

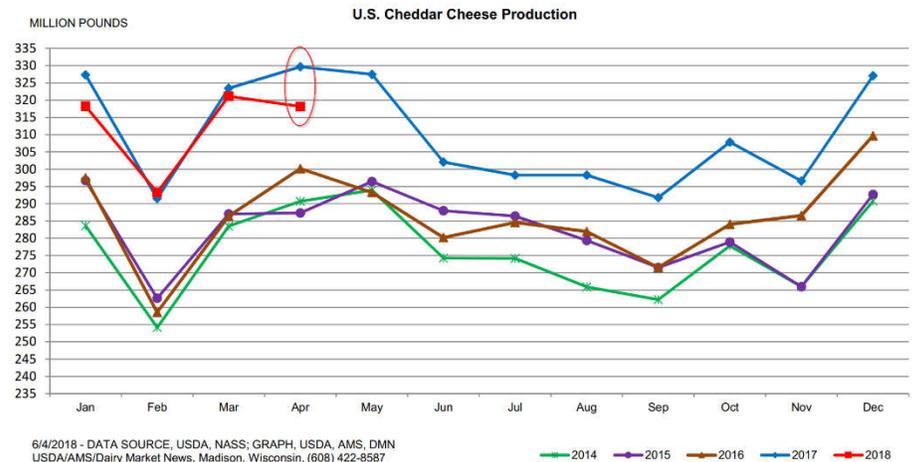
**The KDM Dairy Report – June 8<sup>th</sup>, 2018**

SPOT MARKET	6/1	6/8	Change	Trades
Cheddar Blocks	\$1.5975	\$1.6350	\$0.0375	35
Cheddar Barrels	\$1.5200	\$1.5650	\$0.0450	39
Butter	\$2.3775	\$2.3900	\$0.0125	19
Grade A NDM	\$0.8250	\$0.8050	(\$0.0200)	14
Dry Whey	\$0.3850	\$0.4125	\$0.0275	5

Futures Month	Class III 06/01	Class III 06/08	Change	Dry Whey	Dry Whey 06/08	Change	Cheese 06/01	Cheese 06/08	Change
Jun-18	\$15.49	\$15.47	(\$0.02)	30.200¢	30.500¢	0.30¢	\$1.648	\$1.640	(\$0.008)
Jul-18	\$16.23	\$16.04	(\$0.19)	33.950¢	34.300¢	0.35¢	\$1.698	\$1.679	(\$0.019)
Aug-18	\$16.79	\$16.62	(\$0.17)	35.500¢	35.500¢	0.00¢	\$1.747	\$1.727	(\$0.020)
Sep-18	\$16.96	\$16.91	(\$0.05)	35.450¢	36.050¢	0.60¢	\$1.761	\$1.755	(\$0.006)
Oct-18	\$16.83	\$16.86	\$0.03	35.575¢	36.500¢	0.92¢	\$1.750	\$1.753	\$0.003
Nov-18	\$16.63	\$16.64	\$0.01	35.125¢	35.175¢	0.05¢	\$1.732	\$1.732	\$0.000
Dec-18	\$16.44	\$16.49	\$0.05	34.900¢	35.825¢	0.93¢	\$1.719	\$1.718	(\$0.001)
Jan-19	\$16.16	\$16.29	\$0.13	34.600¢	35.500¢	0.90¢	\$1.698	\$1.706	\$0.008
Feb-19	\$16.10	\$16.28	\$0.18	34.075¢	35.000¢	0.92¢	\$1.695	\$1.709	\$0.014
Mar-19	\$16.08	\$16.23	\$0.15	35.050¢	34.775¢	(0.27¢)	\$1.696	\$1.708	\$0.012
Apr-19	\$16.10	\$16.25	\$0.15	35.000¢	35.325¢	0.33¢	\$1.693	\$1.706	\$0.013
May-19	\$16.14	\$16.33	\$0.19	34.675¢	35.800¢	1.13¢	\$1.698	\$1.705	\$0.007
12 Mo Avg	\$16.33	\$16.37	\$0.04	34.508¢	35.021¢	0.51¢	\$1.711	\$1.712	\$0.000

