	\$0.05	37.400¢	36.000¢	1.40¢	\$1.721	\$1.716	\$0.005
Aug-17	\$16.60	\$16.55	\$0.05	37.000¢	36.525¢	0.48¢	\$1.736	\$1.735	\$0.001
Sep-17	\$16.70	\$16.64	\$0.06	37.475¢	37.475¢	0.00¢	\$1.744	\$1.742	\$0.002
12 Mo Avg	\$15.85	\$15.84	\$0.01	36.127¢	35.363¢	0.76¢	\$1.668	\$1.669	(\$0.001)

- Butter Central: A few churn operators are curtailing production due to some operational issues in the plant. On the other hand, some butter processors are running operation schedules near to full capacity in order to meet current buyers' needs and the expected high demand in Q4. Microfixing is active in some plants. Print butter sales to retailers and food service are strong this week. Some manufacturers are clearing bulk butter stocks in the f.o.b. spot market. Meanwhile, buyers' interest is inching up.
- Butter West: Churning is largely active as manufacturers continue to gear up for Q4 butter needs. Butter makers are trying to take advantage of available and inexpensive cream. However, a few processors are holding back on churn rates in an effort to balance supply with demand. Inventories are still long. Manufacturers report domestic demand is coming in waves as market prices move lower. Many buyers are comfortable with the availability of butter and are only buying as needed.
- Dry Whey Northeast: Prices continue to trend upwards. Active cheese output augments dry whey production, but current inventories, at best, are adequate for filling only near term contractual customer accounts. Transactions in spot markets are limited and hand-to-mouth, with premiums usually attached. The current dry whey market undertone is firm.
- Dry Whey Central: Prices are steady to higher this week. A few whey buyers are working to get contracts in place for 2017. Industry contacts say the availability of dry whey spot loads has tightened. Production is steady to lower as manufacturers focus more effort on making higher whey protein concentrations.
- Dry Whey West: Prices moved slightly higher this week. Industry contacts say export demand has picked up and has allowed some manufacturers to clear inventories. A few manufacturers report dry whey stocks are committed through much of the remainder of the calendar year and there is limited spot load availability.
- Cheese Midwest: Cheese production is active, but a few cheese plants have scheduled down time for maintenance and repairs this week. Some manufacturers report milk intakes are down. Whether it is a transportation issue, milk production issue or simply an adjustment to milk rebalancing within areas of the region, the available milk is putting some pressure on cheese production volumes. A number of end users say cheese loads have been shorted a little this week as cheese makers juggle orders and production schedules. Domestic retail and food service demand remains strong in advance of the end of year holiday season.
- Cheese West: Cheese production remains strong. Inventories are long, but many industry contacts feel the stocks are manageable. Some manufacturers are shifting production from mozzarella to cheddars to add to aging programs. Domestic cheese demand is solid, especially for retail and food service business.
- CWT has accepted 10 requests for export assistance to sell 1.601 million pounds of Cheddar, Gouda and Monterey Jack cheeses to customers in Asia, the Middle East, North Africa and Oceania. The product has been contracted for delivery in the period from October through December 2016.
- Foreign Cheese: European sliced cheese markets for the third quarter exhibited a tight supply and brisk demand. Cheese production using available milk struggled to match demand, resulting in continuing draws on aging stocks. This resulted in some cheese deliveries being younger cheese stock. Even existing cheese customers with orders experienced some cuts and allocation of supplies. Semi hard cheese demand is expected to increase into later autumn, while milk volumes are expected to decline into November, resulting in tight cheese availability for the immediate future.
- International: Global milk production has fallen faster than expected in recent months, with the resulting rally in global dairy markets expected to be sustained into 2017, according to Rabobank's latest Dairy Quarterly report. Demand for dairy products, particularly butter and cheese, has remained strong in the US and has strengthened in Europe, resulting in a more dramatic reduction in surpluses available for export on to global dairy markets than had been expected just a quarter ago.
- Exports: The U.S. Dairy Export Council reported this week that record exports of milk powder to Mexico, and dry whey to China helped led to the first year-over-year increase in dairy exports in more than two years. Milk powder exports to Mexico were up 80% vs. a year ago, while total

NDM/SMP exports were 39% higher. Total whey exports increased 46% over the same period. Dairy exports in August were equivalent to 16% of US milk production, the highest level since April 2015.

