

**The KDM Dairy Report – February 2<sup>nd</sup>, 2018**

SPOT MARKET	1/26	2/2	Change	Trades
Cheddar Blocks	\$1.4725	\$1.4625	(\$0.0100)	3
Cheddar Barrels	\$1.3200	\$1.3250	\$0.0050	25
Butter	\$2.1300	\$2.1150	(\$0.0150)	9
Grade A NDM	\$0.7100	\$0.7225	\$0.0125	21

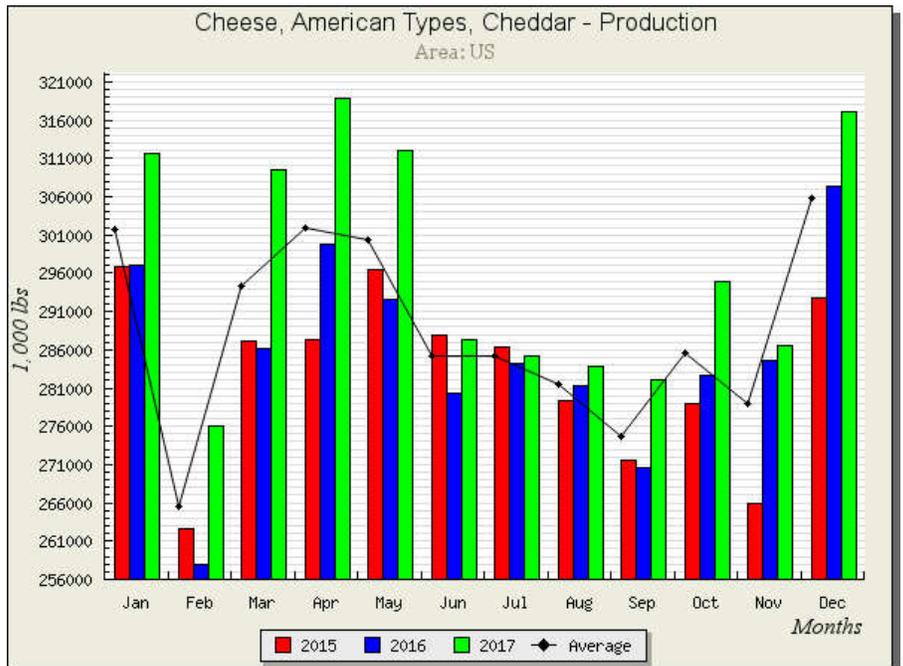
Futures Month	Class III 01/26	Class III 02/02	Change	Dry Whey	Dry Whey 02/02	Change	Cheese 01/26	Cheese 02/02	Change
Feb-18	\$13.32	\$13.63	\$0.31	26.250¢	26.250¢	0.00¢	\$1.457	\$1.487	\$0.030
Mar-18	\$13.44	\$13.61	\$0.17	27.200¢	26.175¢	(1.03¢)	\$1.465	\$1.492	\$0.027
Apr-18	\$13.68	\$13.80	\$0.12	27.300¢	26.300¢	(1.00¢)	\$1.487	\$1.506	\$0.019
May-18	\$14.06	\$14.14	\$0.08	27.900¢	27.000¢	(0.90¢)	\$1.522	\$1.533	\$0.011
Jun-18	\$14.48	\$14.52	\$0.04	28.825¢	27.950¢	(0.88¢)	\$1.560	\$1.569	\$0.009
Jul-18	\$15.02	\$15.00	(\$0.02)	29.250¢	28.750¢	(0.50¢)	\$1.612	\$1.617	\$0.005
Aug-18	\$15.44	\$15.38	(\$0.06)	29.275¢	28.725¢	(0.55¢)	\$1.652	\$1.652	\$0.000
Sep-18	\$15.63	\$15.57	(\$0.06)	29.400¢	28.750¢	(0.65¢)	\$1.673	\$1.674	\$0.001
Oct-18	\$15.75	\$15.78	\$0.03	29.800¢	28.675¢	(1.13¢)	\$1.692	\$1.691	(\$0.001)
Nov-18	\$15.68	\$15.75	\$0.07	29.850¢	28.650¢	(1.20¢)	\$1.687	\$1.689	\$0.002
Dec-18	\$15.59	\$15.61	\$0.02	30.575¢	29.000¢	(1.58¢)	\$1.670	\$1.676	\$0.006
Jan-19	\$15.40	\$15.40	\$0.00	30.275¢	30.275¢	0.00¢	\$1.655	\$1.660	\$0.005
<b>12 Mo Avg</b>	<b>\$14.79</b>	<b>\$14.85</b>	<b>\$0.06</b>	<b>28.825¢</b>	<b>28.042¢</b>	<b>(0.78¢)</b>	<b>\$1.594</b>	<b>\$1.604</b>	<b>\$0.009</b>