**What's Bullish:**

- Exports: Dairy product exports in April pushed to a new all-time high, according to the USDEC. Butterfat exports jumped 190% YOY, followed by WMP up 136%. Cheese exports recorded a 22% increase. YTD, dairy exports are 22% higher than in 2017. On a milk solids basis, April's dairy exports worked out to 18.8% of total U.S. milk production during the month; a new record.
- Dairy Products Report: Cheddar cheese output in April declined 3.5% vs. last April, and was down 0.9% from March, according to USDA. Cheddar production usually increases from March to April (see graph). Total cheese output managed just a 0.9% gain over last year.
- Cheese stocks at USDA-selected storage centers declined 1% over the period 05/01 through 05/28.
- Dairy cow slaughter for the week ending 05/26 totaled 54,400 head, up 1.3% vs. the same period a year ago.
- Fluid Milk Southeast: Milk output has dropped this week as the weather has been very hot with little to no rain.
- Fluid Milk Central: Hauling issues have become more than a nuisance for fluid milk and cream suppliers in the Midwest and beyond. Problems are numerous: trucker shortages, electronic logs forcing missed destinations and increasing freight costs to name a few regularly reported factors. Milk yields this week showed signs of tapering. The recent heatwave in the upper Midwest, plus reports of increased culling, are what most contacts suggest are leading to declining volumes. Cheesemakers report that spot milk remained discounted, although loads offered thinned considerably from recent weeks.
- Fluid Milk Southwest: Farm milk output in California is variable depending on the reporting processing facilities. In some areas, milk production is steady while in others it is declining. As hotter temperatures are prevalent, milk components are also starting to decrease. In Arizona, milk production is steady to trending down. Butterfat components are starting to decrease, especially in areas with higher recorded temperatures. Some market participants believe that the spring flush is over. Processing plants are running at below full capacities.
- Butter Northeast: Production levels are moderate as demand for fluid cream increases along seasonal patterns. Overall, demand is steady at good levels. Global interest is active.
- Dry Whey Northeast: Spot prices are firming. Whey production is fairly stable, but some market participants report many manufacturers are sold out of available stocks and do not have offers on the spot market. Current demand is stable and many traders and end users are looking for extra loads when available. Moreover, some industry contacts are willing to purchase at premiums from marketing agents. The market undertone is firm.
- Dry Whey Central: Demand is on the rise as inventory reports suggest continued tightness. The dry whey market tone remains bullish. Many spot transactions are taking place closer to and above the \$.30 mark. Offers have been regularly reported in the mid \$.40s, but buyers are skeptical about the large price increases in such a short window of time. Whey production is up as cheesemakers continue to receive discounted milk loads. However, Class III producers have suggested milk availability has declined this week.
- Dry Whey West: Industry contacts note a market tone that is firming. Dry whey is moving well in both the international and domestic markets. Production is active, but so far has been unable to overcome the recent demand. Inventories are tight to highly committed.
- Foreign Cheese: The cheese market was strong in April and May, and it is showing the same tendency this month. Cheese sales within the EU and in the export market are good. The weaker exchange rate is contributing to a boost in international orders. Although cheese is currently among the most produced dairy products in the EU, stocks are at lower levels due to higher demand.
- International: Butter prices in Western Europe firmed. This keeps prices at the highest level of 2018 and above where they were one year ago. Demand for butter remains strong. Buyers are more likely to concede higher pricing quoted by manufacturers. Now with the milk season perhaps near the point of decreasing in many areas, there is awareness that cream will likely become less available and that leads to more interest in completing contracting for Q3 and in some cases, Q4. Many buyers want to secure pricing and availability. 82% butterfat averaged a U.S. equivalent \$3.27/lb this week.



- CWT member cooperatives accepted offers of export assistance to sell 892,8872 pounds of Cheddar and Monterey Jack cheese to customers in Asia and Central America. The product has been contracted for delivery in the period from June through October 2018.
- International: Skim milk powder prices in Western Europe are higher, and firmer pricing is expected to continue. Most scheduled SMP production in coming weeks has already been committed. Inquiries from buyers continue to be received, both internal EU and export buyers. Demand from outside the EU is described as very good. This encourages manufacturers to be firm as to pricing and buyers to be more flexible. Current contracting discussions reflect strong buying interest through Q3 and even into Q4. Buyers are very interested in current SMP production.
- International: This is the time of year with seasonally lower milk production in Australia. Winter is setting in and welcome substantial rain has recently fallen in Southeast Australia. While the rainfall is welcome in bringing moisture to dry soil, the persistent rain is now leading to concerns about mold and yeast in stored hay. Demand for hay is strong in the region. Concerns are voiced as to depleting the stocks too quickly.
- International: New Zealand has begun a process of killing cow herds with mycoplasma bovis (m. bovis). Farms with m. bovis affected herds will not be allowed to move the cows on June 1, or ever, except to slaughter. Building a new herd will take some time. Observers note that many farms simultaneously rebuilding from zero could lead to regionalized inflation for replacement cow pricing. Generations of breeding programs will be gone for the affected dairy producers. It will take some time to come close to replicating not only herd size, but also quality.

