

The KDM Dairy Report – June 9th, 2017

What's Bullish:

- A heatwave is expected to scorch an area from the Midwest to the Northeast, with record highs predicted. The weather pattern will take shape this weekend and is expected to dominate the area into next week. It will also feel humid, with dew points rising into the 60s to around 70 degrees. This combination of temperatures in the 90s and high dew points will make it feel even hotter than what the thermometer indicates.
- This week's GDT auction saw the dairy price index climb (0.6%) for the sixth consecutive time. The gain was led by cheddar cheese, up 14.5% to a U.S.-equivalent \$1.94/lb.
- Dairy cow slaughter for the week ending 05/27 totaled 53,600 head, up 5.1% vs. the same period a year ago.
- Fluid Milk Northeast: The peak has passed as milk output in the Northeast and Mid-Atlantic is generally steady, with light seasonal declines. Surplus milk diversion to manufacturing is light to moderate with a few plants operating at/near capacity.
- Fluid Milk Southeast: Milk production is steadily declining along seasonal lines. Some manufacturing plants are taking on extra milk. Class I demand is sluggish, however. In Florida, the weather is very hot, in the 90s, as rain causes some flooding. Milk production continues to decline seasonally. Cream markets are seeing higher multiples, 1.20-1.38, depending on need and time of purchase. Supplies are shorter and competition for available supplies show some aggressiveness. Ice cream production schedules continue to build seasonally. Soft serve mix sales have improved as temperature climb in some areas. Churning is lighter.
- Butter Northeast: Butter production is steady to light this week. Some butter makers are churning only for contracted needs. A number of manufacturers have shut off their churns for maintenance and also to source their cream in other ways. The cream demand is strengthening, as Class II commodities like ice cream are showing increased demand. Some Eastern traders communicated cream trading activity is highly active, as a handful of market participants just barely purchased enough cream. Butter interest continues to be strong as retail advertisements are released. Domestic butter prices in the global market are good and look to be moving higher.
- Butter Central: Butter demand is up this week. Domestically, retail and food service demand remains steady to strong, and international interests have increased. Butter production is steady, as producers try to get ahead of export opportunities and fall storage. As Class II manufacturers are nearing peak season, Central region butter producers expect cream availability to tighten.
- Butter West: Retail butter demand is strong. Industry contacts are watching extended weather forecasts closely. A few contacts suggest that if the region gets a lot of hot weather, ice cream manufacturers may increase cream demand quickly, resulting in less cream to move into the churns and higher butter prices. End users are uneasy about this scenario and want to make sure they have coverage for late year butter needs.
- NDM East: Nonfat dry milk moved higher on both ends of the range, and shifted higher on the bottom of the mostly price series this week. Prices are stable and showing signs of strength.
- NDM Central: Prices edged up on both ends of the price range and bottom of the mostly price series. Low/medium heat NDM inventories are available, but high heat NDM production is primarily limited to contractual needs, and inventories are reportedly tight.
- NDM West: Prices shifted upward at the bottom of the price range and the top of the mostly price series. The market undertone is weak, but demand for RBST free NDM is increasing. High heat nonfat dry milk prices are higher. The market undertone is firming. Production is irregular, and supplies at most manufacturing plants are tight.
- Foreign cheese: EU cheese demand is on an unchanged high level. Stocks continue to be tighter. At the moment, production is falling, and it is expected to further decrease in the coming weeks. Sales to Southern Europe and other European countries remain high, and cheese is regularly ordered. Mozzarella's interest increased noticeably due to current weather conditions. Cut cheese sales to other European countries increased as well. With restricted market predictability, cheese sellers' willingness to conclude long-term contracts is limited. Buyers are trying to cover themselves.
- International: Prices for most dairy products have increased in the early part of the year. Skim milk powder prices recovered a bit and are now slightly above intervention prices. EU butter prices are at a 2017 high and an end to the price strength is not yet believed to be close. Many dairy industry participants still expect EU milk production for 2017 to increase +0.6%. However, a big unknown for the months to come (in terms of milk production) is the uncertainty of weather.
- International: Oceania butter prices remain below pricing in the EU, but are now at the highest level of 2017, a U.S.-equivalent \$2.58/lb. Cheddar cheese prices increased as well, reaching the highest level of 2017, a U.S.-equivalent \$1.80/lb.
- International: In Argentina, milk volumes continue to be lower, and unable to satisfy all requests from manufacturers. Cheese and bottled milk continue to be the main products to be manufactured. In Uruguay, milk production is slowly increasing, in line with seasonal trends. Although milk/cream volumes are increasing, supplies are less than sufficient to cover all manufacturing needs. Cream availability continues tight and premiums high on a bullish market. In Brazil, the milk/cream supply remains less than adequate to meet all processing needs with the exception of bottled/UHT milk and cheese.