**What's Bullish:**

- Weekly cold storage numbers indicate cheese stocks at USDA-selected warehouses declined 6% (5.8 million lbs) over the period 01/01 through 01/29.
- Dairy cow slaughter for the week ending 01/20 totaled 68,100 head, up 8.3% vs. the same period a year ago. That's the highest weekly total since the third week of 2016.
- Fluid Milk East: Milk production is steady to lower as many market participants report there has been stressful weather conditions, and lower feed quality has taken a toll on production. Some manufacturers report milk volumes clearing into intakes have been lower the last couple of weeks. Cheese makers communicate production is at steady levels, however they are receiving just enough milk loads for production needs. Southeast milk production is fairly flat and market participants report milk availability is steady to somewhat limited. Milk is being pulled from other regions to support production demands.
- Dry Whey: 2018 is proving to be a fairly busy year for whey buyers and sellers. Exports are continuing to be reported as a big provider of storage relief for dry whey producers.
- Cheese Northeast: Milk availability is steady to tight as some cheese makers report they are receiving just enough loads for scheduled production levels. With the upcoming Super Bowl, domestic cheddar cheese block sales are up.
- Cheese Midwest: Generally, all cheese sales are meeting expectations, which is a turnaround from as recently as mid-January. Process cheesemakers, in particular, have suggested that sales have increased from a very slow start in 2018. Pizza cheese suppliers also report a demand uptick from previous weeks. There is some positivity regarding market tones among cheese contacts. Although the path to some steadiness has not been cogent, there is currently a bullish sentiment as prices are appealing to buyers who have, until recently, been very hesitant to purchase.
- Cheese West: With ample milk supplies, cheese production is active and many facilities are running at or near full capacity. However, some Class II manufacturers have pulled a little more milk into their facilities, helping ease the pressure on cheese processors. Industry contacts report an increase in demand from both export and domestic markets, possibly due to lower prices. Whether due to more favorable prices or the Super Bowl surge, manufacturers note an increase in buyer activity. Although inventories are still heavy, the uptick has drawn total cheese stocks down slightly.
- Foreign Cheese: Ample milk availability in the European Union is triggering more cheese production. Nonetheless, in Germany, the market for cheese is strengthening. Processors are sold out for the upcoming weeks, and they report not having enough stocks to fulfill additional cheese requests. The German spot prices for cheese are also rising.
- International: New Zealand has been very dry and hot over the past week. Some measure of recovery had started with more consistent rain. However, recently that reversed with returning quite dry conditions. Many areas have been hitting record high temperatures for January. An impact of weather conditions is that many farmers have been unable to grow sufficient feed for winter, and have been using stored feed and buying supplements for stock, as well as selling off animals. Cheddar prices in Oceania are steady to higher. Observers believe that pricing levels now prevailing are deemed pretty reasonable and are also likely to nudge upward.
- CWT has accepted 25 requests for Export Assistance from cooperatives to sell 4.365 million pounds of Cheddar and Monterey Jack cheese to customers in Asia, the Middle East and North Africa. The product has been contracted for delivery in the period from January through April 2018.

**What's Bearish:**

- Dairy Products Report: Cheddar cheese output in December was 3.2% higher than last December, according to USDA, while total cheese output increased 2.6%. Butter output jumped 4.2% YoY.
- Cattle on Feed Report: There are plenty of replacement animals waiting to join the herd. USDA reported there were 4.78 million milk cow replacements (heifers 500 lbs and over) as of Jan 1<sup>st</sup>, up 1% (27,000 head) from a year ago.
- Fluid Milk Central: Milk yields are plentiful in the Midwest, as weather has been ideal for cow comfort. Cheesemakers continue to find deals on spot milk, as a number of cheese contacts relay their internal milk supplies are sufficient.
- Fluid Milk Southwest: California milk output continues its seasonal increase and milk supplies are bountiful. Reports suggest that milk yield has



increased above forecasted volumes. Arizona milk output is up this week. Milk loads available for processing are also on the rise. Manufacturing plants are working at full capacity but seem to not have enough processing capacity to clear all the farm milk. Some of them are anxious about how they will manage the milk during the flush season which is getting close.

- Fluid Milk Pacific Northwest: Industry contacts say milk production per cow is stronger this season. So far, this winter has been mild and conducive to cow comfort. Intakes are starting to climb slightly.
- Butter: Cream into butter production is available to abundant. Butter output is generally heavy. Churns are mostly active as manufacturers are working on burning through their cream supplies. Contacts report growing inventories as preparation for the upcoming spring holidays.
- International: November 2017 production in the EU was up 5.5% compared to November 2016. Leaders were Germany, +6.4%; France, +5.4%; United Kingdom, +7.8%; and Italy, +5.3%.

**Recommendation:**

Basis between spot market prices and USDA's National Dairy Products Sales Report grew wider this week. On Wednesday, barrels settled at \$1.32/lb, but the NDPSR survey put 500-lb barrels at \$1.41/lb. What that means is that cheese being bought and sold off-exchange, is at a higher price level. It's the survey prices that go into, and ultimately determine futures settlement prices. With such a strong and somewhat unexpected survey price this week, February Class III settled the week up 31¢. In light of very bearish supply fundamentals, the question now is why the strong basis? Dairy Market News updates this week were decidedly friendlier to cheese. Buyers that have been sitting on the sidelines, may have decided that cheese prices might not go down much more, and so started getting more aggressive. Milk for manufacturing is actually getting a bit tight out East, due to weather and feed quality issues. Improved demand leading up to Super Bowl has helped keep fresh inventories in check, and exports are improving. January Class III settled at \$14.00, the lowest settlement since June 2016, and we are still facing sub \$14 milk in the next several months. Prices probably haven't been low enough, long enough to really curtail domestic milk production, but weekly dairy cow slaughter numbers are increasing. We're also hearing through some of our banking connections that there will be operations that are shuttered in the coming months. Looking beyond our borders, cheese demand is strong in Germany (sold out), while heat in New Zealand is beginning to take a toll on milk production. We still have to deal with a mountain of powder in the EU putting a drag on the NDM market, and today's 2.5% loss in the stock market was based on fear of a potential increase in interest rates. Should that happen, it would most likely strengthen the USD, making our ag exports more expensive / less competitive. There are lots of unknowns still out there, making it hard to predict short-term moves in the market. However, we would still recommend producers who have already sold much of their 2018 milk to start getting upside protection in the form of call options. Contact us and we'll help you put together a plan to protect your income.

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