

The KDM Dairy Report – November 11th, 2016

What's Bullish:

- Spot Market: Butter gained 11¼¢ during the week to close at \$2.01/lb on 36 trades. Grade A NDM picked up 3¢ to close at \$0.87¼/lb on volume of 17 loads.
- World Ag Supply & Demand Report: USDA increased their 2017 Class III price forecast sharply higher and now expect it to average \$15.75/cwt, up \$1.10/cwt from last month's projection. Factors include a herd size that is growing less than expected, and higher prices forecast for both dry whey and cheese next year.
- Butter stocks at USDA-selected storage centers fell 9% (2.4 million lbs) in just the first nine days of Nov. Cheese stocks over the same period declined 1\$ (777k lbs).
- Fluid Milk Northeast: Northeast and Mid-Atlantic farm milk production is steady along seasonal trends. Upcoming holiday retail demand is pushing bottled milk needs higher in some areas. Class II supplies are adequate for meeting production needs as strong interest prevail. Buyer are having a hard time finding cream in a tight Northeast market. Demand is strong, as some buyers/sellers who are short on supplies note a willingness to pay loftier multiples to obtain the loads they need.
- Cream Central: Availability is tighter in the region as Class II/III production heats up ahead of the holidays. Production of sour cream, dips, cream cheese, and specialty drink items is higher. Cream multiples firmed throughout the region. Drought has reemerged as a concern for areas of Nebraska, Oklahoma, and Texas, especially for fields planted to overwintering crops.
- Fluid Milk Pacific Northwest: Milk production in the Pacific Northwest is following typical seasonal patterns and a little lower than previous weeks. Bottling demand is stable and milk intakes are steady at manufacturers. Some industry contacts say solids are still a little down as compared to previous years. Single serve milk items are pulling good volumes of milk. Western cream requests from sour cream, dips, and cream cheese manufacturers are inching up. In addition, butter churners continue pulling large amounts of cream. As a result, regional cream supplies are tightening, boosting cream premiums.
- Butter Northeast: Churning remains active at moderate to high levels to service holiday demand. Because seasonal butter orders persist, in higher volumes, plants continue to pull additional stocks from cold storage for processing and packaging customers' thriving print order needs. In general, most processors are cautiously keeping stocks in balance, on the low side. Class II product demand is seasonally strong and pulling ample volumes of cream. This week, reported bulk butter transactions included prices ranging 4 to 8 over the CME Group with various time frames and averages used.
- Butter Central: Production is steady in the region. Cream requests from Class II processors are increasing in order to meet the strong year-end holiday manufacturing needs. Consequently, cream supplies are tightening. Some processors are microfixing bulk to supplement print butter output. Retail and food services requests remain strong. Bulk butter prices reported ranged from one cent under market to 7 cents over the market.
- Butter West: Production is active as processors work hard to keep up with strong seasonal demand. Cream is generally in good supply, but other holiday favorites are also pulling at cream supplies. According to some industry contacts, retail and bulk butter demand are drawing stocks lower. A few buyers are seeking out additional loads of butter for purchase. On occasions, an urgent need to buy is pushing resales above market prices for bulk butter.
- Dry Whey Northeast: Prices are steady to firm, adjusting marginally lower at the bottom of the range. The market appears mostly in balance, but spot loads continue to be in tight supply as most production gears to contracted needs. Some buyers see dry whey incrementally advancing for the near term.
- Dry Whey Central: Manufacturers report whey is moving well through contracts. Some suppliers are needing to juggle loads or push back deliveries at times to meet contracted obligations. Inventories are a little tighter. Industry contacts note manufacturers are making a little less dry whey in favor of higher protein concentrations.
- Dry Whey West: Prices moved higher at the top of the mostly price series, but are otherwise stable. Some end users note tightness in the whey market and many manufacturers report stocks are highly committed through the end of the year.
- Cheese Midwest: Cheese processors are eager to make cheese as fast as they can to keep up with holiday orders. Retail demand is steady for both cut and wrap cheese and process cheese. Some contacts say the warm fall weather has helped extend grilling season longer than typical. Industry contacts suggest the desire for fresh cheese is strong and driving market prices.
- Cheese West: Cheesemakers report the strong seasonal demand for branded and bulk cheese is continuing. Retail cheese consumers are pulling good volumes. Although cheese inventories are generally high, a few contacts report some varieties of fresh block cheese are harder to come by. In some cases, processors are shorting loads as a way to juggle orders with available stocks. Many manufacturers are running production schedules as hard as they can in order to stay on top of holiday shipments.
- Foreign Cheese: Strong demand and tight supplies are helping support prices of foreign type cheese. Declining milk intakes have hampered cheese production and steady seasonal sales are keeping inventories relatively low, especially for cut cheese.
- International: Milk production continues to trend lower in most countries in Western Europe. The impact of milk prices, lingering weather conditions, and programs to lessen farm milk output are all having an impact on the milk supplies across the region. Levels are below a year ago

