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The KDM Dairy Report – January 27th, 2017

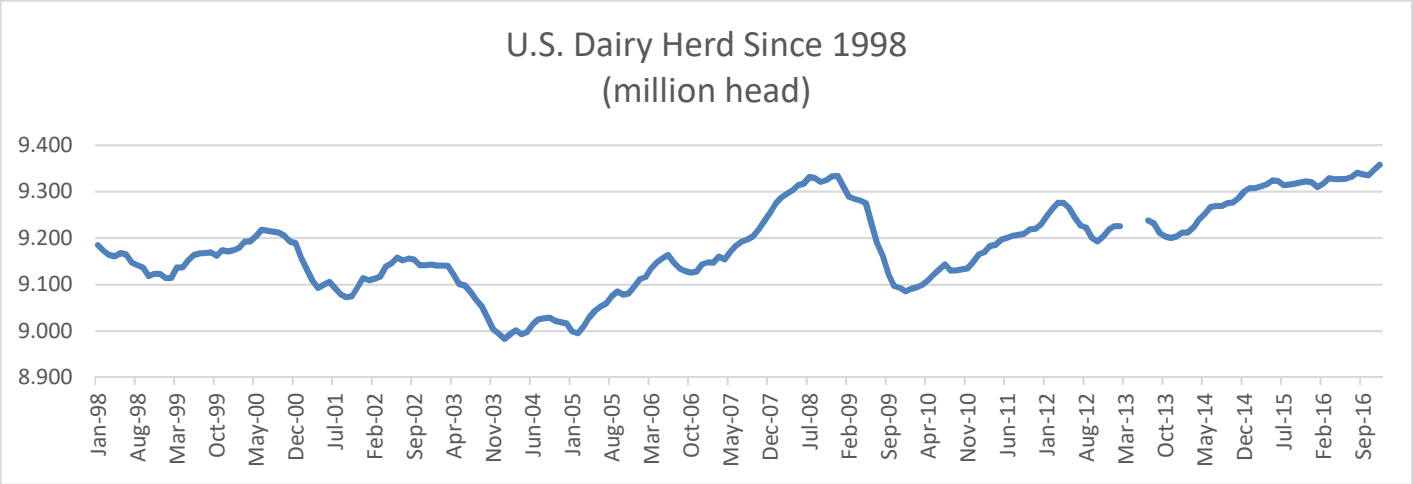
Futures Month	Class III 01/27	Class III 01/20	Change	Dry Whey 01/27	Dry Whey 01/20	Change	Cheese 01/27	Cheese 01/20	Change
Jan-17	$16.75	$16.77	($0.02)	44.250¢	43.525¢	0.73¢	$1.699	$1.702	($0.003)
Feb-17	$16.62	$16.96	($0.34)	46.750¢	46.500¢	0.25¢	$1.671	$1.708	($0.037)
Mar-17	$17.15	$17.40	($0.25)	46.900¢	47.450¢	(0.55¢)	$1.725	$1.745	($0.020)
Apr-17	$17.43	$17.67	($0.24)	47.400¢	48.100¢	(0.70¢)	$1.751	$1.764	($0.013)
May-17	$17.51	$17.73	($0.22)	47.500¢	48.300¢	(0.80¢)	$1.759	$1.770	($0.011)
Jun-17	$17.67	$17.86	($0.19)	47.400¢	49.250¢	(1.85¢)	$1.774	$1.785	($0.011)
Jul-17	$17.81	$17.92	($0.11)	47.500¢	49.200¢	(1.70¢)	$1.784	$1.791	($0.007)
Aug-17	$17.88	$17.95	($0.07)	47.750¢	49.250¢	(1.50¢)	$1.795	$1.786	$0.009
Sep-17	$17.88	$17.93	($0.05)	47.750¢	49.775¢	(2.03¢)	$1.795	$1.790	$0.005
Oct-17	$17.72	$17.82	($0.10)	47.650¢	50.000¢	(2.35¢)	$1.780	$1.780	$0.000
Nov-17	$17.60	$17.68	($0.08)	47.750¢	50.000¢	(2.25¢)	$1.770	$1.768	$0.002
Dec-17	$17.30	$17.41	($0.11)	47.750¢	50.000¢	(2.25¢)	$1.743	$1.740	$0.003
12 Mo Avg	**$17.44**	**$17.59**	**($0.15)**	**47.196¢**	**48.446¢**	**(1.25¢)**	**$1.754**	**$1.761**	**($0.007)**

What's Bullish:

