

**The KDM Dairy Report – May 26<sup>th</sup>, 2017**

**What's Bullish:**

- Spot Market: Block cheese finished the week up 6¼¢ to settle at \$1.73¼/lb on 22 trades, while barrels closed a penny higher at \$1.48/lb on 50 trades. NDM increased 1¼¢ to settle at \$0.92¼/lb on 26 trades, but butter decreased 1¼¢ to close at \$2.36/lb on 11 trades.
- Cheese stocks at USDA-selected storage centers declined 3% over the period 05/01 through 05/22.
- Livestock Slaughter Report: 228,100 dairy cows were removed from the milking herd in April, up 0.5% from April 2016.
- Dairy cow slaughter for the week ending 05/13 totaled 55,400 head, up 10.4% vs. the same period a year ago. YTD, the cull rate is up 3.3% vs. 2016.

Futures Month	Class III 05/26	Class III 05/19	Change	Dry Whey 05/26	Dry Whey 05/19	Change	Cheese 05/26	Cheese 05/19	Change
May-17	\$15.61	\$15.60	\$0.01	51.075¢	50.500¢	0.58¢	\$1.542	\$1.544	(\$0.002)
Jun-17	\$16.51	\$16.32	\$0.19	48.925¢	48.000¢	0.92¢	\$1.637	\$1.621	\$0.016
Jul-17	\$17.04	\$16.77	\$0.27	47.000¢	46.800¢	0.20¢	\$1.706	\$1.678	\$0.028
Aug-17	\$17.40	\$17.15	\$0.25	45.350¢	45.500¢	(0.15¢)	\$1.750	\$1.723	\$0.027
Sep-17	\$17.44	\$17.27	\$0.17	44.700¢	45.500¢	(0.80¢)	\$1.760	\$1.736	\$0.024
Oct-17	\$17.24	\$17.18	\$0.06	43.125¢	43.475¢	(0.35¢)	\$1.751	\$1.743	\$0.008
Nov-17	\$17.08	\$17.02	\$0.06	42.000¢	42.250¢	(0.25¢)	\$1.740	\$1.730	\$0.010
Dec-17	\$16.86	\$16.83	\$0.03	41.075¢	41.750¢	(0.67¢)	\$1.725	\$1.716	\$0.009
Jan-18	\$16.71	\$16.62	\$0.09	39.975¢	39.975¢	0.00¢	\$1.718	\$1.710	\$0.008
Feb-18	\$16.65	\$16.55	\$0.10	39.400¢	39.400¢	0.00¢	\$1.707	\$1.710	(\$0.003)
Mar-18	\$16.61	\$16.50	\$0.11	39.000¢	39.000¢	0.00¢	\$1.710	\$1.705	\$0.005
Apr-18	\$16.50	\$16.39	\$0.11	38.000¢	38.000¢	0.00¢	\$1.704	\$1.706	(\$0.002)
<b>12 Mo Avg</b>	<b>\$16.80</b>	<b>\$16.68</b>	<b>\$0.12</b>	<b>43.302¢</b>	<b>43.346¢</b>	<b>(0.04¢)</b>	<b>\$1.704</b>	<b>\$1.694</b>	<b>\$0.011</b>

