

The KDM Dairy Report – May 19th, 2017

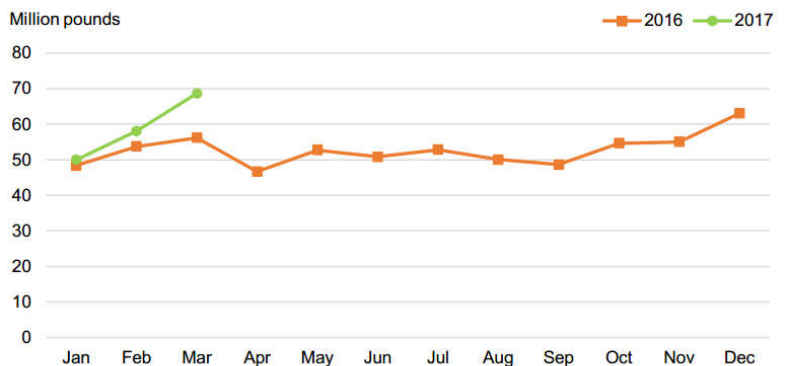
What's Bullish:

- Spot Market: Butter surged 11¼¢ for the week to settle at \$2.37½/lb on 26 trades, while Grade A NDM gained 5¼¢ to close at \$0.91½/lb on 34 trades. Blocks increased 3½¢ to settle at \$1.67/lb on 10 trades, but barrels declined 6¢ to closet at \$1.47/lb on 39 trades.
- This week's GDT auction saw the dairy price index increase 3.2%. It was the 5th consecutive increase. Butter led the way with a jump in price of 11.2% to a U.S.-equivalent \$2.49/lb. Cheddar cheese increased 0.6% to a U.S.-equivalent \$1.69/lb.

Futures Month	Class III 05/19	Class III 05/12	Change	Dry Whey 05/19	Dry Whey 05/12	Change	Cheese 05/19	Cheese 05/12	Change
May-17	\$15.60	\$15.58	\$0.02	50.500¢	51.000¢	(0.50¢)	\$1.544	\$1.539	\$0.005
Jun-17	\$16.32	\$16.21	\$0.11	48.000¢	48.250¢	(0.25¢)	\$1.621	\$1.618	\$0.003
Jul-17	\$16.77	\$16.68	\$0.09	46.800¢	46.525¢	0.27¢	\$1.678	\$1.679	(\$0.001)
Aug-17	\$17.15	\$17.10	\$0.05	45.500¢	45.225¢	0.27¢	\$1.723	\$1.728	(\$0.005)
Sep-17	\$17.27	\$17.28	(\$0.01)	45.500¢	45.250¢	0.25¢	\$1.736	\$1.746	(\$0.010)
Oct-17	\$17.18	\$17.14	\$0.04	43.475¢	43.750¢	(0.27¢)	\$1.743	\$1.740	\$0.003
Nov-17	\$17.02	\$16.95	\$0.07	42.250¢	42.250¢	0.00¢	\$1.730	\$1.730	\$0.000
Dec-17	\$16.83	\$16.73	\$0.10	41.750¢	41.050¢	0.70¢	\$1.716	\$1.712	\$0.004
Jan-18	\$16.62	\$16.54	\$0.08	39.975¢	39.400¢	0.58¢	\$1.710	\$1.704	\$0.006
Feb-18	\$16.55	\$16.50	\$0.05	39.400¢	38.775¢	0.63¢	\$1.710	\$1.706	\$0.004
Mar-18	\$16.50	\$16.50	\$0.00	39.000¢	38.175¢	0.83¢	\$1.705	\$1.707	(\$0.002)
Apr-18	\$16.39	\$16.43	(\$0.04)	38.000¢	37.175¢	0.83¢	\$1.706	\$1.709	(\$0.003)
12 Mo Avg	\$16.68	\$16.64	\$0.05	43.346¢	43.069¢	0.28¢	\$1.694	\$1.693	\$0.000

- CWT has accepted 8 requests for export assistance to sell 930,351 pounds of Cheddar and Gouda cheese and 220,462 pounds of butter to customers in Asia, the Middle East, and North Africa. The product has been contracted for delivery in the period from May through August 2017.

U.S. cheese exports



Sources: U.S. Dept. of Agriculture, Foreign Agricultural Service; U.S. Dept. of Commerce, Bureau of the Census.

