

**The KDM Dairy Report – December 23<sup>rd</sup>, 2016**

**What's Bullish:**

- Spot Market: Butter finished the week up 5¼¢ to settle at \$2.24¼/lb on 15 trades. Grade A NDM closed at \$1.02/lb on 14 trades, which was unchanged.
- Livestock Slaughter Report: Commercial dairy cow slaughter in November trimmed 243,200 head from the milking herd. That was a 5.6% increase from a year ago, and the highest November total since 2013.
- Butter stocks at USDA-selected warehouses have declined 4% through the first 19 days of December. Cheese stocks over the same period were even, to slightly lower.
- Butter Northeast: Retail and food service orders, although slower this week, are still good. The majority of manufacturers have booked and shipped all holiday orders. While a surge in the butter price is typical the week prior to the Christmas holiday, some market participants are still adjusting to strong fluctuations that occurred at the CME the past week. This lends a tone of firmness even as prices withdrew somewhat this week.
- Butter West: Cream is plentiful as the Class II winter holiday order rush concludes and Class II manufacturers wind down production levels. A few processors say the butter churns are busy trying to clear the excess cream. Butter inventories are seasonally lower and a few industry contacts suggest stocks may be tighter than they have been for some time. Domestic demand is still good as consumers prepare for holiday gatherings.
- Dry Whey Northeast: Prices are unchanged on a firm market. Demand remains good. Inventories are light with limited offerings available for spot market applications. Some domestic buyers searching for additional loads from processors are unsuccessful and relying on active resale markets for product.
- Dry Whey Central: Prices edged higher this week. Manufacturers report much of their work to get Q1 and 2017 annual contracts is finished. Demand is steady with most current activity flowing through contracts. Processor inventories are comfortable and possibly a little lower than previous weeks.
- Dry Whey West: Prices for western whey are higher at the top of both the range and mostly price series. Industry contacts say demand seems good, and in some cases, strong. Inventories are a little lower. Some contacts suggest there isn't much excess whey available.
- NDM: In the Northeast, prices are stronger despite heavier output, as increased demand consumes product. In the Central region, producers report inventories as either sold out or balanced. In the West, spot prices shifted higher this week. Demand from hot chocolate dry mix manufacturers is good. Inventories are highly committed through the end of the year. Processors are holding stocks and limiting tenders in the spot market, anticipating higher prices in the near future. Consequently, some buyers/end users are having some difficulty finding NDM spot loads. The demand from Mexico is active but manufacturers' offers are limited.
- Cheese Midwest: Cheese producers report another strong week in orders. Pizza cheese has slowed a bit as more traditional holiday type cheeses are in higher demand. The trend of longer barrel inventories continues, as blocks tighten and are in higher demand for contract deals throughout 2017. Milk supply reports have been varied. Some cheese producers are buying spot loads at discounted rates, while others report a scarcity of milk.
- Starting in 2015 and at an even higher level in 2016, California processors find themselves in a situation where there is not enough milk to keep all plants full, according to a news article this week. That trend is likely to continue as more dairies and cows continue to leave the state.
- International: October milk output in the EU was generally lower. Only the Netherlands and Italy had positive milk production compared with October last year. The following countries reported declines as shown: Denmark, -5.1%; Germany, -3.7%; France, -7.7%; Ireland, -4.3%; and the United Kingdom, -6.0%. A significant factor in those countries with lower production has been lower cow numbers. This has occurred either by producers reducing herd size, or in some cases, ceasing dairy production.
- International: Whole milk powder prices in Western Europe slightly increased at each end of the price range, reaching the highest level of 2016. Production is believed to have slightly declined in recent weeks. A number of manufacturers find less profit in WMP than butter and cheese. There has been very recent buying interest from countries in Africa and the Middle East, which have historically sourced from New Zealand. The reasons for this recent shift have been some slowing of export volumes from New Zealand. WMP exports from the EU during October are 13.6% below the level during October last year according to Eucolait.
- International: New Zealand November milk production and milk solids lagged the levels one year ago. November 2016 milk production was 2.85 million MT, down 4.4% from a year ago. November milk solids, at 234.77 million kg, are down 5.3% vs. Nov '16. The lower milk production was not surprising to many New Zealand dairy observers. Rainy weather during November, especially on the South island, was expected to impact milk production. Despite a rising milk price, increasing numbers of dairy producers are believed to feel they are experiencing undue pressure from lenders as to their mortgages.

