

The KDM Dairy Report – March 2nd, 2018

SPOT MARKET	2/23	3/2	Change	Trades
Cheddar Blocks	\$1.4950	\$1.5600	\$0.0650	4
Cheddar Barrels	\$1.4600	\$1.4750	\$0.0150	33
Butter	\$2.1725	\$2.2000	\$0.0275	80
Grade A NDM	\$0.6725	\$0.6625	(\$0.0100)	4

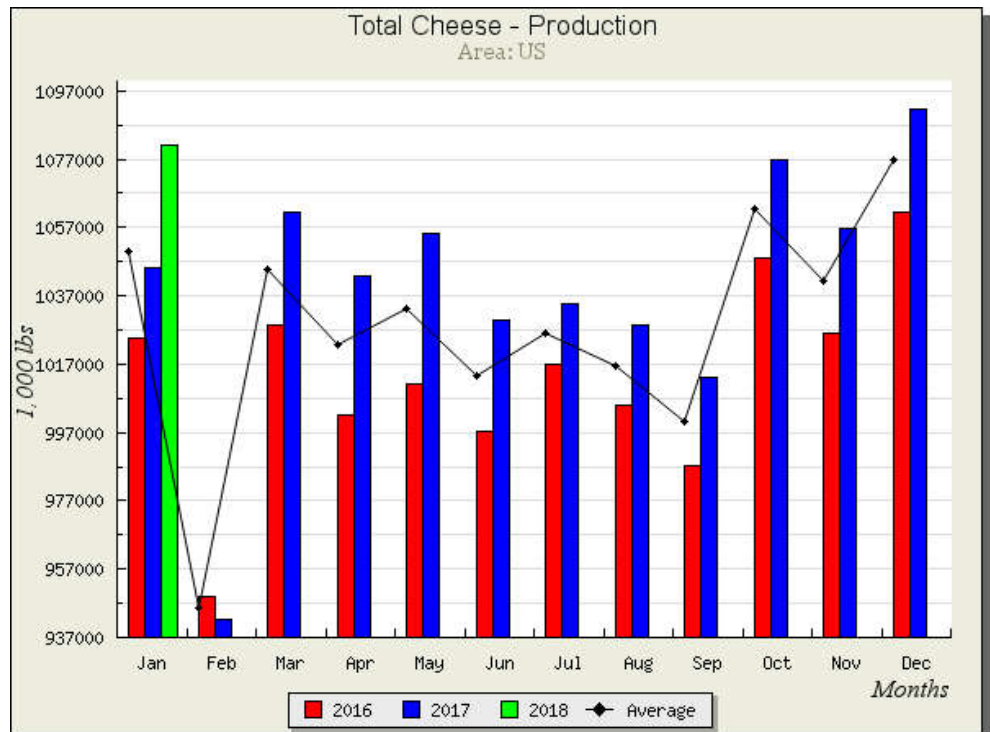
Futures Month	Class III 02/23	Class III 03/02	Change	Dry Whey	Dry Whey 03/02	Change	Cheese 02/23	Cheese 03/02	Change
Mar-18	\$13.87	\$14.12	\$0.25	24.250c	25.000c	0.75c	\$1.522	\$1.541	\$0.019
Apr-18	\$13.86	\$14.09	\$0.23	26.250c	25.700c	(0.55c)	\$1.514	\$1.536	\$0.022
May-18	\$14.06	\$14.23	\$0.17	26.700c	25.925c	(0.77c)	\$1.527	\$1.544	\$0.017
Jun-18	\$14.61	\$14.75	\$0.14	27.500c	26.550c	(0.95c)	\$1.583	\$1.596	\$0.013
Jul-18	\$15.21	\$15.27	\$0.06	28.000c	27.250c	(0.75c)	\$1.638	\$1.648	\$0.010
Aug-18	\$15.57	\$15.63	\$0.06	28.700c	27.625c	(1.08c)	\$1.673	\$1.680	\$0.007
Sep-18	\$15.84	\$15.89	\$0.05	29.100c	28.400c	(0.70c)	\$1.695	\$1.700	\$0.005
Oct-18	\$15.95	\$15.95	\$0.00	29.100c	28.600c	(0.50c)	\$1.706	\$1.706	\$0.000
Nov-18	\$15.81	\$15.83	\$0.02	29.000c	28.500c	(0.50c)	\$1.698	\$1.700	\$0.002
Dec-18	\$15.72	\$15.75	\$0.03	29.500c	29.000c	(0.50c)	\$1.677	\$1.689	\$0.012
Jan-19	\$15.54	\$15.52	(\$0.02)	31.000c	30.500c	(0.50c)	\$1.666	\$1.670	\$0.004
Feb-19	\$15.60	\$15.57	(\$0.03)	30.750c	30.750c	0.00c	\$1.666	\$1.670	\$0.004
12 Mo Avg	\$15.14	\$15.22	\$0.08	28.321c	27.817c	(0.50c)	\$1.630	\$1.640	\$0.010