- Fluid Milk Pacific Northwest: The wintry weather in the region resulted in lower milk yields. Therefore, some manufacturers are receiving less milk supplies this week. In the mountain states of Idaho, Colorado, and Utah, milk output is slightly down, mainly due to the cold weather. Heavy accumulation of snow on the roads is creating some milk delivery delays.
- Dry Whey Northeast: Prices continued to advance this weeks. Available stocks are meeting near term customer commitments. Reports generally indicate limited offerings to buyers in spot markets. Overall, dry whey demand is strong, with no signs of relaxing. The market maintains a firm undertone.
- Dry Whey Central: The market tone for dry whey continues to remain firm. Contacts suggest U.S. price points are not competitive in some foreign markets, but domestic demand is steady. With strengthening demand in the higher protein concentration market, dry whey production is easing back a bit. Contacts report seeing fewer spot market options available this week. Some contacts report not anticipating a spot price decrease in the near future. Whey is moving well through existing contracts, but inventories are reportedly tight.
- Dry Whey West: The market tone continues to be firm as demand is above the current supply. Some manufacturers have shifted production away from dry whey and towards higher end whey protein concentrations. As a result, dry whey output is down and inventories continue tightening. Processors report good demand for dry whey in domestic and Mexican markets.
- NDM East: Inventories are in balance to short of buyer interest. Demand is fair to good and clearing most current offerings. Interest in condensed skim is active.
- NDM Central: The market tone is primarily firm. Production is maintaining strong output, with increases in milk volumes, but buying interest is also good across domestic and export accounts.
- Cheese Northeast: Cheese production is rising seasonally along with milk output. However, cheese cutters/packagers are busy as retail orders remain fairly strong, while bolstered by preparations for Super Bowl weekend festivities. Foodservice interest is holding well. Stocks within the region are mostly adequate.
- Cheese West: Production is active and cheesemakers report good supplies of milk used for manufacturing. However, cheese demand has remained solid after a strong holiday season. Price fluctuations are prompting buyers in export markets to make a few more purchases. Domestic retail, cut and wrap, and food service demand has remained solid. And, the demand for cheese destined for pizzas is strong amid the football playoffs and Super Bowl. Inventories for fresh cheese blocks are in good supply, but do not appear to be overly heavy. Barrel stocks are still long.
- International: China's birthrate in 2016 was the highest this century, as the relaxed one-child policy started changing birth trends. Births increased 7.9% in 2016 to 17.86 million. About 45% of newborns joined families that already had one child.

What's Bearish:

- Spot Market: Class III components gave up more ground this week. Block cheese lost 1¢ on 10 trades to settle at $1.68¾/lb, while barrels shed 8¾¢ on 27 trades to close at $1.44¾/lb. Grade A NDM declined 5¾¢ on 9 trades to settle at $0.94¾/lb and butter lost 3¢ on 9 trades to close at $2.22/lb.
- Milk Production Report: December milk output was up 2.2% vs. the prior year, according to USDA, while cow numbers jumped 11,000 head from Nov. At 9.358 million head, the herd size is at its largest level since modern record-keeping began in 1998 (see chart below). Yikes! And, we're getting more out of our cows. Milk per cow increased from 1,875 to 1,908 lbs.



