

The KDM Dairy Report – December 9th, 2016

What's Bullish:

- Exports: Total U.S. dairy exports in October jumped a whopping 17% by volume over a year ago, according to U.S. Dairy Export Council data. The total value of these exports rose 5% to reach their highest level in 16 months. The surge was led by butterfat, up 233%. YTD, dairy exports by volume have crossed in to positive territory, now up 1%. From a milk solids standpoint, October dairy exports reached an equivalent of 15.7% of U.S. milk production during the month.
- CWT has accepted 15 requests for export assistance to sell 1.565 million pounds of Cheddar cheese and 220,461 pounds of butter to customers in Asia, the Middle East, and Oceania. The product has been contracted for delivery in the period from December 2016 through March 2017.

Futures Month	Class III 12/09	Class III 12/02	Change	Dry Whey 12/09	Dry Whey 12/02	Change	Cheese 12/09	Cheese 12/02	Change
Dec-16	\$17.10	\$17.16	(\$0.06)	39.250c	39.350c	(0.10c)	\$1.776	\$1.778	(\$0.002)
Jan-17	\$16.68	\$16.96	(\$0.28)	41.300c	41.850c	(0.55c)	\$1.713	\$1.742	(\$0.029)
Feb-17	\$16.88	\$16.98	(\$0.10)	42.175c	42.025c	0.15c	\$1.737	\$1.743	(\$0.006)
Mar-17	\$17.01	\$16.89	\$0.12	41.025c	42.025c	(1.00c)	\$1.742	\$1.730	\$0.012
Apr-17	\$17.00	\$16.83	\$0.17	42.250c	41.875c	0.38c	\$1.745	\$1.724	\$0.021
May-17	\$17.05	\$16.89	\$0.16	42.250c	41.675c	0.58c	\$1.753	\$1.732	\$0.021
Jun-17	\$17.25	\$17.17	\$0.08	41.750c	42.275c	(0.52c)	\$1.769	\$1.749	\$0.020
Jul-17	\$17.48	\$17.55	(\$0.07)	41.750c	42.325c	(0.58c)	\$1.786	\$1.782	\$0.004
Aug-17	\$17.60	\$17.60	\$0.00	42.100c	42.325c	(0.23c)	\$1.802	\$1.800	\$0.002
Sep-17	\$17.65	\$17.68	(\$0.03)	42.500c	42.550c	(0.05c)	\$1.804	\$1.801	\$0.003
Oct-17	\$17.47	\$17.43	\$0.04	42.000c	42.325c	(0.33c)	\$1.787	\$1.785	\$0.002
Nov-17	\$17.30	\$17.29	\$0.01	41.800c	42.750c	(0.95c)	\$1.765	\$1.758	\$0.007
12 Mo Avg	\$17.21	\$17.20	\$0.00	41.679c	41.946c	(0.27c)	\$1.765	\$1.760	\$0.005