What's Bullish:

- Cheese stocks at CME-approved warehouses decreased 2% (2 million lbs) over the period 02/01 through 02/26.
- Dairy cow slaughter for the week ending 02/17 totaled 67,100 head, up 7.2% vs. the same period a year ago.
- Ag Prices Report: The milk-feed ratio for Jan fell to 2.19, the lowest level since July 2016.
- Butter: While cream into churns is available, there are reports that cream loads into butter plants are becoming harder to come by as Class II and III producers reenter the cream market. Interest in butter is mostly strong.
- Cheese Midwest: Cheesemakers are reporting steady retail and food service demand. Mozzarella and provolone buyers, some of whom are located in other regions, are expected to add orders ahead of the college basketball tournament season. Spot milk loads were mostly discounted; however, the cheese market tone is generally positive. Buyers have continued to show interest in the face of increasing and/or stabilizing market prices.
- Foreign Cheese: Demand on the international market has increased again. In the EU, cheese production is steady. In Germany, demand within the country and abroad are all up. Therefore, prices continue to increase. Stocks for immediate needs are limited.
- International: Dairy imports by China in January jumped 43.8% by volume compared to a year ago, according to CLAL data, including an increase in cheese imports of 48%.
- International: Butter prices in Europe firmed, reaching the highest level of 2018. A recent uptick in butter orders from food manufacturers in the EU has helped generate upward prices. Many expect price firming to continue into March.
- International: New Zealand milk production in January was down 4.2% by volume vs. a year ago, according to DCANZ. January milk solids fell an even sharper 7.4% YoY.
- International: Butter prices in Oceania are higher. Some buyers were seeking to close deals this week for near term delivery, which strengthened upper range prices more than lower range prices. Export demand was noted as an important factor moving prices higher. Seasonal butter production in Australia July-December 2017, was 19.2% below the same period one year earlier, according to Dairy Australia.
- International: As of February 19 the percentage of usable water in soil mostly ranged from 0 to 10 percent throughout Argentina, which represents signs of severe dryness. Dairy producers are very concerned about their profitability due to a potential increase in the price of grains. Farm milk production is steadily declining throughout the continent while fat and protein levels in the milk remain low. Milk requests from bottlers are increasing. Conversely, there are less than sufficient milk intakes to cover some manufacturing needs. Butter manufacturing is lower, driven by shorter cream supplies.

What's Bearish:

