

The KDM Dairy Report – November 4th, 2016

What's Bullish:

- Spot Market: Block cheese gained 17¢ for the week to settle at \$1.90/lb on just 3 trades. Barrels raced 26¼¢ higher to close at \$1.86/lb on 16 trades.
- Dairy Products Report: America's tastes are changing. While Total Cheese output in September was up 1.6% vs. a year ago, Cheddar cheese output declined 0.5%, and was down 3.2% from August, according to USDA data. Double-digit gains in output were seen in Feta, Gouda Romano and Parmesan cheeses, to account for the YoY gain. Butter production inched 0.4% lower than Sep '15, but was 2.3% higher than Aug.

Futures Month	Class III 11/04	Class III 10/28	Change	Dry Whey 11/04	Dry Whey 10/28	Change	Cheese 11/04	Cheese 10/28	Change
Nov-16	\$16.80	\$15.69	\$1.11	35.825¢	35.300¢	0.53¢	\$1.774	\$1.657	\$0.117
Dec-16	\$16.45	\$15.57	\$0.88	35.900¢	36.550¢	(0.65¢)	\$1.730	\$1.632	\$0.098
Jan-17	\$15.93	\$15.56	\$0.37	36.525¢	36.500¢	0.02¢	\$1.678	\$1.634	\$0.044
Feb-17	\$15.98	\$15.71	\$0.27	36.550¢	37.025¢	(0.48¢)	\$1.675	\$1.643	\$0.032
Mar-17	\$16.05	\$15.95	\$0.10	36.250¢	37.000¢	(0.75¢)	\$1.686	\$1.663	\$0.023
Apr-17	\$16.10	\$16.00	\$0.10	37.100¢	37.100¢	0.00¢	\$1.688	\$1.672	\$0.016
May-17	\$16.13	\$16.10	\$0.03	36.850¢	37.100¢	(0.25¢)	\$1.695	\$1.681	\$0.014
Jun-17	\$16.29	\$16.26	\$0.03	37.000¢	37.000¢	0.00¢	\$1.705	\$1.696	\$0.009
Jul-17	\$16.49	\$16.41	\$0.08	37.250¢	37.500¢	(0.25¢)	\$1.719	\$1.720	(\$0.001)
Aug-17	\$16.70	\$16.62	\$0.08	37.025¢	38.000¢	(0.98¢)	\$1.746	\$1.735	\$0.011
Sep-17	\$16.85	\$16.70	\$0.15	38.050¢	38.050¢	0.00¢	\$1.751	\$1.738	\$0.013
Oct-17	\$16.82	\$16.60	\$0.22	38.325¢	38.250¢	0.08¢	\$1.747	\$1.732	\$0.015
12 Mo Avg	\$16.38	\$16.10	\$0.28	36.888¢	37.115¢	(0.23¢)	\$1.716	\$1.684	\$0.033

- For the period 10/01 through 10/31, cheese stocks at USDA-selected storage centers declined 5% (4.8 million lbs).
- The most recent GDT auction on Tuesday resulted in a strong 11.4% increase in the dairy price index. The large gain was led by WMP up 19.8%. The GDT price index has now risen in 6 of the last 7 auctions.
- Fluid Milk Southeast: Milk production is steady. Supplies are in balance with demand. Auxiliary manufacturers' milk receipts are typically at contract minimums. Increasing drought in parts of the area has caused further pasture deterioration, leading to delays in planting winter wheat and cover crops. Cream supplies are tight. Sources suggest active interest from international markets is impacting availability. Seasonally strong cream cheese processing and active butter churning continue to pull on cream supplies.
- Butter: Cream for churning is readily available in the West and Central regions. However, in the East, cream volumes are tightening with reports of supplies clearing to foreign markets. Nationwide, cream production is active. Most operation schedules are focused on print butter as requests from retailers improve along seasonal patterns. Demand from the food service sector is fair to good. Some processors are microfixing stored bulk stocks to supplement current print production. Contacts in the West report demand for retail butter is seasonally heavy and helping draw down inventories.
- Dry Whey Northeast: Prices continue to increase in the region as f.o.b. spot transactions established the upper end of the range. Dry whey demand is good, while are tight in the region, providing for a firm undertone.
- Dry Whey Central: Some manufacturers report more inquiries from buyers and spot sale prices trending higher. Dry whey producers are beginning to develop contracts for 2017. A few processors say domestic demand is good and export demand is present, but comes and goes. Dry whey is moving well through existing contracts.
- Dry Whey West: Prices are mostly higher with only the top end of the mostly price series holding steady. Industry contacts continue to describe a slow increase in dry whey prices. Some manufacturers report inventories being highly committed through the end of the year. Domestic demand is solid and contacts say export demand is good.
- Cheese Northeast: Production is steady as manufacturers maintain full operating schedules with available milk volumes. Spot milk availability is limited in the region. Cheese orders are steady to increasing from retail buyers looking to add to supplies ahead of the year-end holidays. Manufacturers are cautious not to expand projected needs too far ahead of current orders. As cream moves north, cream cheese manufacturers seeking surplus cream loads note a tight market.
- Cheese Midwest: Production is strong and many manufacturers are using all the milk available to them. A few processors are surprised the milk supply is not a little heavier. Some contacts mention they could run a few more loads, but are having trouble finding available spot loads of milk. Industry contacts note an increase in cheese orders. Sales seem to be picking up as the Q4 holidays draw closer. Inventories are generally comfortable, but, in some cases, blocks are a little tighter due to the seasonal increase in demand.
- Cheese West: Production is seasonally strong and active, while manufacturers say milk supplies are in good balance with needs. However, orders for holiday retail demand are increasing and industry contacts report a solid pull from food service accounts.
- Foreign Cheese: Stocks continue to be tight. Manufacturers report low stock volumes coupled with strong demand have forced processors to make adjustments to deliveries and allocations. Cheese makers expect seasonally lower milk supplies and increasing cut cheese demand over the next few months. They anticipate the situation to drive potentially higher prices for foreign type cheese through the winter holidays.
- Exports: Data released by the U.S. Dairy Export Council today show that total dairy exports for September were up 4.6% by volume vs. a year ago. It was the fourth consecutive month YoY gains. On a milk solids basis, the U.S. exported the equivalent of 14.7% of its milk production in September.