- Cold Storage Report: Butter stocks in cold storage at the end of December were up 13% vs. a year ago, and up 9% vs. Nov. American cheese stocks were 4% and 2% higher, respectively. Total cheese stocks increased 5% vs. Dec '15.
- Holdings at USDA-selected storage centers indicate butter stocks have jumped 10% over the period 01/01 through 01/23. Cheese stocks are up 3% over the same period.
- Fluid Milk Northeast: In the Northeast and Mid-Atlantic, milk production is slowly rising around typical patterns. Fat and protein tests are edging slightly higher and yields are seasonally good.
- Fluid Milk Southeast: Milk production is increasing. After good demand, many bottlers found themselves with too much milk and began canceling orders. As a result, increased volumes are clearing to manufacturing plants. Milk production continues to climb in Florida. Output varies as some areas of the state report more moderate gains. Export milk shipments totaled 100 loads this week. The fluid cream market remains weak. Offers are fully adequate for fair to good demand. Eastern condensed skim remains readily available. Traders are having to clear loads out of region, as some cheese makers are showing more interest in wet solids. Heavy volumes are being dried.
- Fluid Milk Central: Dairy operators report milk production is level to higher, with steady improvements in butterfat and protein components. Within the region, milk marketers report there are instances of milk clearing from one state to another, and these load movements are depressing spot milk prices in the receiving states. In addition, some Class III plant managers are trying to clear loads of their usual milk intake volumes to put a damper on cheese production. This, reportedly, is due to ample commodity cheese inventories. Spot milk prices are under some pressure as availability grows, with a current range of $2.00 under to flat Class.
- Fluid Milk Southwest: Milk production in California is steady to slightly lower manly due to the soggy climate. Some dairy operations throughout the Central Valley are still recovering from last weekend's rainstorms that resulted in flooding and mudslides. However, according to many processors, the milk supply is more than adequate to cover all manufacturing needs. Bottling milk orders from several retail outlets and restaurants look to be up this week, but Class 2 demand is flat. Although rain showers are present in Arizona, milk production continues inching up. Class I demand is flat as pipelines from several market channels are full. Milk production in New Mexico is trending down, principally due to muddy conditions at some dairy operations. Nevertheless, there are enough milk volumes for manufacturing.
- Butter Northeast: With the volume of cream offered to manufacturing remaining plentiful, butter churns are running at near capacity levels in some production venues. Some suppliers are moving cream volumes long distances in order to clear loads. The likelihood of butter output rates slowing, in the near-term, is doubtful as some processors look to build bulk butter inventories. Print butter interest is mostly light, typical for this time of year. Wholesalers are ordering as needed, as some feel prices may in time, move lower.
- Butter Central: Cream supplies for butter makers remain abundant. Spot cream offers are available, but some butter producers are sufficiently stocked with cream on hand. Available cream means butter production continues to run at fully active levels. Bulk butter is building into storage. Print production is starting to strengthen as some butter makers begin, or are in the midst of, spring holiday preparations. Reports on demand are on the fair to strong side. Some contacts report demand is improving from earlier in the month, but remains behind last year's mark.
- Butter West: Heavy cream supplies continue moving into butter production as some processors continue clearing surplus cream. Accordingly, butter output remains strong this week. At this point, cream demand from churners is light. Bulk inventories continue building into cold storage.
- NDM West: Prices for low/medium heat nonfat dry milk (NDM) are lower on the range and mostly series. For some buyers/end users, the recent NDM spot pricing downward trend at the CME is starting to make sense with the market, as large supplies are readily available. Some processors are trying to clear 2016 NDM supplies, offering loads at prices close to the bottom of the range. Low/medium heat NDM production is active as many western balancing plants continue clearing large condensed skim volumes into dryers. Inventories are steady to building.
- Cheese Midwest: Following recent trends of readily available milk for most cheesemakers, cheese production continues at fully active levels. With most cheddar styles, demand has been fair to relatively strong. Pizza cheese producers are reporting fair demand during the Super Bowl season. However, cheese inventories remain available and some extra cheese is being offered on the spot market. Cheese buyers report being sufficiently stocked.

Recommendation:

Cheese continues to move well in the country, but an increasing milk supply as we head in to the flush period is keeping cheese plants busy. Blocks are in fairly good balance, but we find ourselves in an oversupply situation with barrels. Thus, the block-barrel spread in the spot market has grown to an unsustainable 24¢, which is the widest it's been since Dec, 2009. Something is going to give. The barrel settlement at $1.44¾ ties a low set on 10/13/2016. Adding to the bearish sentiment were the Milk Production report, showing our herd size reaching a new, modern-era high, as well as Cold Storage numbers showing supplies continue to swell. That's not necessarily all bad. Demand is growing too, so both production and storage need to increase to meet those needs, just not too quickly. Geopolitical events don't often directly affect the dairy markets, but we are growing increasingly concerned over our relationship with Mexico. They are our number one export market, totaling $1.2 billion in sales in 2016. As the value of the peso has declined and rhetoric ratcheted up, we hope a tariff war does not break out. The Russian embargo on Wester European dairy products made a significant impact on their market. Finally, the increase in the herd size this early is concerning. While there are several long-term bullish fundamentals we are encouraged by (improved exports, great domestic demand, slow output recovery in EU and Oceania), a rapid increase in the U.S. herd size could limit upside price potential in the second half of 2017. Producers that receive a sizable component bonus might want to consider getting come light coverage July-Dec, which settled today at $17.70 average. It really is hard to predict where prices will be that far out. A lot can happen both good and bad, but there is enough uncertainty that perhaps taking some risk management action at these levels might be wise. Each operation needs to evaluate the current financial condition, as well as their margins, input costs, etc. to make this decision. Up front, prices continued to erode, with double-digit losses for the week. Current spot prices work out to just $15.70/cwt. Unless bidders can lift that barrel price, more premium is likely to be shaved off Class III futures in the near term.