- Fluid Milk Southeast: Farm milk output in the Southeast is steady. However, declines are reported in some areas. Florida's milk production has taken a slight downturn. Unseasonable high temperatures are expected to accelerate this trend.
- Butter Northeast: Butter production is strong, but decreased in balancing operations in the East. Some manufacturers have stopped churning to sell their cream supply. Cream buyers report mixed multiples, as there have been signs of strength. Butter prices are steady, but some market participants see a rise in the demand for butter. Retail orders are strong.
- Cream Central: Cream remains available and butter churns are continuing at active levels. However, retail butter orders are stronger than expected. Retail demand reports, in previous weeks, have varied from plant to plant. This week's reports on demand are generally bullish. Butter makers suggest demand may have been stimulated by the possibility of increasing market prices. Reported bulk butter prices are 2 to 7 cents over the market.
- NDM Northeast: Prices shifted higher on both ends of the range and mostly price series this week. With increased export opportunities, some market participants report seeing firmness to the low/medium heat NDM price. Production is active, but some manufacturers do not have extra supply to sell.
- NDM Central: Prices increased on both the range and the mostly price series. Some contacts suggest recent spot prices have been low, comparative to futures prices, and the market is self-correcting. In any case, some domestic buyers and end users are showing increased interest and willingness to purchase NDM at higher prices.
- NDM West: Prices moved higher on both the range and the mostly series. Some industry contacts report that the market is tight and firming up. They are even buying extra loads of NDM to hedge against future increases in prices, as they are expecting prices to further move up.
- Cheese Northeast: Wholesale selling prices for cheddar and Muenster increased this week. Cheese production is steady as milk output continues to clear into vats. With the heavy output, inventories are building, but retail interest is improving, as outdoor grilling becomes more of interest as warmer weather hits. With U.S cheddar cheese prices at a competitive edge in the global markets, sales have been strong.
- Cheese Midwest: Production is active and milk is available. However, cheese demand is up across the region. Process cheese manufacturers report seeing an uptick in retail demand, as grilling season has begun. Pizza and traditional cheese manufacturers also report that sales are better than expected. The market undertone has improved.
- Cheese West: Production in the region is active as some areas are still experiencing increasing milk production. However, some industry contacts suggest that sales into the international market are picking up and the U.S. cheese price is competitive. This week, some processors have increased their export opportunities to Mexico, Asia, and Australia.
- International: European dairy contacts report generally lower milk intakes than last year, but are seeing some increase in the recent weeks as the weather improves and aids cow comfort. Manufacturers report good demand for dairy products and stronger prices. Cheese buyers are actively seeking to assure coverage well into the year. Cheese stocks are tight, as are many of the other dairy products. Internal European demand, along with a slight increase in exports, has kept most surplus inventories in check.
- International: Butter and butter oil prices in Western Europe continue to rise as demand for milk fats outpace supply. Under normal conditions, butter stocks build through the spring in advance of the heavier-demand and lower-production times at the end of the calendar year. However, butter inventories are currently tight. Butter production is off a little due to lower milk intakes, and butter makers have only a few spot loads to offer. Available loads are quickly secured by buyers. End users, wanting to assure near-term and long-term coverage, are willing to pay prices often at the top end of the range. January-March EU butter production decreased 4.0% according to Eurostat. 82% butterfat averaged a U.S.-equivalent \$2.58/lb.
- International: European whey prices moved slightly higher. Internal European demand is relatively strong and able to keep inventories, which are committed to tight.
- International: Skim milk powder (SMP) prices in Europe are moving higher as internal European demand is strengthening. Production of SMP has slackened due to milk deliveries not meeting expectations, and active cheese production is pulling hard on available milk intakes. Inventories of uncommitted SMP are tight.
- International: According to Dairy Australia, April 2017 milk production was down 6.3% from April 2016. Australia's milk production season to date is down 8.0% compared to last season. However, poor quality silage has been a challenge and a number of farmers are looking for alternatives.

- International: Oceania butter prices are higher. Prices have generally been trending up all season and show no signs of slowing down. Cheddar prices continue to show firmness, with a gush at the top of the range. Production is mostly steady. As fat interest shows no sign of slowing down, with strong consumer cheese demand, prices are encouraged.
- International: Although milk output is higher in Argentina, farm milk/cream intakes remain less than sufficient to meet all manufacturing needs. Therefore, some processors are prioritizing bottled milk and cheese production. The cream market undertone remains strong as demand is above supply. Although milk/cream intakes are increasing in Uruguay, supplies are less than adequate to meet all requests from manufacturers. Most cream supplies are highly committed through contracts. Butter processing is limited, determined by the availability of cream. Scattered rain showers returned to key dairy states in Brazil, hampering milk yields in some dairy farms. Overall, the milk supply remains less than sufficient to cover all processing needs with the exception of cheese and bottled milk. Sales of cheese to various market channels are increasing. This is helping to reduce high cheese stock levels in some plants.