Futures Month	Class III 12/23	Class III 12/16	Change	Dry Whey 12/23	Dry Whey 12/16	Change	Cheese 12/23	Cheese 12/16	Change
Dec-16	\$17.38	\$17.32	\$0.06	39.925¢	39.750¢	0.17¢	\$1.798	\$1.795	\$0.003
Jan-17	\$16.64	\$16.95	(\$0.31)	43.350¢	42.475¢	0.88¢	\$1.696	\$1.738	(\$0.042)
Feb-17	\$16.98	\$17.14	(\$0.16)	44.075¢	43.125¢	0.95¢	\$1.722	\$1.750	(\$0.028)
Mar-17	\$17.26	\$17.35	(\$0.09)	45.050¢	43.600¢	1.45¢	\$1.743	\$1.762	(\$0.019)
Apr-17	\$17.42	\$17.48	(\$0.06)	45.300¢	43.875¢	1.43¢	\$1.761	\$1.775	(\$0.014)
May-17	\$17.55	\$17.50	\$0.05	45.300¢	44.125¢	1.18¢	\$1.776	\$1.775	\$0.001
Jun-17	\$17.65	\$17.55	\$0.10	45.100¢	44.125¢	0.98¢	\$1.783	\$1.781	\$0.002
Jul-17	\$17.85	\$17.62	\$0.23	45.500¢	43.550¢	1.95¢	\$1.800	\$1.792	\$0.008
Aug-17	\$17.90	\$17.66	\$0.24	45.600¢	43.750¢	1.85¢	\$1.803	\$1.803	\$0.000
Sep-17	\$17.95	\$17.75	\$0.20	45.750¢	43.750¢	2.00¢	\$1.811	\$1.796	\$0.015
Oct-17	\$17.79	\$17.63	\$0.16	45.650¢	43.750¢	1.90¢	\$1.797	\$1.793	\$0.004
Nov-17	\$17.61	\$17.44	\$0.17	46.150¢	44.900¢	1.25¢	\$1.780	\$1.777	\$0.003
<b>12 Mo Avg</b>	<b>\$17.50</b>	<b>\$17.45</b>	<b>\$0.05</b>	<b>44.729¢</b>	<b>43.398¢</b>	<b>1.33¢</b>	<b>\$1.773</b>	<b>\$1.778</b>	<b>(\$0.006)</b>

**What's Bearish:**

- Spot Market: While butter led a spot move higher, block cheese gave up 11¢ for the week to settle at \$1.69/lb on 10 trades. Barrel cheese lost 14½¢ to close at \$1.55½/lb on volume of 30 trades.
- Milk Production Report: November milk output in the U.S. was 2.4% higher than a year, while cow numbers increased 4,000 head from October. Milk per cow was up 39 lbs vs last year, while the herd size at 9.330 million head reached its highest level since August.

