

The KDM Dairy Report – February 3rd, 2017

What's Bullish:

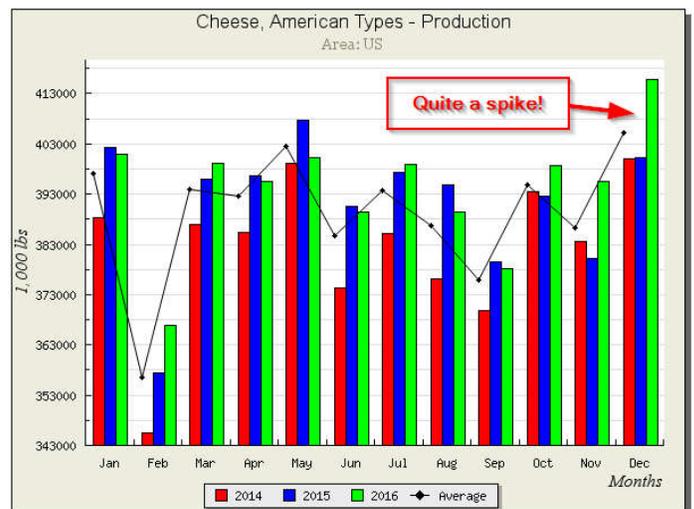
- Spot Market: Barrels ripped 26¢ higher this week to settle at \$1.70¢/lb on 23 trades. Blocks finished the week up a more modest 5¼¢ to close at \$1.74/lb on just 3 trades.
- Cattle Report: USDA's semi-annual look at the nations cattle inventories showed the numbers of all heifers for milk replacement, 500 pounds and over, were lower compared to January 2016. Nationally, there are 60,000 fewer milk cow replacement heifers on hand.
- Dry Whey Northeast: Prices are significantly higher at the top of the range on f.o.b. spot sales. Whey streams are

Futures Month	Class III 02/03	Class III 01/27	Change	Dry Whey 02/03	Dry Whey 01/27	Change	Cheese 02/03	Cheese 01/27	Change
Feb-17	\$16.87	\$16.62	\$0.25	47.275¢	46.750¢	0.52¢	\$1.693	\$1.671	\$0.022
Mar-17	\$17.19	\$17.15	\$0.04	47.500¢	46.900¢	0.60¢	\$1.724	\$1.725	(\$0.001)
Apr-17	\$17.26	\$17.43	(\$0.17)	48.250¢	47.400¢	0.85¢	\$1.732	\$1.751	(\$0.019)
May-17	\$17.31	\$17.51	(\$0.20)	48.250¢	47.500¢	0.75¢	\$1.738	\$1.759	(\$0.021)
Jun-17	\$17.54	\$17.67	(\$0.13)	47.475¢	47.400¢	0.08¢	\$1.758	\$1.774	(\$0.016)
Jul-17	\$17.75	\$17.81	(\$0.06)	47.575¢	47.500¢	0.08¢	\$1.783	\$1.784	(\$0.001)
Aug-17	\$17.90	\$17.88	\$0.02	48.000¢	47.750¢	0.25¢	\$1.802	\$1.795	\$0.007
Sep-17	\$17.92	\$17.88	\$0.04	48.250¢	47.750¢	0.50¢	\$1.800	\$1.795	\$0.005
Oct-17	\$17.82	\$17.72	\$0.10	48.250¢	47.650¢	0.60¢	\$1.782	\$1.780	\$0.002
Nov-17	\$17.67	\$17.60	\$0.07	48.250¢	47.750¢	0.50¢	\$1.771	\$1.770	\$0.001
Dec-17	\$17.48	\$17.30	\$0.18	48.500¢	47.750¢	0.75¢	\$1.752	\$1.743	\$0.009
Jan-18	\$17.00	\$16.90	\$0.10	48.750¢	47.975¢	0.77¢	\$1.712	\$1.701	\$0.011
12 Mo Avg	\$17.48	\$17.46	\$0.02	48.027¢	47.506¢	0.52¢	\$1.754	\$1.754	(\$0.000)