- U.S. cheese exports increased 12% in Q1, according to USDA (see graph). Analysts at the U.S. Dairy Export Council suggest growing global cheese appetites should bode well for U.S. cheese suppliers. The potential is there to increase U.S. dairy exports to the equivalent of 20% of U.S. production. That would mean an additional 100,000 tons of cheese being exported by 2021.
- Weekly cold storage numbers indicate cheese stocks at USDA-selected storage centers declined 3% (2.7 million lbs) over the first 15 days in May.
- Dairy cow slaughter for the week ending 05/06 totaled 54,900 head, up 4.6% vs. the same period a year ago.
- Butter Northeast: Production is steady to strong as available cream clears to churns. In some manufacturing plants, salted production overshadows unsalted because of contractual needs and requests. Butter prices in the Northeast are steady to higher. Some market participants report strong retail orders. Retail interest is steady to increased for salted and steady to fair for unsalted. Recent news of export opportunities increasing has many individuals wondering what will happen to the butter price. The market undertone is steady, with some signs of strength.
- Butter Central: Production is active in the region, as readily available cream continues to flow into butter churns. Some contacts are seeing better-than-expected sales numbers. Some suggest a global tightness on milk fat has some buyers purchasing butter ahead of an increasing export demand.
- Butter West: Larger pulls of cream from ice cream manufacturers are allowing butter makers to ease back a little on production. U.S. market butter prices have been prodded higher by tight supplies and subsequent higher prices abroad. However, butter inventories here in the U.S. remain long. The recent price increases have prompted a rush of domestic buying activity as some buyers are eager to assure late year coverage.
- NDM East: Prices for low/medium heat nonfat dry milk (NDM) in the East shifted upwards on both ends of the range and mostly price series this week. With milk readily available in the region, low/medium heat NDM production is strong as dryers are full and operating at steady levels. However, some manufacturers are fully committed with contracts and do not have any excess low/medium heat NDM to sell. There are also manufacturers who have supply, but are holding off on selling to see where the price will go. Some market participants report strong interest and that prices are firming. Increased export opportunities are also a potential factor in the higher price for international skim milk powder.
- NDM Central: Prices increased on both ends of the price range and mostly price series. Some contacts are concerned about the recent firmness of low/medium heat NDM prices with the availability of supplies and continually active production. Nevertheless, the market continues to exhibit strength. Domestic demand is fair, and strengthening. Some contacts expect firmness to continue.
- NDM West: Spot prices shifter higher this week, tracking upward pricing movements of various indices and offshore auctions. Some processors believe the market is gaining ground based on higher NDM values in futures markets and higher international demand. Therefore, some NDM processors are still stocking with expectations to sell at higher prices in the short term. The stocks of some manufacturers are committed to new contracts starting in June and throughout Q3.
- Cheese Northeast: A strong milk supply continues to factor into generous cheese production volumes for regional cheese processors. While sales into food service appear somewhat mixed, retail orders have improved seasonally in area markets. Nonetheless, cheese supplies are increasing with heightened production rates. Global markets should provide some respite as higher international prices equate to a competitive price advantage that drives stronger sales of U.S. cheddar stocks into various export channels.

- Foreign Cheese: Cheese demand is following a strong trend in the European Union. Demand from domestic and international markets continues to be very good. In some areas, it is growing at above average rates. The markets for cheddar and mozzarella are currently increasing. Asia and Southern Europe have good demand for EU cheese, partly due to the coming holiday season. Prices are increasing, while supplies are declining despite the effort to increase production.

What's Bearish:

- Milk Production Report: April milk output in the U.S. increased 2.0% compared to a year ago, while cow numbers increased 8,000 head from March, to 9.390 million head. Milk per cow jumped 25 lbs to 1,949. Output gains were led by SD up 12.8%, NM up 7.5%, CO up 7.2% and KS up 7.2%. CA output declined 1.1% while WI was up just 0.6%.
- Fluid Milk Northeast: Farm milk output is steady at high levels. Fluid milk supplies are excessive beyond Class I needs, thrusting heavier milk intakes into balancing plants. Class II plants are still running at capacity. In parts of the Mid-East, milk production is steady, but receipts are building incrementally in other areas. Demand for fluid milk is seeing some reduction following fair to good bottling orders over the first 7-10 days of May. Most manufacturing plants are full.
- Fluid Milk Southeast: Milk production is still close to peak. Bottling plants in the Southeast are seeing a slight uptick in orders with active retail demand, but cheese plants designated to handle the surplus milk volumes are busy with heavy intakes. In Florida, mostly steady milk production with diminished bottling orders prompted some handlers to transfer loads out of state. Milk shipments exported out of the state, 170 loads, are unchanged from last week. Cream supplies remain heavy.
- Fluid Milk Central: Milk production continues undiminished in the Central U.S. Some contacts suggest spring flush is near its peak, while others foresee similar milk surpluses into June. Class I demand is steady, but concerns persist about upcoming school vacations. Midwestern cheesemakers are taking on milk spot loads from \$3.00 to \$6.00 under Class III. Other cheese producers are using internally sourced milk supplies and do not plan to use spot milk in the near term. Cream remains available.
- Fluid Milk Southwest: California handlers indicate that milk production is mixed this week. In some areas, it is higher, while other areas see a decline in production. Fluid milk interest is flat as many school districts adjust their orders in preparation to close for the summer break. Farm milk output in Arizona is mixed due to the weather being cooler this week. Temperatures are expected to be back into the 100s by next week. Balancing plants are processing the increased volumes with minimal delays. Bottled milk orders from educational institutions are steady to lower as they get ready to close for the upcoming summer break. New Mexico milk production at the farm level is flat. Handlers report that the availability of spot milk is increasing as a result of less milk utilization by processors. Class I interest is slightly down and Class II demand is steady.
- Fluid Milk Pacific Northwest: Milk production is steady to higher. Cow comfort has improved as warmer temperatures and a little less rain build into the region. Bottling demand is edging back as the school terms at some educational institutions are coming to a close. Manufacturers report no problems getting the milk needed for processing. Many processors are running facilities at or near capacity.
- Dry Whey East: prices edged lower at the bottom of the range, on light trading. The downshift in price has begun a wait-and-see attitude for some, with thoughts of the market moving lower.
- Dry Whey Central: Prices declined on the bottom of the price range and saw declines on both ends of the mostly price series. Dry whey production remains active, as discounted milk continues to flow into Midwestern cheese plants. Dry whey export interest reports vary by contact, but some producers noted a slowdown in global demand. Dry whey inventories are generally adequate.
- Dry Whey West: Many market participants describe the market tone as weak. Whey is moving through regular contracts, but buyers are not seeking much extra. Inventories are largely plentiful.
- Cheese Midwest: There is no shortage of milk for cheesemakers in the region. Some cheese producers continue to take on spot milk, at prices ranging from \$3.00 to \$6.00 under Class, whereas others report using internal supplies. Cheese production continues actively, keeping in line with milk supplies. Block supplies vary by producer. Barrel inventories are long, and producers are pushing to clear some aged product. Process cheese producers are reporting slight increases in sales, whereas traditional and pizza cheese demand has increased noticeably.
- Cheese West: Production is at or near full capacity, facing challenges in processing the plentiful milk. Cheese supplies are long, especially for barrels. Inventories for block cheese are a little better balanced, but contacts report some offers at heavily discounted prices. Traders and manufacturers are eager to move cheese in any market possible. The grilling season has begun and domestic retail demand is steady. However, some market participants feel the recent price increases in market trading could choke off available export opportunities.

Recommendation:

Spot butter reached its highest price since Dec, 2015, while NDM jumped to levels not seen since Feb of this year. The surge in these components put Class IV milk above Class III for the first time in months. While we continue to languish under heavy milk supplies and corresponding dairy product output, the prospects for improved international trade continue to look better and better. The job of the futures market is price discovery of the future, and it appears that this increasingly positive global outlook is what is motivating current futures price increases, in spite of short term bearish fundamentals. NDM prices are still near recent lows and look to have some substantial upside potential after butter's run this week. If that happens, the Class IV price advantage over Class III will grow much wider, and should direct milk away from cheese production. Longer term, this is supportive for Class III's going forward. For producers who are starting to think about Q1 or the first half of 2018, we would hold off on sales, and instead look at buying courage calls to sell into, at strike prices \$1.50 to \$2.00 above current futures prices. Expect volatility to continue in the near term as cheese supplies, especially barrels, are still long. Cooler weather in parts of the U.S. are also delaying grilling season. But Memorial weekend is around the corner, and with it, warmer weather to follow. We still believe the lows are in and done for the year. Producers with 2nd half 2017 contracts with upside risk, should take protective action and also consider buying call options.

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