- Cold Storage Report: Butter stocks in U.S. warehouses at the end of November were up 21% vs. a year ago. American cheese stocks were 2% higher, while total cheese stocks were 3% higher over the same period.
- Fluid Milk Northeast: Milk production is increasing in more areas of the East. Bottling plant schedules are being reduced accordingly as retail sales fail to offset the impact of schools closing for the holiday period. In New England, milk production is steady to slightly heavier. Further south in the Mid-Atlantic, milk output is increasing along normal patterns, with volumes advancing marginally in some areas.
- Fluid Milk Southeast: Farm milk production is marginally higher. As warmer weather prevails, Florida's milk production is slightly lower. However, Class I sales are steady to lower, allowing milk export shipments to grow to 70 loads this week (up from 25 loads last week). The fluid cream market is weaker. Spot prices are mixed, with multiples ranging 1.10-1.30. Demand was fairly good over the weekend, but has slowed as the week progressed. Cream availability is ample. The condensed skim market is steady to weaker. Offering are more than ample for slower spot demand. Prices are unchanged this week, but contacts report that offers at distressed pricing are being discussed for the holiday weekend.
- Fluid Milk Central: Southern and northern Central region farm milk production is generally steady. A recent cold snap sent temperatures into the subzero range, which challenged cow comfort for dairy operations in the northern tier of states. With adequate feedstocks on hand, though, most dairy producers noted the weather had fairly minor impacts on milk production. Bottler demand is trending sharply lower. Orders from K-12 school districts plummeted due to the upcoming closures over the yearend holidays. Many higher education institutions are also cutting back orders as the fall semester ends. Spot milk availability has improved substantially. Milk buyers for Class III operations report the number of loads available this week exceeded expectations. Prices range from \$2.00 to \$4.00 under Class. Cream availability improved throughout the region. End users reported cream loads from the West region are readily clearing into Central II/IV operations.
- Fluid Milk Southwest: In California, farm milk production is higher, in line with seasonal trends. Sales into Class I are trending noticeable lower as most educational institutions will be closed during the winter break. Therefore, milk is becoming more available for cheese manufacturing. Balancing plants are expected to be actively processing milk. With cooler temperatures averaging 77 degrees in Arizona, milk production continues trending up. Industry participants report plenty of milk is available for most manufacturing needs. Class I orders from educational institutions are lower as most K-12 schools enter the semester break. In New Mexico, milk output is higher, following seasonal patterns. With most schools closing during the winter break, milk sales into Class I are lower.
- Fluid Milk Pacific Northwest: Milk production remains seasonally strong. Bottling demand has decreased due to educational institutions taking their winter breaks. A lot of the now liberated milk is finding its way into manufactured dairy product lines. Dairy farmers report good quality feed and in good amounts. Manufacturers have plenty of milk available to them. Heavy volumes of western condensed skim are clearing into NDM and MPC processing and are expected to be higher during the upcoming holiday weekend. Condensed skim utilization for cheese fortification is active. With weaker cream demand from sour cream, eggnog, and cream cheese processors, cream is becoming more available for butter making. Some manufacturers are trying to clear heavy cream volumes into churns.
- Butter Central: Cream supplies are more available for churning. Therefore, some butter makers are actively churning and are anticipating running full production schedules over the holiday weekend. On the other hand, some butter manufacturers are reducing output rates in order to balance butter stock levels. According to them, the market is weak and they do not want to build large supplies at current prices.
- Cheese Northeast: Manufacturers expect output to be somewhat heavier during the yearend holiday period, with extra fluid milk availability due to waning school demand. Manufacturers are careful to maintain stocks at reasonable yearend levels. Aged cheddar is seeing the typical good seasonal interest. Food service interest should continue to hold steady into the New Year. The market undertone is not as firm.
- Cheese West: Cheese makers report good consumer demand continuing through the early part of the week. However, holiday shipments have been made and industry contacts expect orders to slow. According to some buyers, there is plenty of cheese in inventories across the region. Cheese barrels are long and some buyers are making purchases at heavily discounted prices for barrels that have a little more age. These contacts say blocks are also in good supply, tighter than barrels, but no shortage and on hand for most processing needs.
- International: According to some industry participants, recent rains have helped improve the quality of pasture and forage in the main dairy areas of Argentina and Uruguay. In the southern states of Brazil, farm milk supply is trending lower, following summer trends. However, dairy producers from Minas Gerais and other nearby states, note atypical steady milk yields, mainly due to high quality feed. Milk intakes moving into cheese processing are more than suitable. Brazilian cheese manufacturing is active and inventories are building.

#### Recommendation:

A bull market doesn't go up without retracements, which is what we saw this week. With holiday orders complete, there has been a lull in cheese demand, resulting in greater availability of both blocks and barrels. Those extra loads showed up as increased offers in this week's spot market. With most educational institutions out the next two weeks, there will be extra milk available for manufacturing. Expect continued offerings as we move ahead. The global picture still looks encouraging. Demand for butter is strong, and while stocks were higher in this week's Cold Storage Report vs. a year ago, the drawdown from October was substantial. The move away from margarine continues in the U.S. Global demand for powder is also picking up, as countries who normally source from Oceania have started looking elsewhere due to lack of supply. While cheese prices in this week's spot market fell, both butter and NDM were flat to higher. NDM made a high of \$1.05/lb this week, a level not seen since Oct '15. Dry whey prices are also surging. Producers should look at further price weakness as yet another opportunity to purchase upside protection on existing sold contracts. Buying call options can also be used to trigger future sell orders once predetermined levels are hit, with the result being little to no upside risk after the sale. With global cheddar cheese prices hovering around \$1.70/lb, we do not think current spot prices will last. At a \$1.62/lb block/barrel average, further weakness should trigger export demand, if it hasn't already. When the holiday excess is gone, we expect cheese prices to recover and probably make new highs.

**Note:** Our offices will be closed on Monday, Dec 26<sup>th</sup> in observance of Christmas. In addition, there will be NO report next week. Our offices will also be closed on Monday, Jan 2<sup>nd</sup>, in observance of New Year's Day. Markets are closed on these dates. On behalf of all of us here at KDM Trading, Inc., we wish you and yours a very Merry Christmas and Happy New Year.

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