- circumventing into higher proteins, as improved returns shift production away from dry whey. Strong domestic demand is holding, accompanied by increased interest from export markets. The undertone is firm.
- Dry Whey Central: Prices edged up in both the range and mostly price series this week. Domestic demand for dry whey is solid. Production of dry whey continues to be steady, limited to some extent by the strong demand for higher protein concentrations.
- Dry Whey West: Prices moved higher this week. Although some industry contacts report dry whey demand has cooled a bit compared to several weeks ago, manufacturers are still seeing good domestic and international demand. Dry whey inventories are balanced to tight. Production is steady, but increased manufacturing of higher whey protein concentrations places a cap on dry whey production.
- International: Early expectations are for milk product prices in a number of Western European countries to remain stable or slightly higher. Overall lower milk production is a significant factor mentioned as leading to this expectation. Preliminary information from processors in Germany estimates that production remains near 4% lower from one year earlier. Processors in France believe final data will reflect milk production about 4.4% below one year earlier. Domestic dairy product demand in Germany has increased due to population gains. The Federal Statistical Office reports an increase of 600,000 people in the last year, attributed particularly to immigration. In Eastern Europe, Russia continues to import higher volumes of various dairy products from sources not party to the embargo. Russian imports of butter January-November 2016 increased 1.2% from the same period of 2015. Russian skim milk powder imports for the period are up 21.3%, imports of whole milk powder increased 41.9% and whey imports increased 15.3%.
- International: A wet spring in New Zealand has contributed to lower milk production. December 2016 milk production was 2.69 million MT, down 2.8% from December 2015. December milk solids, at 225.50 million kg, down 3.1% from December 2015. Cheddar cheese prices in Oceania are steady. Cheese manufacturers in New Zealand point out that even with lower milk production in New Zealand, cheese exports swam against the tide and have been stronger, perhaps reflecting the profitability of making cheese. New Zealand cheese exports January-November 2016 were up 13.5%.
- International: After heavy showers during the past few weeks in Argentina, muddy conditions persist in several dairy operations, taking a toll on cows' comfort. At this point, farm milk intakes are tending lower and are well below last year's levels. As a result, manufacturing milk volumes have been noticeably curtailed, especially for SMP and WMP. With less cream supplies, butter output has been affected, too. During December, Argentina farm milk production was down 3% from the previous month and 19% below a year ago. From January to December 2016, milk output totaled 9,677 million liters, down 14% from the same period of 2015. In Uruguay, milk production is seasonally down primary due to higher summer daytime temperatures averaging around 95 degrees. Butter production remains active with good demand from the domestic market, as well as from Russia.
- International: A severe water deficit prevails in important dairy states of Brazil. Overall, Brazilian milk production is down, mainly impacted by high daytime temperatures. Bottled milk requests are up as several schools are reopening during this week to start the new school year 2017. Cheese makers are receiving moderate milk volumes, while production remains active. Cheese demand from wholesalers is moderate, but is good from food service. Some cheese processors continue holding inventories, expecting higher domestic prices in the near term.

What's Bearish:

- Spot Market: While cheese prices were on the rise this week, butter settled at \$2.15¢/lb, down 6¼¢ on 9 trades. Grade A NDM edged ¼¢ lower to \$0.94/lb on 3 trades.
- Dairy Products Report: The U.S. continues to set cheese output records, with December being the most cheese made in any month, ever. American cheese output during the month was up 3.9% vs. a year ago, while total cheese output increased 1.3%. Butter output, on the other hand, declined 6.7% vs. last December, but was 13.3% higher than in Nov.



