

The KDM Dairy Report – October 14th, 2016

What's Bullish:

- The seasonal drawdown has begun. Both cheese and butter stocks declined at USDA selected storage centers over the period 10/01 through 10/10. Butter holdings fell 10% (2.3 million lbs) while cheese supplies fell 3% (2.3 million lbs).
- CWT has accepted six requests for export assistance from members who have contracts to sell 1.195 million pounds of Cheddar, Gouda and Monterey Jack cheeses to customers in Asia, the Middle East and Oceania. The product has been contracted for delivery in the period from October 2016 through December 2017.
- Dry Whey Northeast: Supplies are currently tight, with users of dry whey seeking additional loads in other regions. The demand for fall baking needs adds to overall demand. International markets remain active. The market undertone is strengthening.
- Dry Whey West: Industry contacts report inventories with many manufacturers are tight. In some cases, dry whey stocks are fully committed. Secondary markets remain active. Some manufacturers are opting to produce higher whey concentrations instead of dry whey.
- Cheese Northeast: Current orders are being filled as a few processors operate near capacity. Mozzarella orders are good, with reports of inventories sold out for the year.
- Cheese Midwest: Production is below full capacity. A number of processors say they could run more milk through the vats, but are hesitant to buy the extra loads of milk unless priced favorably. Demand for natural cheese entering retail cut and wrap facilities has remained strong. However, due to the seasonal slowdown of grilling and lagging impacts of market prices, demand for process cheese is currently a little soft. Cheese inventories are long, but do not seem to be of major concern to industry contacts. For the most part, the stocks are well balanced by age and variety. And cheese industry contacts expect the inventories to be drawn down through domestic Q4 holiday demand and through an improvement of export market opportunities.
- Cheese West: Inventories are a bit long, but processors expect the seasonal demand to help draw down stocks. Industry contacts suggest domestic retail demand is solid, and lower prices are prompting buyer interest.
- International: Western European dairy processors and manufacturers report that for early October, there is less milk being received from farms than last year at this time. A factor in the decline is believed to have been recent lower milk prices, which has motivated a number of dairy producers to sell older cows as well as feed less. Orders for packaged butter are increasing following these stronger prices, because buyers are stocking before yet even higher expected prices materialize. Some buyers are not able to obtain desired quantities. The strength of orders being filled is causing some delivery bottlenecks. Butter is being withdrawn from private storage to help fill orders. Industrial cream is less available in the current climate. Cheese stocks in Western Europe remain tight, limited by lower milk production. This is quite similar to recent weeks. Few voices are heard expecting much of a change in the near term. The bulk of cheese currently manufactured is committed prior to production.
- International: Milk production in Ukraine is down from year ago levels in September for the 8th month of 2016. September production was 5.4% below September 2015 milk production. Production January-September this year is 2.78% lower than in 2015.
- International: August milk output in Australia was down 9.3% vs. a year ago. YTD, output is down 9.7% this milking season (July-Aug). Bad weather has hurt milk output in New Zealand. Daily milk volumes in October have fallen around 10% compared to a year ago. The wet weather is hitting just as the region is heads towards its peak. Current expectations are that milk collections at the peak will be well below previous season peaks.

Futures Month	Class III 10/14	Class III 10/07	Change	Dry Whey 10/14	Dry Whey 10/07	Change	Cheese 10/14	Cheese 10/07	Change
Oct-16	\$14.68	\$14.99	(\$0.31)	31.900¢	32.500¢	(0.60¢)	\$1.616	\$1.572	\$0.044
Nov-16	\$15.04	\$15.47	(\$0.43)	34.250¢	34.750¢	(0.50¢)	\$1.650	\$1.600	\$0.050
Dec-16	\$15.13	\$15.44	(\$0.31)	35.250¢	35.475¢	(0.23¢)	\$1.635	\$1.610	\$0.025
Jan-17	\$15.32	\$15.40	(\$0.08)	35.275¢	35.975¢	(0.70¢)	\$1.628	\$1.623	\$0.005
Feb-17	\$15.57	\$15.57	\$0.00	35.750¢	36.500¢	(0.75¢)	\$1.632	\$1.639	(\$0.007)
Mar-17	\$15.64	\$15.69	(\$0.05)	36.000¢	36.475¢	(0.48¢)	\$1.650	\$1.650	\$0.000
Apr-17	\$15.80	\$15.77	\$0.03	36.250¢	36.875¢	(0.63¢)	\$1.654	\$1.656	(\$0.002)
May-17	\$15.96	\$15.97	(\$0.01)	35.775¢	36.550¢	(0.77¢)	\$1.677	\$1.676	\$0.001
Jun-17	\$16.18	\$16.22	(\$0.04)	35.925¢	36.550¢	(0.63¢)	\$1.694	\$1.700	(\$0.006)
Jul-17	\$16.40	\$16.41	(\$0.01)	36.300¢	37.400¢	(1.10¢)	\$1.716	\$1.719	(\$0.003)
Aug-17	\$16.57	\$16.60	(\$0.03)	37.000¢	37.000¢	0.00¢	\$1.735	\$1.736	(\$0.001)
Sep-17	\$16.69	\$16.70	(\$0.01)	36.775¢	37.475¢	(0.70¢)	\$1.735	\$1.746	(\$0.011)
12 Mo Avg	\$15.75	\$15.85	(\$0.10)	35.538¢	36.127¢	(0.59¢)	\$1.669	\$1.661	\$0.008

