

The KDM Dairy Report – February 17th, 2017

What's Bullish:

- Dairy cow slaughter for the week ending 02/04 totaled 66,400 head, up 2.8% vs. the same period a year ago, and the highest weekly total in more than a year.
- Fluid Milk Pacific Northwest: Milk intakes are in good balance with processing needs. Milk handlers say they are getting inquiries from manufacturers in neighboring states that are looking for extra loads of milk. Moving the milk has proven more difficult due to heavy snows along some routes. In the mountain states of Idaho, Colorado and Utah, dairymen are still contending with the lingering effects of recent cold, wet weather. Mud and flooding have

Futures Month	Class III 02/17	Class III 02/10	Change	Dry Whey 02/17	Dry Whey 02/10	Change	Cheese 02/17	Cheese 02/10	Change
Feb-17	\$16.88	\$16.86	\$0.02	48.500c	48.250c	0.25c	\$1.688	\$1.692	(\$0.004)
Mar-17	\$16.87	\$16.91	(\$0.04)	49.500c	49.975c	(0.48c)	\$1.684	\$1.689	(\$0.005)
Apr-17	\$16.90	\$17.02	(\$0.12)	49.250c	50.000c	(0.75c)	\$1.690	\$1.700	(\$0.010)
May-17	\$17.00	\$17.13	(\$0.13)	49.250c	50.025c	(0.77c)	\$1.700	\$1.714	(\$0.014)
Jun-17	\$17.25	\$17.39	(\$0.14)	49.000c	50.200c	(1.20c)	\$1.723	\$1.740	(\$0.017)
Jul-17	\$17.46	\$17.67	(\$0.21)	48.925c	49.900c	(0.98c)	\$1.747	\$1.768	(\$0.021)
Aug-17	\$17.59	\$17.91	(\$0.32)	48.775c	50.000c	(1.23c)	\$1.765	\$1.785	(\$0.020)
Sep-17	\$17.61	\$17.87	(\$0.26)	48.550c	50.000c	(1.45c)	\$1.767	\$1.788	(\$0.021)
Oct-17	\$17.63	\$17.77	(\$0.14)	48.025c	50.000c	(1.98c)	\$1.765	\$1.780	(\$0.015)
Nov-17	\$17.56	\$17.66	(\$0.10)	47.525c	49.750c	(2.23c)	\$1.758	\$1.770	(\$0.012)
Dec-17	\$17.21	\$17.48	(\$0.27)	48.000c	50.000c	(2.00c)	\$1.737	\$1.750	(\$0.013)
Jan-18	\$17.00	\$17.03	(\$0.03)	49.625c	50.000c	(0.38c)	\$1.714	\$1.716	(\$0.002)
12 Mo Avg	\$17.25	\$17.39	(\$0.15)	48.744c	49.842c	(1.10c)	\$1.728	\$1.741	(\$0.013)