- Dairy Products Report: American cheese output in Jan increased 2.7% vs. a year ago, while total cheese output was up 3.4% and butter output was 4.3% higher than last Jan.
- Butter stocks at CME-approved warehouses increased 33% (4.6 million lbs) over the period 02/01 through 02/26.
- Fluid Milk East: Milk production is moving up in portions of the Northeast, while temperate weather boosts cow comfort. Class I sales dipped slightly, leaving balancing plants running near full capacity. Farm milk output continues to tick higher in the Southeast and Florida and fluid milk sales are down.
- Fluid Milk Central: Milk surpluses remain an anxiety inducer for coop managers and many in the dairy sector in general. Most Class III spot sales were discounted, from \$1 over to \$3.50 under. Some cheesemakers suggest only discounted milk spot loads will be considered in the near term.
- Fluid Milk Southwest: California milk supplies are lavish. Some manufacturers have tight processing capacities because of internal reasons. Consequently, some milk and condensed skim are moving out-of-state



to find new homes. Class I demand is flat. Arizona milk outputs are trending up as they approach their spring flush. Many plants are currently working at full capacities. A couple of contacts report that this year milk outputs are more than last year's. This is creating more challenges with processing capacities. New Mexico milk is finding homes within the state, but balancing plants are busy, working at full capacities to clear the abundant loads of milk they have.

- Fluid Milk Pacific Northwest: Milk production is stable. Manufacturers report there is plenty of milk available for most processing needs.
- NDM Northeast: Production levels are increasing with heavier milk supplies flowing into butter/powder plants. Interest is moderate, and offerings are in excess of the current demand.
- Cheese Northeast: Cheddar plants are operating at full capacity, but market sources indicate regional mozzarella cheese plants are running moderately below capacity. Cheddar stocks are adequate for current demand, with a percentage of output rolling into aging programs. Holiday concentrated sales in retail markets have been good, but manufacturers anticipate a drop in demand.
- Cheese West: Although cheese contacts report a lot of sales activity, the bump for the Super Bowl did not meet expectations. There is an underlying unsettled market tone. Cheese manufacturers know that many of their facilities are already running near full capacity. With heavy milk supplies currently, there is a concern that the coming spring flush could exacerbate dairy market woes.
- International: Observers expect 2018 EU milk production to be above 2017. There is great confidence in gains being registered for the coming spring months. Expectations are that early 2018 export data, when released, will reflect increased cheese exports from the EU. Cheese is a favored use for the increased EU milk production. Aggressive efforts are underway in the EU to expand cheese export opportunities. The EU is the largest global cheese exporter and it plans to keep growing cheese exports.
- International: Improved weather in most dairy regions of Australia, as well as incrementally higher milk pay prices, has led to increases in milk production this season. Many dairy producers and processors comment favorably about dairy commodity price strength in the region.
- Geopolitical: This week's announcement by President Trump of a forthcoming 25% tariff on steel and aluminum imports could potentially hurt a wide range of agriculture exports if a trade war erupts. If history is an example, countries affected by the new tariffs, China in particular, could slap their own tariffs on U.S.-sourced ag products, including dairy.

Recommendation:

Spot butter buyers came in force this week, picking up an astounding 80 loads. However, they were only able to move the price up 2¼¢. That said, it does appear butter demand is on the rise globally, as prices are increasing everywhere. We are reading and hearing about a substantial increase in dairy exports to China. CLAL reported a 43.8% jump in dairy imports by China, including a 48% increase in cheese imports. If this is more than a one-month blip, it could be the start of tightening global dairy supplies. A China-led buying of powder resulted in record high dairy prices in 2014. Before we get too excited, however, we are still dealing with mediocre demand and increasing milk production in the U.S. as we head in to the flush. There is evidence of more dairies selling out, but most of the milking herd is just ending up at other dairies with capacity. Cheese and butter output in January were above year-ago levels, a result of all the surplus milk. We are still cautiously optimistic though. Grain prices have surged, particularly in the soy complex. Meal prices are approaching \$400/ton at the CME, which will increase the cost of production. In addition, spot cheese prices were able to increase this week, in the face of heavy inventories. Demand may be picking up some as buyers looking to secure cheese for aging programs still see current prices, which are the lowest in the world, as a value area to begin purchasing. The lows might be in. While we are still not out of the woods, we would encourage hedgers not to over-sell their output at current prices. While there is certainly downside risk, we believe the upside risk is greater. Milk already sold/contracted should be protected using call options, especially July-Dec. Up front, look at cheap put options to get a floor price in place, and hope they expire worthless.

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