What's Bearish:

- Spot Market: While cheese prices zoomed upwards, Grade A NDM declined ¾¢ for the week to settle at \$0.84¼/lb on 11 trades. Likewise, butter gave up 3¼¢ to close at \$1.89¼ on 21 trades.
- Fluid Milk Northeast: Milk production is mostly steady, balancing plants are seeing an uptick in intakes as pools of designated holiday milk volumes clear to manufacturing.
- Fluid Milk Central: Slow, steady increases in farm milk intakes are noted throughout the region at balancing plants. Freshening started during the last week or two in the north Central area, lagging the south Central by about a month. Dairy operators are transitioning cows to the milking string. Some additional milk volumes are clearing to bottling to meet production needs of holiday related items, such as eggnog and specialty flavored milk. Demand for milk spot loads is mixed, as is availability.

- Fluid Milk Southwest: In California, the humid conditions caused by recent thunderstorms are reducing farm milk production. However, according to many manufacturers, milk supplies are in good balance with processing needs. Bottled milk orders from educational institutions are steady to lower, as some schools will be closed during the next week's Veterans Day holiday. Arizona, milk yields are higher, following seasonal patterns. Milk butterfat and protein components are seasonally improving. Milk volumes are sufficient to meet current manufacturing needs. Class I pulls from many retail channels are strong, but steady from food service accounts. Demand for Class II is active ahead of the year-end holidays. Milk intakes moving into Class III processing facilities are higher this week. In New Mexico, milk output is trending higher. The cooler temperatures are reducing stress on cows. Bottled milk sales to grocery stores are up this week. Class II sales are steady. Milk volumes moving into cheese processing are higher.
- Fluid Milk Pacific Northwest: Recent cold and rainy weather is impacting cow comfort and suppressing milk production somewhat. However, manufacturers say milk intakes are fairly well balanced with processing needs. In addition, contacts suggest Idaho has had some herd expansion and milk is readily available in the state. Much of the milk produced is still finding homes close by.
- NDM Northeast: Inventories are moderate and building. Some sellers are looking to move quantities, in light of growing inventories. Buyers are content in looking around for what they consider the most suitable offer. Overall, buyer interest is light to moderate.
- NDM Central: Prices moved lower in the range. Most NDM manufacturing plants are producing seasonal output at levels well below plant capacity. Yet, inventories are building, as sales are mostly slow.
- NDM West: Prices for western low/medium heat nonfat dry milk are slightly lower on the range, following declines in various indices. Outside contracts, sales transactions are light. Some buyers/end users are quiet, delaying purchases, anticipating lower prices in the next few weeks. Low/medium heat supplies are readily available in the spot market. Drying schedules of low/medium heat NDM are active in most processing plants.

Recommendation:

Shock and disbelief describe many observing the dairy market this week. A sharply tightening milk supply in New Zealand saw the GDT auction make a strong move higher early in the week. Then, a somewhat tighter block supply gave sellers pause, allowing bidders to push the block/barrel average to \$1.88/lb, a level not seen since Nov 2014. Wow! The market may have gotten a bit ahead of itself here. In just a matter of a couple weeks, we have gone to being at close to parity to the world's cheese prices, to the most expensive. Ask yourself, where do we go from here? \$2.00 cheese? And how long is that sustainable? In the short-term, it becomes a math game. Current spot prices work out to a stunning \$18.00/cwt. Throw in the weekly survey premium and a settlement of well over \$18/cwt is possible for the December contract should prices hold. And that is where disbelief has taken hold. Despite current spot prices, Dec Class III, while solidly higher this week, settled at just \$16.45, even though it begins its calculation in less than two weeks. The futures curve has gone from pricing in a premium, to a solid discount. Current fundamentals suggest demand for cheese is good. On the international side, we have the jump in the GDT plus continued milk output declines in the EU. Cheese remains tight there. And our cream market is beginning to tighten as more cream is leaving our shores from Eastern ports. We really have no idea how long this strength will last in the spot market, but should it hold another week, the Dec and Jan contracts should scream higher as they try to catch up to spot. This could be a great opportunity for hedgers to sell in to a potential over-reaction induced by new buyers and short-covering. Further out, the 2017 contracts picked up another 14¢, with the average jumping to \$16.39. We would still not be sellers there, unless the Q1 contracts really ramp up in response to our current spot market. Look at grabbing some cheap PUT options Dec and Jan next week if this rally continues.

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 or complete 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