Futures Month	Class III 11/11	Class III 11/04	Change	Dry Whey 11/11	Dry Whey 11/04	Change	Cheese 11/11	Cheese 11/04	Change
Nov-16	\$16.81	\$16.80	\$0.01	36.000c	35.825c	0.17c	\$1.769	\$1.774	(\$0.005)
Dec-16	\$16.65	\$16.45	\$0.20	36.500c	35.900c	0.60c	\$1.749	\$1.730	\$0.019
Jan-17	\$15.96	\$15.93	\$0.03	37.050c	36.525c	0.52c	\$1.676	\$1.678	(\$0.002)
Feb-17	\$15.98	\$15.98	\$0.00	37.100c	36.550c	0.55c	\$1.670	\$1.675	(\$0.005)
Mar-17	\$16.04	\$16.05	(\$0.01)	37.250c	36.250c	1.00c	\$1.670	\$1.686	(\$0.016)
Apr-17	\$16.05	\$16.10	(\$0.05)	37.125c	37.100c	0.02c	\$1.678	\$1.688	(\$0.010)
May-17	\$16.05	\$16.13	(\$0.08)	37.000c	36.850c	0.15c	\$1.680	\$1.695	(\$0.015)
Jun-17	\$16.20	\$16.29	(\$0.09)	37.025c	37.000c	0.02c	\$1.695	\$1.705	(\$0.010)
Jul-17	\$16.38	\$16.49	(\$0.11)	37.250c	37.250c	0.00c	\$1.716	\$1.719	(\$0.003)
Aug-17	\$16.65	\$16.70	(\$0.05)	37.050c	37.025c	0.02c	\$1.741	\$1.746	(\$0.005)
Sep-17	\$16.80	\$16.85	(\$0.05)	38.050c	38.050c	0.00c	\$1.748	\$1.751	(\$0.003)
Oct-17	\$16.80	\$16.82	(\$0.02)	38.325c	38.325c	0.00c	\$1.745	\$1.747	(\$0.002)
12 Mo Avg	\$16.36	\$16.38	(\$0.02)	37.144c	36.888c	0.26c	\$1.711	\$1.716	(\$0.005)

and tracking near the seasonal low point. Cream markets are active with firm pricing. Butter prices are steady to slightly higher. The market undertone is mostly steady to firm. There are indications of tightness in local supplies of fresh packaged butter for store demand. Also, a good call for cream for holiday related demand is occurring. Cream supplies are tight and prices are high.

- International: Milk production in Australia is steady to mostly lower, tailing off from the likely peak. Levels are down sharply, around 10% on average, from a year ago. Wet conditions remain pervasive, hampering current milk output. Currently, seasonal projections are projected to be 6-8% lower versus the prior year.
- International: New Zealand milk output continues to trend lower from the seasonal high point in October with volumes remaining lower than a year ago in November. Rains continue to fall at heavy rates across the North Islands and are a hindrance to pasture growth, resulting in lower milk production.
- International: In Argentina and Uruguay, farm milk output is seasonally steady to lower, after reaching the peak of the spring flush. Pulls from cheese manufacturers are strong. Bottled milk demands from retailers and several restaurants are up. In Chile, milk production is steady, but below levels from the previous year. Farm milk production is steady to higher in Brazil as some dairy operators are adding more cows to the milking parlor. However, the food processing industry continues growing in Brazil, demanding more milk, especially milk powders. Overall, milk volumes are below the current processing needs.

