

The KDM Dairy Report – October 21st, 2016

What's Bullish:

- Spot Market: Block cheddar finished the week up 10¢ to settle at \$1.65/lb on 8 trades, while barrels picked up 11¢ to close at \$1.57 on 12 trades. Grade A NDM gained a penny to reach \$0.88/lb on 19 trades, but butter gave up 2½¢ to settle at \$1.76/lb on 5 trades.
- Fluid Milk Southeast: Diverse weather extremes are affecting the region's cow forage supply. Flooding from Hurricane Matthew has engulfed fields of unharvested soybean crops in many coastal areas. Cream demand is increasing. Spot purchases of cream pushed multiples higher. Sour cream and yogurt are seasonally active. Skim condensed is tight according to some milk market sources.

| Futures Month | Class III 10/21 | Class III 10/14 | Change | Dry Whey 10/21 | Dry Whey 10/14 | Change | Cheese 10/21 | Cheese 10/14 | Change |
|------------------|-----------------|-----------------|---------------|----------------|----------------|--------------|----------------|----------------|------------------|
| Oct-16 | \$14.73 | \$14.68 | \$0.05 | 32.400¢ | 31.900¢ | 0.50¢ | \$1.577 | \$1.616 | (\$0.039) |
| Nov-16 | \$15.46 | \$15.04 | \$0.42 | 34.725¢ | 34.250¢ | 0.48¢ | \$1.639 | \$1.650 | (\$0.011) |
| Dec-16 | \$15.21 | \$15.13 | \$0.08 | 36.825¢ | 35.250¢ | 1.58¢ | \$1.606 | \$1.635 | (\$0.029) |
| Jan-17 | \$15.36 | \$15.32 | \$0.04 | 36.275¢ | 35.275¢ | 1.00¢ | \$1.624 | \$1.628 | (\$0.004) |
| Feb-17 | \$15.55 | \$15.57 | (\$0.02) | 36.300¢ | 35.750¢ | 0.55¢ | \$1.640 | \$1.632 | \$0.008 |
| Mar-17 | \$15.76 | \$15.64 | \$0.12 | 36.325¢ | 36.000¢ | 0.33¢ | \$1.656 | \$1.650 | \$0.006 |
| Apr-17 | \$15.90 | \$15.80 | \$0.10 | 36.525¢ | 36.250¢ | 0.27¢ | \$1.665 | \$1.654 | \$0.011 |
| May-17 | \$16.00 | \$15.96 | \$0.04 | 36.700¢ | 35.775¢ | 0.93¢ | \$1.681 | \$1.677 | \$0.004 |
| Jun-17 | \$16.20 | \$16.18 | \$0.02 | 37.100¢ | 35.925¢ | 1.18¢ | \$1.698 | \$1.694 | \$0.004 |
| Jul-17 | \$16.40 | \$16.40 | \$0.00 | 37.100¢ | 36.300¢ | 0.80¢ | \$1.715 | \$1.716 | (\$0.001) |
| Aug-17 | \$16.55 | \$16.57 | (\$0.02) | 37.000¢ | 37.000¢ | 0.00¢ | \$1.735 | \$1.735 | \$0.000 |
| Sep-17 | \$16.65 | \$16.69 | (\$0.04) | 37.325¢ | 36.775¢ | 0.55¢ | \$1.739 | \$1.735 | \$0.004 |
| 12 Mo Avg | \$15.81 | \$15.75 | \$0.07 | 36.217¢ | 35.538¢ | 0.68¢ | \$1.665 | \$1.669 | (\$0.004) |