#### What's Bearish:

- Fluid Milk Northeast: Milk production is moving up as milk loads are heavy in the area. Balancing plants are at near capacity for processing needs. Class I and III sales are flat to lower. Yet, Class II and IV sales are steady to strong. Mid-Atlantic milk production is steadily increasing. Operations are working on full schedules to work through milk loads. However, market participants report balancing operations are handling milk loads well, as parts of the Mid-Atlantic never got a true spring flush like in past years.
- Fluid Milk Pacific Northwest: Milk production remains strong but has eased with the passing of the peak of spring flush. Schools have mostly closed for the year, shifting some milk away from bottling and into manufactured dairy goods. Manufacturers say they are getting plenty of milk and intakes are generally in good balance with processing needs. In the mountain states of Idaho, Utah and Colorado, milk production has had year over year increases. Current milk production is strong and continues to grow into the peak of spring flush.
- Butter Central: For some upper Midwestern butter makers, cream remains fairly tight locally. However, bulk butter is very available, particularly from the Western region. Some regional butter analysts have relayed that U.S. butter markets may have hit their 2018 apex. They suggest inventory increases in the U.S., and in some import destinations, are going to impact the markets during what is typically the butter boom season, the fall.
- Butter West: Cream continues to be readily available to processors. Bulk butter churning is one of the main activity of most butter manufacturers at the moment. Some of them are stocking bulk butter for usage in the fourth quarter as they are concerned that production capacities might become limited. Butter inventories are growing.
- NDM Central: Prices were mostly steady, but slipped on the top of the range. Spot market activity was a little slower than a busy week 22, as some have pointed out that Mexican buying has lightened. Drying is active, as condensed skim is readily available in the region and throughout the country.
- NDM Northeast: Prices are unchanged to lower in the region. The market is fairly quiet as some buyers are responding to perceived weakness in the nonfat dry market. The perception is prompted somewhat by economic fundamentals as intervention stocks find a landing in the Mexican market, accompanied by a weakening peso, compared to a strong U.S. dollar. As a result, purchases in some instances are put on hold.
- Cheese Northeast: Cheese makers are receiving high milk levels into their intakes. Production schedules are running at to near capacity. Cheddar production is strong and market participants report they are clearing extra milk loads. Cheddar cheese interest from retail sectors is fairly steady. Mozzarella orders are steady to slow as educational institutions are closing for the summer. Overall cheese inventories are stable to increasing.
- Cheese Midwest: Spot milk remains discounted for Class III producers; this week's range falls between \$1.50 to \$4 under Class. Cheese plant managers are reporting that cheese production rates are steady to increasing, but lighter demand may reverse the upticks in production as early as next week. Cheese demand remains slow to steady, depending on variety and destination. Pizza cheesemakers report that Eastern buyers have been falling back on necessity buying of late, as market prices have slipped since early May. Some Midwestern cheesemakers point to Mexican tariffs as a potential cause for concern, while suggesting effects may not be felt until later in the year.
- Cheese West: Cheese makers say demand has hit a bit of a lull. Cheese customers are making regular draws, but not asking for more right now. The unofficial start to summer passed last week and grilling season is upon the nation. However, terms are ending for the school year and food service demand is shifting. Buyers and manufacturers are adjusting to the new consumption patterns.
- The GDT Price Index declined 1.3% in this week's auction. Cheddar cheese led the way, falling 3.6% to a US equivalent \$1.81/lb.

#### Recommendation:

Class III futures came off their lows, following the Mexican tariff news, but still settled lower in the front months. The deferred months, however, have seen a consistent bid. Tuesday's GDT auction added more negativity to the market, but trade data released Thursday, showing record exports in April, helped provide a lift to the market to finish the week off. The components that determine the Class III price were all higher in this week's spot market, with a consistent bid seen in cheese and dry whey. And as was pointed out to us by several producers this week, the Margin Protection Program we mentioned in last week's report is most likely not the safety net we suggested. The maximum benefit for 5 million lbs of milk appears to be only about \$7,500. That is quickly eaten up with higher feed costs, and labor expenses up 10-15% at many operations. This helps explain the support seen in the 2019 contracts. Low \$16 milk just does not cut it for many operations, so the upside risk to these contracts at current prices appears stronger than any downside risk. The cheese tariffs by Mexico are still potentially a big issue. But a 15% increase in costs does not necessarily mean they will stop buying. The U.S. still has the cheapest cheese in the world and a huge transportation advantage with Mexico. Cheese is still tight and much higher priced in the EU, while milk output is at seasonal lows in Oceania, so it's unlikely Mexico will start buying from these sources. With schools mostly closed, more milk is available for manufacturing, so it's really hard to say where prices are headed up front. We still have a lot of inventory out there. But if demand remains good and exports continue to surge, that inventory could start to decline. With more geopolitical uncertainty still ahead, volatility is still a very real possibility as the market tries to determine price direction. We would continue to look at buying PUT options July-Aug to protect against a violent move. Longer term, we would hold off sales in the fall and into 2019.