- challenged dairy farmers with maintaining cow cleanliness and milk quality. Milk production has been suppressed somewhat. Processors report milk supplies are adequate for most processing needs, but some processors are looking outside the region for available loads of milk.
- Dry Whey Northeast: Manufacturers and traders seem confident of prices holding at or near the current range. Most buyers agree that there are only a few bargain loads of dry whey available at this time. Stocks appear to be balanced to tight. The market undertone is steady to firm.
- Dry Whey Central: Prices moved up on the top of the range and in the mostly price series this week. With production focus on higher protein varieties and a pickup in demand, dry whey inventories are continuing to tighten. As mentioned, reports suggest a stronger demand this week. Some previous concerns regarding foreign trade have been eased as producers report an uptick in orders from Southeast Asia.
- Dry Whey West: Prices moved higher at the top of the price range this week. Industry contacts note continued strength in whey market prices. Demand is in fairly good balance with production. Contacts report whey is moving well through existing agreements with both international and domestic customers. Production is steady, but lower than previous years. Whey inventories are generally tight and committed.
- Cheese Northeast: Current production is mostly steady to lower as cheese yields drift seasonally lower. Overall, short-term cheese demand remains active. Mozzarella interest is fair to good as some operations amass supplies and rebuild working stocks. Restocking activity for cheddar-aging programs are moderate to good.
- CWT has accepted 13 requests for export assistance on contracts to sell 2.048 million pounds of Cheddar and Monterey Jack cheeses to customers in Asia and Oceania. The product has been contracted for delivery in the period from February through May 2017.
- International: In Western Europe, less milk has been produced in the first weeks of January 2017 than during the same period last year, according to a number of sources. This is specifically noted in Germany, France, the United Kingdom and Sweden. A plan advanced by the Netherlands to address European Commission requirements for lowering phosphate pollution would reduce cow numbers by 100,000. The plan has now been accepted and approved by the European Commission. Whey prices in Western Europe are at the highest level of 2017 and 2016. Further near term price strength is anticipated by many buyers and sellers. This is leading some buyers to accelerate efforts to secure contracts, which itself adds price strength. The renewed interest in whey is a quick turnaround from more apathetic buyer interest in recent weeks.
- International: Milk production in Russia during December 2016, was .76% lower than November. Total 2016 milk production was 0.24% lower than 2015 production.
- International: Australia is moving toward the end of summer. Weather this week is showing occasional temperature dips. It is a reminder that the season is on the cusp of changing. Milk supplies remain tight and dairy fats are driving the best returns. After domestic milk demand is met, products such as butter are often getting the preference for milk used in manufacturing. Domestic butter consumption continues to challenge the ability of manufacturers to keep up with demand. December 2016 butter production was down 20.3% from December 2015, according to Dairy Australia.
- International: In New Zealand, shorter supplies of dairy fats is a current reality. A number of dairy processors are considered able to demand a premium for products such as butter as a result. After an early year period of relatively stable prices for dairy products, this week there was a sign of price strength with market prices firming for butter, skim milk powder, whole milk powder, and cheddar.
- International: In Argentina, during the last two weeks, heavy rains took place over the main dairy basins, including previously flooded areas in the province of Santa Fe. As a result, farm milk volumes continue declining, generating a supply shortage for many manufacturing needs. With most schools reopening in the next few weeks, requests from bottlers are likely to ramp up soon. Subsequently, manufacturing milk volumes are expected to become tighter in the short term. In Uruguay, farm milk output is down mainly due to higher summer temperatures and muddy paddocks in several dairy operations. Milk components are seasonally down, too. Cream volumes are less than sufficient for butter and other cream based products. In December, Uruguay farm milk volumes sent to processors were 7.4% below the previous month, and 4.6% lower than a year ago. From January to December 2016, milk intakes sent to manufacturing plants totaled 1,773 million liters, down 10.2% from the same period of 2015. In Brazil, milk yields are seasonally down in many dairy operations due to unsteady climate conditions. Fat and protein levels in the milk are lower. As a result, milk intakes and cream supplies are less than adequate in order to cover the strong demand from processors.

What's Bearish:

- Spot Market: Both block and barrel cheese settled the week 3c lower, with blocks closing at \$1.58/lb on 21 trades and barrels closing at \$1.62/lb on 24 trades. Grade A NDM fell 5c to settle at \$0.87/lb on 10 trades, while butter managed to gain 5c to close at \$2.15/lb on 5 trades.
- USDA Weekly Cold Storage numbers indicate butter stocks have increased 18% at selected warehouses over the period 02/01 through 02/13. Cheese stocks over the same period are up 2%.