- Dairy Products Report: Butter output in October was down 3.6% vs. a year ago, while cheddar cheese production notched just a 0.2% increase and total cheese output was up just 0.5%. The key here is that demand is increasing faster than production.
- Fluid Milk Southeast: Milk handlers are seeing an increase in fluid demand as Class I operations replenish designated milk outlets. Limited volumes are moving into manufacturing. Milk production on Florida's farms are currently steady as temperatures warm to record levels. Accordingly, milk handlers anticipate a looming slowdown in production. Milk sales are seasonally strong.
- Fluid Milk Southwest: In North California, milk output is uneven due to the unfavorable weather conditions. On the other hand, the mild climate is sustaining higher milk yields in Southern California. Class I demand from groceries stores and food service are active. Sales into Class II are up, sustained by the strong demand related to the year-end holiday. Lower temperatures and humidity are boosting milk production in Arizona, but a cooler winter climate in New Mexico is starting to take a toll on cow comfort. Some producers are noticing a slight drop in milk production. Manufacturing milk volumes moving into Class III are slightly lower as some cheese plants are having repair/maintenance works this week.
- Butter Northeast: Production is active but tends to vary. Some balancing facilities have adequate cream supply for customers' needs, but limited surplus for churning. Good demand is prompting strong sales for the bulk and print butter categories. Manufacturers looking to fill January 2017 customer deliveries are pulling on the market's bulk supplies. Sources suggest that recent price fluctuations at the CME result from strong demand and diminished availability, as some suppliers back off orders.
- Butter West: Butter makers are looking to make and ship much of the print butter still needed for holiday orders by the end of the week. Retail orders are still strong, but industry contacts expect the demand to slow in the next two weeks as the winter holidays draw near. Butter production is active and cream supplies have been a little tight.
- Dry Whey Northeast: Prices for dry whey are steady to higher. Production rates are unchanged. Inventories are sufficient for near-term needs, but the market undertone is firm with most supplies committed.
- Dry Whey Midwest: Prices moved slightly higher this week. Some manufacturers report inventories are more comfortable than a few months ago, but with 2017 contracting ongoing, a few processors say they are getting tight on supplies, or at least more committed.
- Dry Whey West: Although buyers say they can find whey as needed, inventories are relatively tight and committed into 2017. Dry whey production is steady. Demand is stable and sound.
- NDM Northeast: Prices are firming. Industry participants report domestic demand for new production is active, but availability from producers remains scarce, as supplies are minimal. Contracting for 2017 is ongoing between producers and buyers.
- NDM Central: Prices for nonfat dry milk advanced this week on f.o.b. spot sales. Firmer prices coincide with some manufacturers being oversold on low/medium NDM and having limited holdings to offer in the spot markets. While NDM production is active, at seasonal levels, manufacturers are seeing immediate sales for most product. Condensed skim, which typically moves into NDM manufacturing by way of Eastern suppliers have been slow to materialize.
- NDM West: Prices are higher, in line with upward movements in various indices. According to some processors, the market is firming, as NDM supplies are tight and highly committed thru the end of the year. Manufacturers remain optimistic about futures prices, holding some stocks instead of selling.
- WPC: Prices for whey protein concentrate 34% moved higher at the bottom of the price range and significantly higher at the top of the mostly price series. Industry contacts report many buyers are having difficulties acquiring enough WPC34% to fully meet end user needs. Numerous manufacturers and brokers say they continue to get inquiries from buyers they do not know because the shoppers are searching far and wide for available sources. Processor inventories are already becoming committed well into 2017. Production is generally not able to keep pace with the steady demand.
- Cheese Northeast: Production is active as processors operate full schedules to accommodate available milk supplies. Cheese makers continue to see good domestic retail and food service demand.
- Cheese Midwest: Production in the region is active. Spot loads for processing are available here and there, but not at the discounted prices seen during the Thanksgiving holiday weekend. Cheesemakers are in the final push to get orders out the door and on store shelves before the winter holidays. Orders, especially for retail demand, are strong. Orders for food service and deli are a little lighter. Industry contacts expect the brisk sales activity to continue through the end of the week and then somewhat subside over the next few weeks due to the passing holiday season.