What's Bearish:

- Fluid Milk Southwest: Farm milk intakes are trending higher in California. Daytime temperatures continue getting cooler in the Central Valley, aiding dairy herds' comfort. Milk components are still improving. Moderate to heavy manufacturing milk volumes continue clearing into Class 4b as western cheese production continues to be strong. Milk production is higher in Arizona. The cooler temperatures are reducing the stress on cows. Requests from grocery stores and food service for bottled milk are steady to higher, but orders from educational institutions are lower as most schools will be off for fall break soon. In New Mexico, the favorable weather conditions are raising the milk yield at the farm level. Orders from schools are down as the fall break starts by the end of the current week. Manufacturing milk volumes moving into cheese processing plants are mixed this week.
- Fluid Milk Pacific Northwest: Dairy contacts say they are seeing a slight increase in milk production. As manufacturers ramp up to meet holiday demand for dairy products, milk intakes are in good balance with processing needs. Bottling demands are steady. Milk production in the mountain states of Colorado, Utah and Idaho has backed off just slightly, but some industry contacts note milk intakes are up, predominantly due to increases in the milking herd. Most manufacturers are not having any trouble getting the milk needed for processing. Temperatures are providing good cow comfort.
- Butter Northeast: With ample cream currently available, some processors' churns remain seasonally active. Spot market buyers, in general, are making hand-to-mouth purchases with uncertainty, as butter prices plummet. Overall, the market undertone is weak.
- NDM: Current demand is somewhat sluggish, with limited buyer interest as contract sales make up the bulk of transactions. Transactions in spot markets are generally on a need-to-basis. Some NDM customers are shifting buying interests to substitute dairy products that are competitively priced. Hence, manufacturers' inventories are building.
- Cheese Northeast: Milk supplies are adequate for increased cheese production in the region. Plants are running full. Reports suggest milk that typically dispatches to southeastern dairies will not move that direction, the results of expected storm conditions that will likely create delivery problems. Those volumes may possibly add to cheese processors' milk intakes as surplus loads are made available. Cheese inventories are sufficient and building.
- This week's GDT auction showed a decline in the dairy price index for the first time in 4 events. The index fell 3.0%, led by Lactose down 9.7%, SMP down 3.9% and WMP down 3.8%

Recommendation:

Spot cheese prices put in their lows in the early part of the week, then found some support as bidders became more aggressive. As a result, blocks finished the week up 1¼¢ to \$1.55/lb while barrels were unchanged at \$1.51/lb. There were no block trades, but 25 loads of barrels exchanged hands. Grade A NDM and butter both finished weaker, however. NDM lost 1¼¢ to close at \$0.91½/lb while butter fell 4¼¢ to \$1.85/lb. Of note, the barrel volume was down from previous weeks. Have sellers begun running out of surplus? It's a bit hard to say at this point. U.S. demand has held up, but we have heard some talk about orders slowing down, which is unusual for this time of year. And butter prices have fallen sharply with no real end in sight yet. Cream is plentiful and cheap. On the positive side, there are several things in the global picture that are encouraging. Cheese looks to be tight through Q4 in the EU. Dairy exports, led by milk powder and dry whey, helped the U.S. sharply increase the amount of dairy products leaving this country. Global milk production appears to be declining faster than anticipated. Q4 Class III futures all finished in the red, but the 2017 contracts were all higher. We still think the short/medium term is tough to call, with both bullish and bearish fundamentals cancelling each other out. We'll see if seasonal demand picks up and gives spot bidders the advantage next week or not. But we are getting far more positive about 2017 and maintain that producers should be buying call options now in Q1 and Q2, using them to target sell orders. In this scenario, after a successful sale of milk, the previously purchased call option would provide upside protection for any further gains in prices, helping avoid leaving money on the table. We do not recommend selling 2017 at current price levels. Have a great weekend.

This material has been prepared by a sales or trading employee or agent of KDM Trading, Inc. and is, or is in the nature of, a solicitation. This material is not a research report prepared by R.J. O'Brien's Research Department. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that KDM Trading, Inc. believes are reliable. We do not guarantee that such information is accurate and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades. © Copyright 2016 - KDM Trading, Inc. All Rights Reserved