What's Bearish:

- Spot Market: In a reversal of last week, this time, while butter and NDM ended higher, cheese finished the week lower. Blocks gave up 1½¢ to settle at \$1.88½/lb on 5 trades, while barrels shed 10½¢ on volume of 18 loads to close at \$1.76½/lb.
- Fluid Milk Southeast: Producers in the Southeast are seeing balanced milk production. Class I interest has declined as several bottlers cancelled milk orders. As a result, surplus milk is causing some backup as milk volumes clear to subsidiary manufacturing plants. Florida's milk production is generally balanced, but volumes are climbing slightly in some regions of the state. Milk producers are enjoying the seasonal increases, while handlers see good returns as the cheese market moves up. Just 10 loads of milk were imported into Florida this week, vs. 20 last week and 40 a year ago.
- Fluid Milk Central: Mild weather throughout the region is supporting active milk production. As drier weather prevails in the South-Central area, milk quality is returning. Butterfat and protein components are improving seasonally. Throughout the North Central and North East, handlers and manufacturers are planning for the best, while acknowledging that there will be a short-term milk overload around the end of the year. Bottler interest is steady to lower as school accounts decreased orders ahead of the shorter holiday week.
- Fluid Milk Southwest: Farm milk production is higher in the Central Valley of California as temperatures continue falling. In addition, some dairy operators are transitioning cows to the milking string. Milk butterfat and protein components continue improving approaching the seasonal peak. Bottled milk orders from educational institutions are lower as most schools will be closed during the Veterans Day holiday. Milk output has plateaued in Arizona, as daytime temperatures remain steady, averaging 90 degrees. However, in New Mexico, milk yields are trending higher, following seasonal patterns. Class I sales are down as most retail and food service pipelines are full. Milk volumes moving into cheese processing facilities are higher this week.
- NDM: The market undertone remains somewhat quiet and unsettled. According to some processors, the domestic demand is fair, but sluggish from Mexico. Many brokers, buyers, and end users are receiving enough offers from manufacturers. However, some buyers/end users are postponing purchases, expecting lower prices in the near future. Meanwhile, a few manufacturers and resellers are trying to clear aged inventories, selling at prices close to the bottom of the range.
- Cheese Northeast: Milk supplies into cheese production are sufficient as a few manufacturers report a small slide in their intakes. Current production levels are generally steady for end-of-year holiday orders. Demand is good for cream cheese, mozzarella and aged cheddar. Inventories are sufficient for near term commitments.

Recommendation:

During the first part of the week, the spot market continued to climb higher, with blocks reaching as high as \$1.94¼/lb. We talked last week about the market getting a little ahead of itself, and it seems it did indeed. At \$1.94+, where was the upside from there? Certainly cheese wasn't going over \$2/lb, and so, spot prices retraced on Friday. Class III had never really followed, maintaining a sharp discount to spot prices, so while we finished in the red on Friday, Dec '16 futures still ended the week higher. We think this correction was healthy. Out in the country, it appears holiday demand is still alive and well, keeping block cheese on the tighter side, but there appears to be plenty of barrel cheese available. The block-barrel spread has grown to 13¢ and can't stay there forever. Current spot prices work out to about \$17.40 Class III, so including the NASS premium, it's closer to \$18.00. Dec futures, then, are still trading at more than \$1 premium, with the contract beginning its calculation next week. If the spot market can find some stability, Dec should rally. However, if cheese sellers are intent on pushing spot prices lower, that certainly wouldn't happen. In case you were under a rock, we had an election this week. Many wonder what effect, if any, it will have on ag futures. The night of the election, Dow futures were briefly limit down, but recovered much of those losses by the next trading morning. And by the end of Wed, the stock market was close to putting in new highs. The belief that corporate tax relief and deregulation would allow the economy to grow more aggressively brought new investors looking to park their money in stocks. A more robust economy would certainly enhance demand, though there is also the risk that monetary tightening by the Fed would strengthen the USD. Bottom line, it's really hard to say. More importantly, the fundamentals of dwindling milk production in both the EU and Oceania will likely play more significant roles in 2017 dairy prices. We continue to be moderately optimistic, especially for the second half of the year. Producers with existing contracts sold in 2017 should look at corrections like we had this week to purchase upside protection (call options). Up front, we would sell Dec '16 at \$16.95 and \$17.24 levels. Expect more volatility as the market absorbs ongoing new information about the incoming administration, its key appointments and new policies. On this Veteran's Day, we also want to thank our armed forces for the freedom we have to select our own leaders through the electoral process. What an amazing privilege.

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