- Butter Northeast: Cream supplies are available, but not as readily, as demand gains steam. Domestic interest is good, as the CME butter price trends lower. Conversely, the existing low prices create a degree of wariness for manufacturers who sell butter on margins over CME. Reported domestic bulk butter transactions, this week, included prices ranging market to 2 over the CME Group with various time frames and averages used. Export demand is good, prompted by competitive prices.
- Butter West: Seasonal holiday demand is building. Processors report cream supplies are readily available and butter production is steady. Some manufacturers are microfixing bulk butter to rotate older stocks with fresh inventory and to help meet current retail demand.
- Dry Whey Northeast: Spot loads are hard to obtain. Resellers are actively supplying dry whey, but buyers are cautious when purchasing since dry whey, at times, carries a hefty premium. Tightness persists in Northeast dry whey inventories. End of year demand continues to increase.
- Dry Whey West: Prices are steady to higher on limited spot market activity. The top of the price range moved up while other prices held firm. Inventories continue to be tight. Some manufacturers report their dry whey stocks are highly committed through the end of the year. Dry whey production is relatively stable. Domestic and export demand appears steady with dry whey moving easily through contracted agreements.
- NDM Northeast: Prices inched higher in the region, as near-term demand has transformed some East manufacturers' inventories to sold out status.
- Cheese Northeast: With adequate milk supplies on hand and rising milk component levels, area cheese production is seasonally strong as some cheese operations run near capacity. However, some mozzarella inventories are sold out, while the upcoming Halloween holiday is one of the top-five pizza sale days. Hence, cheese orders from wholesalers moving into food service are active. Meanwhile, sources credit a CME price upswing to market uncertainty, arising from talk of additional government surplus purchases along with the impact of world market prices on export volumes.
- Cheese Midwest: Cheese makers say their cheese production has increased slightly. However, a few processors say if spot loads of milk were more available, and at good prices, they could run a few more loads through the vats. Cheese orders are steadily increasing for holiday retail sales. Some industry contacts suggest that cheese was somewhat undervalued prior to the recent jump of block and barrel cheese prices on the CME Group trading. A few manufacturers took advantage of the lower prices and buyer interest to clear stocks. A number of processors describe their inventories as comfortable.
- Cheese West: Cheese makers say milk is fairly well balanced with processing needs. Production is active. A few manufacturers are shifting production focus a little more toward Italian cheese types as opposed to American style cheeses. Domestic retail demand is starting to pick up a little as we get closer to the fall holidays. Demand for barrels and process cheese is a little lighter. Some cheese makers are getting more inquiries from export channels. Although sales have not developed as of yet, cheese makers are hopeful it is a sign that those market opportunities will be able to grow in the near future. Manufacturers report cheese inventories for both barrels and blocks are more comfortable. Lower market prices over the last few weeks spurred on an increase in buyer interest and allowed processors to clear stocks.
- International: After moving negative for the first time in 4 events in the last GDT auction, the dairy Price Index in this week's auction moved back in to positive territory, with a small 1.4% gain. Lactose led the way, up 5.6%, followed by WMP up 2.9%. Analysts expect future GDT auctions to trend higher during Q4.
- International: Dairy Australia reported this week that milk production during the month of September was down 10.2% compared to a year ago. YTD (July-Sep), the new milking season is off to a slow start, down 9.9% vs. 2015.
- International: The growth in European Union milk production is expected to slow to an 8-year low in 2017, according to USDA staff in Europe. Low milk prices and a higher cull rate are contributing to the decline.

What's Bearish:

- Milk Production Report: September milk output in the U.S. was up 2.1% compared to a year ago, about where most analysts expected. Milk per cow increased 33 lbs over last year, however, cow numbers declined 3,000 head vs. August. Gains were led by KS up 6.3%, MI up 5.8%, TX up 5.3% and SD up 5.1%.
- Cold Storage Report: As expected, both butter and cheese stocks continue to exceed last year's levels. Butter stocks at the end of September were a stunning 44% higher than a year ago, but down a very strong 16% from Aug. American cheese stocks were 6% higher than Sep '15, while total cheese stocks were up 7% over the same period.