Futures Month	Class III 06/02	Class III 05/26	Change	Dry Whey	Dry Whey 05/26	Change	Cheese 06/02	Cheese 05/26	Change
Jun-17	\$16.28	\$16.51	(\$0.23)	48.300¢	48.925¢	(0.63¢)	\$1.617	\$1.637	(\$0.020)
Jul-17	\$16.55	\$17.04	(\$0.49)	45.750¢	47.000¢	(1.25¢)	\$1.658	\$1.706	(\$0.048)
Aug-17	\$16.99	\$17.40	(\$0.41)	43.750¢	45.350¢	(1.60¢)	\$1.713	\$1.750	(\$0.037)
Sep-17	\$17.27	\$17.44	(\$0.17)	43.000¢	44.700¢	(1.70¢)	\$1.747	\$1.760	(\$0.013)
Oct-17	\$17.32	\$17.24	\$0.08	42.000¢	43.125¢	(1.13¢)	\$1.756	\$1.751	\$0.005
Nov-17	\$17.26	\$17.08	\$0.18	41.250¢	42.000¢	(0.75¢)	\$1.755	\$1.740	\$0.015
Dec-17	\$17.03	\$16.86	\$0.17	41.350¢	41.075¢	0.27¢	\$1.741	\$1.725	\$0.016
Jan-18	\$16.72	\$16.71	\$0.01	40.550¢	39.975¢	0.57¢	\$1.713	\$1.718	(\$0.005)
Feb-18	\$16.63	\$16.65	(\$0.02)	40.125¢	39.400¢	0.73¢	\$1.718	\$1.707	\$0.011
Mar-18	\$16.59	\$16.61	(\$0.02)	40.000¢	39.000¢	1.00¢	\$1.706	\$1.710	(\$0.004)
Apr-18	\$16.48	\$16.50	(\$0.02)	39.000¢	38.000¢	1.00¢	\$1.702	\$1.704	(\$0.002)
May-18	\$16.50	\$16.52	(\$0.02)	38.500¢	37.000¢	1.50¢	\$1.710	\$1.702	\$0.008
12 Mo Avg	\$16.80	\$16.88	(\$0.08)	41.965¢	42.129¢	(0.16¢)	\$1.711	\$1.718	(\$0.006)

What's Bearish:

- Spot Market: Cheddar blocks gave up 7¢ this week, settling at \$1.63/lb on 12 trades, while barrels lost 7½¢ to close at \$1.41½/lb on 48 trades. Grade A NDM fell 4¢ to settle at 90¼¢/lb on 24 trades, and butter declined a penny to close at \$2.47½/lb on 23 trades.
- Dairy Products Report: Despite lower milk output in April, cheddar cheese production was up 4.8% vs. a year ago, while total cheese output increased 3.7%. Butter production declined 4.1% compared to April 2016.
- Fluid Milk Central: Although weather in the upper Midwest has noticeably warmed, contacts report that cow comfort has not been affected much, and flush milk output continues. Class III milk spot loads were reported from \$2.50 to \$6.00 under Class III. A number of cheese producers reported receiving fewer milk offers this week than in previous weeks. Even as ice cream makers are notably ramping up interests, cream remains available for all uses in the Central region.
- Fluid Milk Southwest: In some parts of California, milk production is higher due to recent cooler temperatures. Class 1 fluid demand is lower. In Arizona, the heat is currently having little impact on milk. With schools being out, many processors are actively balancing more of their milk. In New Mexico, farm milk production is steady to slightly up this week. Class I sales have decreased, putting more pressure on dryers. Inventories are plentiful, and processing plants are working at full capacity to avoid milk discarding. A few contacts report that some plants are sending milk to calf ranches and ground application of condensed and raw milk.
- Fluid Milk Pacific Northwest: Milk production continues to improve after a hard winter and spring. Some contacts suggest it may be newly lactating cows that have provided the boost to milk volumes. Warmer days have improved cow comfort and spring feed is in good supply. With most schools done for the year, milk supplies have shifted to summer consumption patterns. More milk is available for manufacturing. Processors say they have plenty of milk available. Many manufacturers are running their facilities at or near full capacity.
- Dry Whey Northeast: Prices in the region are unchanged to lower. Production rates are holding as steady cheese output develops liquid whey streams. Contracted customers are reported being offered additional loads of dry whey. As a result, sale prices can be negotiated for volume transactions. Dry whey inventories are steady to building.
- Dry Whey Central: Prices dropped on the price range and mostly price series this week. The spot market was active, as many volume loads offered at decreased prices spurred buyers. Whey inventories are available, as Midwestern cheese production and milk intakes have been abundant in recent months.
- Dry Whey West: Market participants describe the whey market as soft. Demand is a little lackluster. End users are not very eager to make new purchases until they use up some of their existing whey supplies. Across the U.S., whey inventories have steadily grown for the first four months of 2017. A few industry contacts say manufacturers' inventories are comfortable or in balance, but others seem to confirm stocks are heavy.
- Cheese Northeast: Cheddar cheese makers still have more milk than needed, while trying to keep production tight. Stocks are adequate for overall slow to steady demand. Some freezing of mozzarella is taking place while cheddar continues to clear into aging programs.
- Cheese Midwest: Milk availability for cheesemakers is mixed this week. Some producers report the continuance of abundant milk supplies, but other cheese producers reported receiving noticeably fewer offers. Milk spots were reported from \$2.50 to \$6.00 under Class. After weeks of generally strong cheese sales, Midwest cheese producers are reporting that demand has slackened a bit after Memorial Day weekend. Cheese inventory reports vary from contact to contact. Some pizza cheese producers report light cheese inventories in recent weeks, as strong demand has dipped into stored cheese.
- Cheese West: Cheese production is active and many facilities are running at or near full capacity. Milk is readily available for most processing needs. Domestic retail demand remains good. Some manufacturers say they are currently getting more inquiries from export buyers, but this business has yet to fully develop. Cheese makers are welcoming any additional business. Inventories are generally heavy, especially for barrel cheese. Stocks of mozzarella are growing seasonally with schools out for the summer and demand for pizza entering the low point for the year.

Recommendation:

Dairy futures may have gotten ahead of themselves a bit, with their aggressive rally over the past few weeks. The long barrel market continued to weigh on the spot market as offers walked the price back down to levels of early May. Blocks continue to be in better balance, but nonetheless finished the week lower as well. With just a week left in pricing June futures, July and August contracts were the hardest hit, as traders apparently think it will take longer to get rid of the excess supply. They could be right. Production continues at near flush levels in the Midwest and Northwest. A new weather forecast is predicting a heat dome over much of the Midwest and Northeast starting this weekend, and lasting several days. If it comes to fruition, it could very quickly bring production down to more manageable levels. Meanwhile, the cream supply is tightening as ice cream production pulls more cream away from butter producers. While \$2.50/lb butter seems high, it is lower than the rest of the world, and demand continues to grow at a good pace. This week's GDT auction also saw a strong rally in cheddar cheese, to nearly \$2.00/lb. With cheese still tight in the EU and U.S. cheese exports to Australia growing, they will play a supportive role in domestic cheese prices eventually. We predict a sharp rally in Class III is going to happen, we just can't say when, but more than likely by the end of Q3. Hedgers should buy "courage calls" to sell in to and continue to purchase upside protection on existing sales. We would leave 2018 alone as we think prices are too low there.

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