- Cheese West: Cheese makers are actively producing and filling remaining cheese orders for the winter holiday season. Retail demand has been strong, but industry contacts expect some of this demand to wane as the window for shipping holiday orders pass. Cheese demand from food service accounts are also seeing good strength, especially for mozzarella and other cheese for pizzas. Cheese stocks are comfortable to tight for fresh blocks, but remain longer for older cheese and cheese used for processing.
- Foreign Cheese: Strong holiday cheese sales in the EU are contributing to inventories being drawn more than would be ideal. However, prices are mostly stable. Negotiations continue for first quarter 2017 contracts.
- International: Milk collections in the EU were 3% lower in September 2016, the 4th consecutive month with a reduction. Significant decreases have been reported in major producing countries including the United Kingdom, Germany, and France. Further milk production slowdown is expected for the balance of 2016. A number of manufacturers are not able to fill butter orders as fast as some customers would like. Whole milk powder prices in Western Europe are now at the highest level of 2016. Demand is expected to strengthen. Domestic customers are negotiating with Western European manufacturers for supplies needed during the first half of 2017.
- International: Milk production in Russia for October 2016 was 14% lower than October 2015.
- International: In Australia, many observers feel the milk production season has shifted to later this year than has been typical. The season so far has endured cold and wet weather. Previous culling of cows will continue to result in somewhat lower milk production. Many producers will be cautious in considering herd expansions, also being aware that price strengthening is partly a function of current milk production volumes. According to Dairy Australia, October 2016 milk production in Australia was 11.4% below October 2015.
- International: In New Zealand, October milk production and milk solids lagged the levels one year ago. October 2016 milk production was 3.04 million MT, down 5.3% from 3.21 million MT in 2015. October milk solids at 247.43 million kg, were down 6.1% from 263.47 million kg in 2015. Stronger milk prices for producers have followed the lower production. A number of dairy processors have recently increased forecasted milk pay prices.
- International: Oceania butter prices are at the highest level of the year. In Australia, butter stocks are tight. Cream supplies available for making butter in Australia and New Zealand are limiting production. Partly this results from lower milk production. Many manufacturers and/or sellers are content to hold out for desired prices. Stocks are so tight that there are reports of some smaller volume commercial users of butter going to retail outlets and buying packaged butter for their manufacturing needs.
- International: The arrival of summer season in Argentina and Uruguay is gradually increasing temperatures, prompting stress in dairy cows. Milk intakes are declining, but for now, there are enough supplies for current manufacturing needs. Butterfat and protein components in the milk are trending down. Cheese and yogurt processing are very active with a strong demand from retailers and food service. According to the National Institute of Milk (INALE), in October, Uruguay farm milk volumes sent to processors were 191.9 million liters, 7.0% below a year ago. From January to October 2016, milk intakes sent to manufacturing plants totaled 1,427 million liters, down 11.4% from the same period of 2015. The October price paid to producers is equivalent to \$0.31 USD/liter or around \$13.83/cwt. Farm milk output is uneven in Brazil as heavy rain conditions prevail in the main dairy state, Minas Gerais. Bottled milk demands from grocery stores and restaurants are good. Large milk volumes are clearing into WMP manufacturing, as demand from the food processing industry is strong. The average gross price received by dairy farmers in Brazil during November was \$1.34 Brazilian reais (\$R) per liter, which is down 10.9% from the previous month, but 27.3% above a year ago. This amount is equal to \$0.42 USD/liter or around \$18.48/cwt.
- This week's GDT auction saw the dairy price index increase 3.5%, the fourth consecutive rise. Cheddar cheese was up 2.2% to a U.S. equivalent \$1.70/lb.

What's Bearish:

- Spot Market: All Class III components fell this week. Block cheese lost 10¢ to settle at \$1.71/lb on 16 trades, while barrels gave up 3¼¢ to close at \$1.57¼/lb on 20 trades. NDM declined 3¢ to settle at \$0.97¼/lb on 13 trades, while butter plunged 13¼¢ to close at \$2.06½/lb on 15 trades.
- Fluid Milk Northeast: Farm milk production in the Northeast and Mid-Atlantic areas of the region is steady. Milk sales into fluid accounts are recovering with the reopening of school. Manufacturers' milk intakes are adequate for production needs.
- Fluid Milk Central: Milk production is steady to higher in the region. Milk available for processing is in good balance right now. Demand for Class I is mixed. Some areas report demand from bottlers is strong, while other suggest weaker demand. Some milk marketers expect Class II to slow in the next week and milk will be diverted into Class III manufacturing. Cream demand is strong as buyers from Mexico and Canada seek out available supplies. However, industry contacts suggest that although cream was tighter last week and into this week, supplies are starting to loosen up as holiday orders get filled.
- Fluid Milk Pacific Northwest: Manufacturers report milk intakes are in line with expectations and adequate for most processing needs. Bottling demand is steady. Industry contacts in the mountain states of Idaho, Colorado and Utah say the favorable amount and quality of feedstuffs are contributing to solid milk production within the region. Milk intakes are in good balance with processing needs. Manufacturers are not having any trouble getting the milk they need.
- Butter Central: Most butter makers are wrapping up production related to the year-end holiday season. Some processors are still buying a few spot loads of cream to support the active butter output. At this point, churners are running operations at full capacity.

Recommendation:

An excess barrel supply and the impending end of holiday ordering season had offers in the spot market pushing prices steadily lower this week. Punching component prices into the Class III calculator yields about \$16.10, yet the front month Jan contract settled at \$16.68, which even including the current positive basis in NASS survey numbers, is slightly premium to spot. In addition, while front month futures finished the week in the red, they were well of their lows, and most 2017 contracts were higher. So what gives? The big, and long-term picture. October exports rocked, while the EU and Oceania continue to struggle with milk output. Demand is good and growing world-wide. While there may be some demand slump after the holidays, we would use that as an opportunity to get upside protection for current hedges. We would not sell beyond March. While output is increasing in the U.S., demand is increasing at a faster pace, while the rest of the world may need to look to the U.S. increasingly to supply butter and powder. We think 2017 contracts are ultimately headed higher, maybe much higher. Hang on, and have a great weekend.

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