- Fluid Milk East: In the Northeast and Mid-Atlantic, milk production is strong. In the Southeast, milk production is slowly increasing. With the volume of milk available, balancing plants are clearing to Class III and IV. In the East, Class I sales are down. With cooler temperatures, milk production continues to climb in Florida. Export milk shipments totaled 110 loads this week. The fluid cream supplies remain unchanged with excess loads available. The eastern condensed skim market remains weak. Traders in the East are clearing loads out of the region, into the Midwest.
- Fluid Milk Central: Steady increases in milk production are noted throughout the region, with comparatively higher week to week increases noted in the South Central area. Most bottlers report that with the school pipelines filled, there are only occasional increases in orders from consumer outlets. Interest in milk loads from Class III manufacturers is steady to lower, with some manufacturers looking for outlets for some part of regular milk intake volumes. As commodity cheese manufacturers back away from taking in additional milk loads, spot milk prices are under some pressure. Buyers report prices range from \$2.00 under to flat Class. Cream demand is steady to lower into Class II production. Ice cream/soft serve production is steady, and still 8 to 10 weeks out from full production schedules. Cream multiples are steady to lower, ranging from 1.05 to 1.18. Western cream loads are flowing into the Central region.
- Fluid Milk Southwest: Milk intakes for manufacturing needs in California are more than adequate. Milk components remain high. Due to recent rains, the drought in California has been noticeable reduced. Many dairy operators are optimistic about water availability for the upcoming spring/summer seasons, as the water level at several reservoirs has improved. Farm milk output in Arizona continues inching up due to cooler temperatures. Milk intakes are in balance with processing needs. Alfalfa hay harvesting is active throughout the state. In New Mexico, milk production is up mainly due to the comfortable climate for dairy herds. There is more than sufficient milk for processing demands. As a result, processors from other regions of the country are helping clear heavy milk supplies.
- Fluid Milk Pacific Northwest: Milk production in the region is stable and balanced. Milk is moving to bottling facilities at normal seasonal levels. In addition, dairy product manufacturers report adequate milk supplies for most processing needs. Milk production in the mountain states of Idaho, Colorado and Utah is seasonally steady. Manufacturers report there is no problem getting the milk needed for most processing needs. Feedstocks are in good supply and the excellent snow pack is giving farmers confidence of adequate water for irrigation needs in the coming year.
- Butter Northeast: Cream supplies are readily available and churns are actively producing butter. As limited volumes of available cream clear into ice cream, and Class II processing in general, purchases of surplus cream by butter processors show substantial increases. Print butter interest is good, with sales above previous year's level, but traders are seeing more hand to mouth purchasing, as few buyers are willing to load up on butter now.
- Butter Central: Cream is still in abundant supply for butter makers in the region. Butter producers are turning cream away, even at relatively reasonable spot prices, as current supplies are sufficient.
- Butter West: Churning is mostly focused on making bulk butter, but with an eye toward print butter for the spring holiday season. A few processors would like to ease back on their butter manufacturing, but it is proving difficult due to the ample supplies of cream that need to clear. Butter inventories are rising while domestic demand remains relatively stable.
- Cheese Northeast: Retail sales are steady to slightly improved. Food services orders are mostly good this week. However, some buyers are holding off on reordering until current stocks are re-evaluated. The cheese market is unsettled to weak.
- Cheese Midwest: Cheese producers point to readily available milk this week. Production continues to meet milk availability levels and remains fairly active. Cheese demand is varied. Some traditional style cheddar producers are seeing a solid demand in the food service and retail sectors, while pizza cheese contacts report slowing sales following the pre-Super Bowl ordering rush. The market undertone is uncertain.
- Cheese West: Cheese makers report good milk supplies continue to push cheese manufacturing. Processors say there is no problem getting enough milk for their needs and they are mostly content with the milk available to them. Cheese makers are willing to buy a few extra loads of milk, but only if the price is right. Inventories for both blocks and barrels are building. Although industry contacts suggest domestic retail and food service demand is good, the market has hit a lull between winter and spring holidays and after dairy products slotted for Super Bowl consumption have shipped.

Recommendation:

The block/barrel spread, which had been at 24¢ start the week, abruptly closed to a normal 3¼¢ in just a couple days. Barrels made the biggest move, finishing the week up 26¢. There certainly was volatility in this move. Block cheese started the week at \$1.69/lb, went as high as \$1.85/lb on Thursday, only to settle at \$1.74/lb on Friday. With the flush period in the U.S. in its early stages, it certainly seemed strange to be knocking on the door of \$1.90 cheese this early, while barrels, recently in the \$1.40's was too low. Now that the spread has corrected, we may just consolidate around these prices for awhile. From a fundamental standpoint, supply over the next few months is going to strain processing capacity. But milk production issues in other parts of the world, highlighted in this report, should be favorable to continued improvement in exports. The dry whey market is tight, as production is limited by higher protein alternatives. Meanwhile, 2nd half Class III prices were largely unaffected by this week's rollercoaster ride in the spot market. The July-Dec average settled at \$17.75 today, just 4¢ off its high settlement of \$17.79. Continued uncertainty about global milk supply going forward is supporting these deferred months. Producers might want to start looking at PUT options for these months. The July-Dec 16.00 PUT averaged 27¢. Or, consider a fence strategy, buying the July-Dec 16.00 PUTs and selling the 20.00 CALLs for a net cost of just 5¢/month. This would yield a floor price of 16.00, with a cap at 20.00. No one likes to be capped, but at 5 cents/month, that is very cheap insurance, and allows you to participate in a rising market, up to a very profitable ceiling. Have a great weekend!

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