What's Bearish:

- Spot Market: Blocks finished the week unchanged at \$1.55/lb on 3 trades, but barrels fell 5¢ to close at \$1.46/lb on 19 trades. Butter plunged another 8¢ to settle at \$1.78½/lb on 8 trades, and NDM lost 4½¢ to close at 87¢ on 5 trades.
- Dairy cow slaughter for the week ending 10/01 totaled 56,200 head, down 5.2% vs. the same period a year ago. YTD, the dairies have trimmed 37,100 head fewer than last year.
- Fluid Milk Northeast: Milk production in the Northeast is seasonally strong. Year over year output remains higher. Pulls from Class I are steady, with adequate remaining supplies into manufacturing. Markets expect stronger pulls from each Class of milk over the next few weeks.
- Fluid Milk Central: Milk production is inching higher in the South Central area as the season advances. A few processors in the Southwest noted Central milk loads were offered into that area. North Central farm milk production is generally steady. Sales into bottling were tepid early in the week as plant managers adjust for mid-semester breaks within area school districts. The pushback on loads from Class I accounts has freed up some milk volumes to clear into Class III/IV plants. However, a few cheese plant managers have already decreased orders for the week due to component levels rebounding, thus decreasing the need for additional milk loads.
- Fluid Milk Southwest: In California, milk output is seasonally higher. Dairy cows are feeling less stressed as temperatures continue dropping in the Central Valley. Heavy manufacturing milk volumes are moving into processing facilities in order to meet the high Q4 needs. In Arizona, milk production is trending up. Temperatures are getting cooler, which is increasing cows' comfort. Bottled milk requests from educational institutions are lower as most schools are on fall break this week. In New Mexico, the favorable climate conditions are supporting dairy herds' comfort. Milk volumes are in good balance with manufacturing needs. Sales into Class I and Class II are lower this week. Higher manufacturing milk volumes are clearing into Class III as many cheese processors are gearing up production in order to meet the high demand during Q4 holidays.

- Fluid Milk Pacific Northwest: Milk production is near the bottom of the annual cycle and following typical seasonal patterns. However, contacts also note that milk intakes are increasing, possibly due to additions to the milking herd. A few manufacturers say school milk pipelines are filled and, between fall breaks and modest price increases, bottling demand has backed off a bit. Processors are having no trouble getting enough milk for most processing needs. Requests from ice cream makers are decreasing. Cream supplies continue growing in the West region.
- Butter: Cream availability for churning continues increasing throughout the country. As a consequence, butter production schedules are very active in most processing plants. Bulk butter inventories are heavy and some manufacturers continue clearing stocks after microfixing. Spot prices remain low, enhancing the interest of several buyers/end users.
- Dry Whey Central: Prices moved higher this week, however a few contacts suggest the whey market may be flattening out. Some manufacturers are finding buyers will push back at prices above the mostly price series. Dry whey is moving well through contracted agreements, but a few processors say their stocks are a little heavier than a few weeks ago.
- NDM: Overall, sales are fairly sluggish with light trading as some users are holding off on holiday orders, waiting for a clearer market picture.

Recommendation:

Overall, the dairy market is still carving out a bottom. While cheese prices plunged at the end of August and into September, it's now butter's turn. Spot butter touched \$1.77/lb on Thursday, its lowest close since April, 2015. Heavy cream supplies are keeping the churns active, while demand has seen a temporary setback, heading in to the holidays. Over in spot cheese, while barrel volume has tapered off some, the end of grilling season has seen demand in the process market slow. Meanwhile, milk production across the U.S. has largely put in its low and has begun to increase. With cooler weather, components have improved as well. Likewise, the drop in beef prices has given dairies less incentive to trim their herds, but to keep milking lower producing cows. Grains remain inexpensive. On the positive side, U.S. cheese demand continues to roll, while milk output in the EU and Oceania are seriously struggling. We do believe this will eventually result in a rise in 2017 milk prices, but it will take an improvement in U.S. exports to do so. The U.S. is ideally positioned to meet growing global dairy product demand, during a period when global milk production is on the decline. If things fall in to line, 2017 could be quite a good year. In the near term though, Q4 looks like it will be range-bound, until we complete this current bottom. Producers should continue to look at buying call options Jan-Jun in order to place standing sell orders once they are purchased.

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