

The KDM Dairy Report – November 18th, 2016

What's Bullish:

- Spot Market: Block cheese gained 2½¢ for the week to settle at \$1.91/lb with just 3 trades. Barrels gave up ½¢ to close at \$1.75/lb on 48 trades. Grade A NDM was up 2¼¢ to settle at \$0.90/lb on 16 trades, while butter picked up 2¢ to close at \$2.03/lb on 25 trades.
- Wow! Butter stocks at USDA-selected storage centers have fallen 49% (13.4 million lbs) over just the first 14 days of Nov. Cheese stocks have declined 5% (3.8 million lbs) over the same period.
- Cream East: Tight cream supplies, prompted by active Class II production and export sales, pushed multiples higher in the East. This week, cream multiples range 1.35-1.45, a slight increase on both ends of the spectrum.

Futures Month	Class III 11/18	Class III 11/11	Change	Dry Whey 11/18	Dry Whey 11/11	Change	Cheese 11/18	Cheese 11/11	Change
Nov-16	\$16.75	\$16.81	(\$0.06)	36.400¢	36.000¢	0.40¢	\$1.760	\$1.769	(\$0.009)
Dec-16	\$16.94	\$16.65	\$0.29	37.425¢	36.500¢	0.92¢	\$1.766	\$1.749	\$0.017
Jan-17	\$16.33	\$15.96	\$0.37	38.350¢	37.050¢	1.30¢	\$1.701	\$1.676	\$0.025
Feb-17	\$16.24	\$15.98	\$0.26	38.500¢	37.100¢	1.40¢	\$1.688	\$1.670	\$0.018
Mar-17	\$16.27	\$16.04	\$0.23	39.000¢	37.250¢	1.75¢	\$1.685	\$1.670	\$0.015
Apr-17	\$16.33	\$16.05	\$0.28	38.800¢	37.125¢	1.68¢	\$1.693	\$1.678	\$0.015
May-17	\$16.33	\$16.05	\$0.28	39.000¢	37.000¢	2.00¢	\$1.695	\$1.680	\$0.015
Jun-17	\$16.50	\$16.20	\$0.30	39.250¢	37.025¢	2.23¢	\$1.705	\$1.695	\$0.010
Jul-17	\$16.61	\$16.38	\$0.23	39.900¢	37.250¢	2.65¢	\$1.722	\$1.716	\$0.006
Aug-17	\$16.79	\$16.65	\$0.14	39.900¢	37.050¢	2.85¢	\$1.738	\$1.741	(\$0.003)
Sep-17	\$17.03	\$16.80	\$0.23	40.125¢	38.050¢	2.08¢	\$1.755	\$1.748	\$0.007
Oct-17	\$16.97	\$16.80	\$0.17	40.000¢	38.325¢	1.68¢	\$1.752	\$1.745	\$0.007
12 Mo Avg	\$16.59	\$16.36	\$0.23	38.888¢	37.144¢	1.74¢	\$1.722	\$1.711	\$0.010

- Fluid Milk Central: Milk production is slowly trending upward, with accompanying increases in butterfat and protein component levels. However, in some areas, milk is well short of keeping production facilities running at capacity. Processors have noted the recent global strength in commodities and consider that a good sign for upcoming dairy demand. Orders from bottlers are steady to higher. Although most school districts have decreased orders because of holiday closures, orders from grocery store accounts are generally higher as those outlet managers stock up ahead of the holiday.
- Cream Central: Availability is tighter in the Central region as Class II/III production heats up ahead of the holidays. With some ongoing cream exports taking place in the East region, clearing of cream from that region into the Central is limited. As a reversal of that trend, a few Central spot cream loads cleared into the East region. Also, some cheese plant managers are using condensed skim or nonfat dry milk and adding cream loads to the fortification process. This is taking additional cream out of the spot market. Production of sour cream, dips, cream cheese, and specialty drink items is higher. Cream multiples are steady to firmer.
- Fluid Milk West: Farm level milk output is up in California, following seasonal trends. Cooler daytime temperatures in the Central Valley, averaging 75 degrees, are relieving cow stress. However, Class 1 retail demand continues to be strong ahead of the upcoming holiday, somewhat limiting manufacturing milk supplies. Demand for eggnog and flavored milk is active. Some dairy operators are buying high quality alfalfa from nearby states since local supplies are tight.
- Butter Northeast: Demand for both print and bulk butter is good. Cream supplies are typically in balance with churning needs. Retail butter orders are good with particularly strong pulls for private label. Bulk butter supplies are declining as manufacturers' inventories are worked lower. Bulk butter prices are ranging from 5 to 8 over the market.
- Butter Central: Class II processors continue pulling substantial amounts of cream ahead of the year-end holiday. As a result, light to moderate cream availability is somewhat curtailing butter production. Consequently, some processors are microfixing bulk stocks in order to complement print butter production. A few manufacturers are selling cream instead of churning.
- Butter West: Production is running strong as butter makers work hard to meet the remaining 2016 commitments. In some cases, processors are feeling a pinch and wondering if there is time to get enough butter made. Demand is solid and sales are drawing down available supplies.
- Dry Whey Northeast: Prices moved slightly higher within the range price series. Production of dry whey is steady, due to seasonally active interest from cheese markets. Manufacturers' stocks, overall, still appear to be tight. Some buyers are relying on resale markets to fulfill their buying needs. Dry whey 2017 contract discussions are ongoing. The market undertone is steady to firm.
- Dry Whey Central: Prices inched higher at the bottom of the range and mostly price series, and made a larger step at the top of the price range. Industry contacts say inventories are generally tighter. Domestic demand is good and whey is moving well through contracts.
- Dry Whey West: Prices edged higher across the price range and the bottom of the mostly price series. Although a few manufacturers say supplies are a little long, other industry contacts suggest inventories have gotten considerably tighter. Some processors indicate their whey stocks are committed into Q1 2017.
- Cheese Northeast: With available milk supplies, cheese production continues at a high rate as some plants run full schedules, while continuing to monitor inventory levels. Food service demand remains strong. Retail cheese promotions increased ahead of the Thanksgiving holiday to further sales.
- Cheese West: Production is active, though seasonal retail sales are strong. Manufacturers report good demand for branded cheese. Buyers are placing regular orders for fresh commodity blocks. Some manufacturers report inventories for fresh blocks are low or highly committed through the end of the year. Favorable pricing several weeks ago, and tight supplies in other international cheese producing regions have helped draw stocks down. Cheese inventories are still long for barrels, however.
- This week's GDT auction saw the dairy price index climb a solid 4.5%. Gains were led by butter milk powder, up 13.3%, and Cheddar cheese, up 11%. Cheddar cheese settled at a U.S.-equivalent \$1.68/lb.
- CWT has accepted 11 requests for export assistance to sell 1.609 million pounds of Cheddar, Gouda and Monterey Jack cheese, and 308,647 pounds of butter to customers in Asia, the Middle East, and Oceania. The product has been contracted for delivery in the period from November 2016 through February 2017.