- Fluid Milk East: East region milk production is fairly level. In some Northeastern and Southeastern areas, production is climbing marginally and is expected to continue. Contacts in the Southeast reported no weather issues this week, and hauling deliveries have been on time to facilities. Class I sales in the East are mixed. In the Northeast, sales are lower, and market participants anticipate no change next week due to some schools being out for winter break. Florida will export around 125 loads of milk this week. The Eastern cream supply is plentiful and available.
- Fluid Milk Central: Haulers in the South Central area indicate milk pickup volumes are building from week to week. Mild temperatures are conducive to cow comfort in the area, and drier weather is improving the condition of holding pens. Milk quality is steady to improving. In the North Central area, above average daytime temperatures are supporting active milk production. Alongside the mild late winter temperatures, dairy operators report stores of forage stocks on hand are ample to carry herds through to the expected first harvest of 2017 alfalfa. Silage is readily available throughout the upper Midwest. Most bottlers indicate year over year sales volumes are trending lower in many categories. Demand for spot milk loads is unsettled. Many areas within the Central region, as well as other regions, are oversupplied with milk for fulfilling supply contracts. Milk is available on a spot basis from many outlets within and outside the region. The mix of spot loads included conventional milk as well as organic milk clearing into conventional markets due to a lack of regional organic processing capacity. Spot load prices range from \$2.00 to \$1.50 under Class.
- Fluid Milk Southwest: Milk production in California is steady. Dairy industries in the state expect to have more water for livestock throughout the year because of the rain received over the last few weeks. Milk quality has slightly decreased due to muddy conditions in some dairy farms, but there is enough milk for manufacturing needs. Milk yields are increasing in the state of Arizona, reaching high volumes. Manufacturers are receiving heavy milk intakes, resulting in driers running at full capacity. They are looking for out-of-state manufacturers to take the supplies they cannot process. Some plant managers do not have enough capacity to dry their milk. Therefore, they are turning their milk into liquid condensed buttermilk and sending it to processors in California to dry it. Milk is also clearing into Class III and Class IV. Many dairy industry leaders are expecting milk production to peak by the end of March. Harvesting of good to excellent alfalfa hay is active throughout Arizona. Milk production continues to be higher in New Mexico as temperatures remain favorable to cow living conditions. Due to plant maintenance and repair projects, milk volumes are building up from day to day. With the number of loaded trailers being high, some handlers are working with haulers to identify all available equipment to continue milk pickups. Some of the milk is clearing out of state to Colorado and Texas. A few cheese manufacturers are running at full capacity and struggling to hit orders.
- Cream West: The region is flooded with cream. Most manufacturers are churning their cream into butter, but could not process it all. As a result, the remaining supplies are clearing to other regions at lower prices. Demand is weak.
- Butter Northeast: With excess cream being readily available, East churns are making a lot of butter. Supplies are more than adequate to meet current demand. At some butter plants, stocks are increasing.
- Butter Central: Churns are seeing plenty of cream available for butter production. Prices for cream are discounted and some butter makers are utilizing the spot cream market when suitable to their needs. Butter production in the region is increasing. The spring holiday ordering season has begun and overall butter demand is growing, but bulk butter inventories continue to build.
- Butter West: Production is active while cream supplies are plentiful. Butter is moving well through existing agreements and creating a steady draw, but some industry contacts say there is not a lot of demand outside of current contracts. Butter stocks are building as production outpaces demand.
- NDM East: Prices for low/medium nonfat dry milk are steady to lower in the range. Milk production continues to climb, increasing condensed skim volumes available for drying. Hence, manufacturing schedules typically scale up, mostly over the weekends, to clear loads for midweek intakes. As the market weakens with declining prices, a few producers are not taking new NDM orders.
- NDM Central: Prices moved down on the range and mostly price series this week. Spot offers of NDM, at moderate prices, are available and some buyers are waiting to see if prices decrease further. Production of NDM is active, as milk remains readily available. Inventories of NDM are reportedly long.
- NDM West: Spot prices are lower, showing signs of a bearish market. There are plenty of offers from processors and traders, but buyers' interest looks to be light to moderate. Some buyers/end users are taking a wait and see approach, putting pressure on the market to get lower prices. Meanwhile, some manufacturers are clearing stocks from 2016 ahead of the spring flush, selling NDM at prices close to the bottom of the range. Mexican buyers have been quiet, analyzing SMP tenders from other international manufacturers outside the U.S. The strong U.S. dollar is making NDM/SMP imports from U.S. to Mexico more expensive, and less attractive. NDM supplies are building.
- Cheese Midwest: Cheese makers in the region continue to see readily available milk. Most cheese producers are hesitant to purchase spot milk, as contract and current supplies are sufficient for their needs. Producers who cut back on production to manage growing cheese inventories are preparing to increase production schedules, as milk continues to flow in. Overall demand of cheese is slow. The spring holiday ordering season has yet to pick up for some process cheese producers. Retail and food service sales are also reportedly lower. Some contacts suggest the instability of the cheese market is causing buyer apprehension. Block and barrel inventories are long.
- Cheese West: Cheese manufacturers say domestic cheese demand is nothing spectacular right now. Some industry contacts describe the cheese market as being in a type of post-holiday/post-Super Bowl lull. Current contracts are creating a good draw on stocks, but buyers appear hesitant to purchase much extra. In addition, lower prices have yet to attract a lot of large volume export buyers. A few cheese makers are buying some extra loads of milk to stay current on contracted obligations, while other cheese makers would like to ease back on production to limit the stock build up prior to the spring flush. Inventories are generally long on barrels and only slightly better for cheese blocks.

Recommendation:

Class III components generally lost ground in this week's spot market, contributing to futures settling lower up front. While fundamentals continue to be supportive on the international side, domestically, we have more milk than we can process, and the situation will get worse as we head into peak production. Overall, demand is ok, but we are in a sales lull between Super Bowl and Easter and the start of grilling season. Both cheese blocks and barrels are relatively long throughout the U.S. Producers should buy PUT options to protect the months up front. We believe the back months will rally, once we get past peak production and demand improves. Markets will be closed on Monday for Presidents Day.

This material has been prepared by a sales or trading employee or agent of KDM Trading, Inc. and is, or is in the nature of, a solicitation. This material is not a research report prepared by R.J. O'Brien's Research Department. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that KDM Trading, Inc. believes are reliable. We do not guarantee that such information is accurate or complete and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades. © Copyright 2017 - KDM Trading, Inc. All Rights Reserved