- Livestock Slaughter Report: Commercial dairy cow slaughter in September was down 2.7% (6,700 head) vs. Sep '15. The total was lower than 5 of the last 6 years.
- Livestock, Dairy and Poultry Outlook Report: USDA has raised their estimate for the 2017 dairy cow herd, to 9.395 million head. Herd expansion is expected to continue into the second quarter of 2017. As a result, USDA raised their 2017 milk production estimate by 1.2 billion lbs, or 2.4% higher than 2016. Low milk output in Oceania and the EU should result in increased exports, but the higher domestic output estimate resulted in USDA sharply lowering their Class III price forecast \$0.80 to \$14.65 average.
- Fluid Milk Northeast: Milk production remains steady. During the month of September, pooled milk receipts resulted in the highest volume ever for the month. Fluid milk sales are steady. Manufacturing milk supplies are adequate at comfortable plant levels. Milk handlers in the Mid-Atlantic are seeing steady production, with loads supplying areas of the Central region.
- Fluid Milk Central: Farm milk production is steady to slightly higher in the region as favorable weather conditions are conducive to cows' comfort. The butterfat and protein components in the milk continue improving. Requests from ice cream manufacturers for NDM are seasonally waning. Demand for spot cream from butter processors is light.
- Fluid Milk Southwest: In California, farm milk production is up, following typical seasonal patterns. Milk protein and butterfat components are steadily improving. Heavy milk intakes continue clearing into Class 4b processing plants, as many cheese manufacturers are running operations at near to full capacity. Farm milk yields are higher in Arizona due to cooler temperatures. Milk production is slightly lower in New Mexico due to the high humidity affecting cows' comfort. However, processors are having no trouble getting enough milk for most manufacturing needs.
- Fluid Milk Pacific Northwest: Dairy contacts in the mountain states of Colorado, Utah and Idaho report milk production continues to slowly trail off seasonally. However, components are improving. In Idaho, several new dairy installations and existing farms adding cows have given a boost to cow numbers. Many dairy farmers seem willing to hold onto cows longer with inexpensive feed and low cull cow prices.
- Butter Central: Production is active as moderate to heavy cream supplies continue clearing into churns. Many manufacturers are running operations at full capacity in order to meet current needs and the anticipated high demand during the Q4 holidays. Microfixing is active. Bulk butter stocks are heavy in most processing facilities. In order to lower inventory levels, some processors are selling bulk butter at discounts.
- Dry Whey Central: Some buyers are willing to take a wait and see attitude, opting to work through inventories or look for bargains. Demand is steady and manufacturers report spot sales are there if dry whey is available. Dry whey inventories are tighter than earlier in the summer, but a few manufacturers report a willingness to carry a little heavier stocks into next year. Production is steady and in line with cheese production. Industry contacts say demand from Southeast Asia for feed proteins has backed off somewhat.
- NDM Central: Prices are steady to lower in the mostly series, but mixed in the range. End user interest is sluggish for purchases according to market participants. Some buyers are waiting for a shift to higher production situations in the next few weeks that could potentially lower NDM market value.
- NDM West: The market undertone is unsettled. Some buyers are holding off their purchases in order to get lower prices. On the other hand, some end users want to settle Q1 2017 contracts in anticipation of prices going higher. Low/medium heat NDM drying schedules are active in most processing plants as heavy milk volumes continue clearing into dryers. Inventories are readily available in the market.

Recommendation:

It was a tale of two-halves, as the spot market was very strong in the first part of the week, only to give back some of those gains in the second half. Class III's still finished the week mostly in the positive, but only the November contract was solidly higher. The international picture continues to make news with a decline in milk output expected going in to 2017 for the EU and Oceania regions. Export interest is beginning to pick up as commercial interests begin to realize they may need to turn to the U.S. for product at some point. Nothing happens very fast in dairy, exports included, so it will take some time for the train to leave the station. Several monthly reports were released by USDA this week, including the Milk Production, Cold Storage, Livestock Slaughter and LDP Outlook Reports. While they all leaned bearish, they were mostly as expected, so had minimal effect on the market. One silver lining – cow numbers actually declined month-to-month, after a substantial revision higher from USDA in the prior Milk Production report. Many were wondering if this month's report would show another substantial gain, and it did not, showing a small reduction in the herd size instead. Going forward, we are neutral to cautiously optimistic in the near term. Holiday orders are ramping up and cheese is moving well. But we also have a large inventory problem to deal with. We'll stick with our recommendation from the past few weeks. Buy call options in Q1 and Q2, placing sell orders once you have secured them. Grain prices seem to have found some life. If feed costs begin to go up, milk prices should follow eventually.

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