What's Bearish:

- Milk Production Report: Output in October was 2.5% higher than a year ago, the biggest YoY increase in 2016. The dairy herd is 15,000 head higher than a year ago, while milk per cow jumped from 1,838 to 1,880. Cow numbers did decline 2,000 head from the prior month, however.
- Fluid Milk Northeast: While milk production is steady at seasonal levels, manufacturing milk supplies in the Northeast and Mid-Atlantic regions are mixed with most supplies somewhat balanced. Class I and Class II demand is mostly steady. Balancing plants in the region are preparing for heavier holiday milk intakes.
- Fluid Milk Southeast: The region is seeing stronger milk production prompted by cooler temperatures, especially in areas of the deeper South. Over the past weekend, bottling sales dropped off, but have picked back up this week as handlers note a number of add-ons. Class II sales are strong. Not much milk is moving into manufacturing. In Florida, the weather has cooled down with nights in the high 50s and days in the 70s. Accordingly, milk production is seeing a steady rise. Sales to bottling increased as anticipated. The change in milk production levels led Florida flipping from a net importer, to a net exporter, with 7 f.o.b. spot loads shipped out this week.
- Fluid Milk Southwest: Farm milk yields are increasing in Arizona due to the favorable climate conditions. Milk intakes are in good balance with manufacturing needs. Bottled milk orders from educational institutions are down, but up from several retail and food service accounts. Demand from Class II is seasonally higher. New Mexico farm milk intakes are higher, in line with seasonal patterns. Class I sales are steady to higher as some grocery stores are restocking coolers ahead of the holiday shopping weekend. Sales into Class II are up. Manufacturing milk volumes moving into Class III are steady.
- Fluid Milk Pacific Northwest: Dairy contacts report plenty of milk for most processing needs. Milk production is seasonally steady with a lot of milk moving to cheese manufacturing. Bottling demand is stable. Cheese manufacturers anticipate more milk to be available for processing runs next week due to the holiday break. Milk production in Idaho, Colorado and Utah is stable and in good supply. Processors are not having any trouble getting milk they need, and the milk is finding homes at nearby plants. Farmers have good supplies of feedstuffs for dairy herds.
- Cheese Midwest: Production is active as manufacturers are working hard to get orders filled before the holidays. Cheese makers report some ripples in demand and milk supply due to the Thanksgiving holiday. Available spot loads of milk had been a little short the previous weeks, but some manufacturers say milk is getting freed up by reduced holiday production schedules at a few facilities. A few industry contacts also suggest cheese orders are mixed. In some cases, shoppers are eager to get their orders secured before the holiday rush. A few others think demand is easing and starting to show signs of the holiday pipelines getting filled.

Recommendation:

With the lead time for holiday ordering rapidly shrinking, it appears demand for block cheese is stronger than current over supply of barrel cheese. The spot prices moving in different directions, the spread reached as much as 23¢ on Thursday; an unsustainable level. Many thought surely it would be blocks that came down to tight the spread (and they still might!), but on Friday, we saw blocks gain ½¢ while barrels shot up 8¼¢, narrowing the spread to a still-wide 16¢. With current spot prices working out to about \$17.60 Class III and December futures, in its first week of pricing, settling at \$16.94 today, there is still plenty of upside left in this month, should spot prices hold or go even higher. However, there is some chatter about holiday pipelines beginning to fill in the Midwest, though block cheese appears committed through the end of the year in the West. Add to that general firmness in the dry whey market and we could see further price appreciation. Indeed, despite a somewhat bearish Milk Production report, the U.S. is the only major dairy-producing region climbing in milk production. There is growing concern about milk supply availability heading in to 2017 as output in the EU and Oceania continue to decline. The U.S. dairy industry is ideally situated to meet global demand next year. The 2017 contracts continued to gain traction as these large, macro fundamentals become more widely known and anticipated. Commercial hedgers have begun to realize that prices have already hit bottom and are on the way up. Buying of all 2017 contracts was active this week as futures contracts were solidly higher. The 2017 average is now sitting at \$16.59, up from a low of 16.03 at the end of September. It is alarmingly close to setting a new high, with 16.62 being the previous high set on 8/18. A breakout to new highs would be technically bullish and likely encourage further buying in the form of long hedging. Dairy producers should not be aggressively selling 2017 contracts, in our opinion, give global developments. Maybe our new president will “make milk prices great again!”. Have a great weekend.

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