#### What's Bearish:

- Cold Storage Report: American cheese stocks in cold storage at the end of April were 14% higher than a year ago, according to USDA, while total cheese stocks were 10% higher, respectively. After a massive gain from 2015 to 2016, somehow the U.S. was able to tack on another huge gain in 2017. Butter stocks, however, declined 1% YoY.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic is brimming at/near seasonal peak levels. Noticeably, the total volume of producers' milk receipts posted a new record for the month of April, along with producers' butterfat. As well, Class IV volumes were the highest ever. Manufacturing for both areas report heavier supply intakes, especially into area balancing plants. Class I interest is steady to declining as bottlers push back some, prompted by the upcoming holiday and school closings.
- Fluid Milk Central: Milk output is at/near the spring flush peak. Outlooks vary on when the decline of milk production will begin. Nevertheless, at this time, milk output is ample. Class I demand is slower. Many colleges have closed for summer vacation. K-12 schools in the South Central region have begun to close, while most North Central school districts are breaking in the next few weeks. Class III producers, reportedly encouraged by the cheddar block price increases, are taking in more milk than in previous weeks. Milk going into cheese vats is \$3.00 to \$5.00 under Class. There is no shortage of cream in the Central states.
- Fluid Milk West: California milk marketers report that farm milk production is mixed, but ample for needs. With the coming Memorial Day weekend, milk availability is expected to increase as many balancing plants will be closed on Monday. Class 1 interest from educational institutions and bottlers is flat. In Arizona, milk production is lower this week compared to last week. However, there are enough supplies to meet processing needs. Balancing plants are running at near full capacity clearing any excess milk. Class I intakes from schools are lower as they prepare to close for the summer break. Class II milk requests from ice cream manufacturers are active. In New Mexico, milk yield is steady to slightly lower due to temperatures getting warmer. However, bottled milk demands from educational institutions continue to be lower as most schools closed this week for the summer break. Class II demand is light, and Class III interest is steady.
- Fluid Milk Pacific Northwest: Milk production is edging seasonally higher. Warmer temperatures have been building into the region and aiding cow comfort. Bottling demand is waning as more educational institutions close for the school year. Milk intakes are plentiful for manufacturing needs. In the mountain states of Idaho, Utah and Colorado, milk production is strong. Industry contacts suggest cow numbers in the region are up. Warming temperatures are improving cow comfort and farmers are starting first hay cuttings in parts of the region.
- Butter West: Demand has eased slightly as U.S. market prices continue to rise. Some buyers are taking a wait and see approach to purchases, hoping prices will settle at lower levels. Butter production is active due to plenty of cream available for the churns. However, a few processors would like to slow production to better manage stocks. Inventories are heavy and growing.
- Dry Whey Northeast: Prices shifted downward on both the top and bottom of the range this week. Some Eastern market participants are selling their whey supply at lower prices to deplete inventories. Demand is fair to quiet. Whey production is active, producing heavy output. Inventories are controllable to building. The market tone is steady to weakening.
- Dry Whey Central: The spot market was active, but offers outpaced purchases. Producers and sellers are seeing pushback at prices which were agreeable as recently as mid-May. Dry whey production continues apace, as plentiful milk finds its way into active cheese vats. Dry whey inventories are adequate to long, and some producers are offering large volumes at discounted prices in an attempt to manage whey stocks.
- Dry Whey West: Demand is mixed. Some producers state that their sales are slower due to higher prices in the market.
- International: Apart from the endless precipitation over recent months, season-to-date milk production is higher than year ago volumes. With the steady rainfall, trailed by a couple of hurricanes in April, some expected moisture levels would likely suppress field conditions, and subsequently pasture use. However, farms worked through the events to realize gains in farm milk production. Skim milk prices are lower at the top of the range but steady at the bottom. Sources suggest pressure from stockpiles is instrumental in driving prices. In general, skim milk powder remains something of an undesirable product for now, as demand is sluggish. Export interest is slow to fair.

#### Recommendation:

Dairy futures whipsawed both ways this week as the reality of heavy domestic milk output and cheese stocks, clashed with increasingly bullish international tightness. Domestic demand is also on the rise, lending support. Until warmer weather takes a bite out of milk output, and grilling season is in full swing, expect more of this back and forth action. We still believe the lows are behind us and that the longer-term trend is up. Producers should look at retracements as opportunities to buy upside protection on existing sales, and rallies to purchase floor price protection in the form of PUT options. In both cases, this is because we believe you need to leave your upside potential open, vs. being locked in to a fixed price. Give us a call if you need help understanding this concept. We can work with you on your existing plant contracts to capture some of that potential upside.

**Note:** We will be closed on Monday in observance of Memorial Day. Have a great weekend, and cherish your freedom! Thank a veteran or active service member!

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