

The KDM Dairy Report – June 22nd, 2018

SPOT MARKET	6/15	6/22	Change	Trades
Cheddar Blocks	\$1.5950	\$1.4900	(\$0.1050)	5
Cheddar Barrels	\$1.4500	\$1.2850	(\$0.1650)	88
Butter	\$2.3525	\$2.2900	(\$0.0625)	7
Grade A NDM	\$0.7875	\$0.7625	(\$0.0250)	12
Dry Whey	\$0.4100	\$0.3975	(\$0.0125)	0

Futures Month	Class III 06/15	Class III 06/22	Change	Dry Whey	Dry Whey 06/22	Change	Cheese 06/15	Cheese 06/22	Change
Jun-18	\$15.37	\$15.25	(\$0.12)	30.750c	30.800c	0.05c	\$1.631	\$1.619	(\$0.012)
Jul-18	\$15.43	\$14.66	(\$0.77)	33.750c	32.650c	(1.10c)	\$1.622	\$1.549	(\$0.073)
Aug-18	\$15.92	\$15.36	(\$0.56)	34.250c	32.000c	(2.25c)	\$1.666	\$1.627	(\$0.039)
Sep-18	\$16.39	\$15.93	(\$0.46)	34.125c	31.350c	(2.78c)	\$1.717	\$1.682	(\$0.035)
Oct-18	\$16.47	\$16.02	(\$0.45)	34.750c	31.675c	(3.08c)	\$1.725	\$1.695	(\$0.030)
Nov-18	\$16.25	\$15.92	(\$0.33)	34.000c	30.975c	(3.03c)	\$1.705	\$1.691	(\$0.014)
Dec-18	\$16.18	\$15.83	(\$0.35)	34.375c	30.250c	(4.13c)	\$1.702	\$1.682	(\$0.020)
Jan-19	\$16.02	\$15.73	(\$0.29)	33.975c	30.025c	(3.95c)	\$1.693	\$1.677	(\$0.016)
Feb-19	\$15.96	\$15.73	(\$0.23)	34.400c	30.000c	(4.40c)	\$1.694	\$1.678	(\$0.016)
Mar-19	\$15.93	\$15.74	(\$0.19)	33.600c	30.000c	(3.60c)	\$1.695	\$1.680	(\$0.015)
Apr-19	\$16.05	\$15.82	(\$0.23)	34.650c	31.000c	(3.65c)	\$1.694	\$1.690	(\$0.004)
May-19	\$16.15	\$15.96	(\$0.19)	34.825c	31.900c	(2.93c)	\$1.705	\$1.697	(\$0.008)
12 Mo Avg	\$16.01	\$15.66	(\$0.35)	33.954c	31.052c	(2.90c)	\$1.687	\$1.664	(\$0.023)

What's Bullish:

- Livestock Slaughter Report: 245,100 dairy cows were removed from the milking herd in May, up 3.3% vs. a year ago, and the highest May total since 2013.
- Cheese stocks at USDA-selected storage centers declined 1% over the period 06/01 through 06/18.
- Dairy cow slaughter for the week ending 06/09 totaled 55,100 head, up 4.6% vs. the same period a year ago.
- Fluid Milk Southeast: Milk production is declining as seasonally hot temperatures and intermittent rain showers distress cow comfort. Class I sales are ticking higher, with little to no milk into manufacturing. Loads from the West are helping fulfill milk needs. In Florida, milk producers are reporting reductions in milk volumes. With the warm temperatures, some loads are being declined at receiving plants.
- Fluid Milk Southwest: In California, dairy farmers are keeping a close eye on the heatwaves. This week, milk output is lower. Milkfat components are diminishing as expected. In Arizona, farm milk production has decreased, but not as much as expected. Recent rains and humidity have created an uncomfortable atmosphere for cows. In New Mexico, farm milk production is slowly dropping as dairy farmers expected. Warmer weather conditions are impacting cows' wellbeing and starting to reflect on total milk output.
- Dry Whey Northeast: Prices increased on the top of the range this week. The majority of spot sales are ranging in the mid to high \$0.30s. The spot market is currently tight. Inventories in warehouses are low as the majority of stocks are going to regular contracts. Overall market conditions are firm, despite concerns over international trade.
- Foreign Cheese:
 - CWT accepted offers of export assistance to sell 1.345 million lbs of Cheddar, Gouda and Monterey Jack cheese and 137,789 lbs of butter to customers in Asia, the Middle East, and Oceania. The product has been contracted for delivery in the period from June through December 2018.
 - International: Early June heat in Germany and other parts of Western Europe has resulted in milk production declining significantly according to some observers. German production was estimated to be about 1% below levels a year ago. Components also suffered. Cheese stocks in Western Europe, especially Germany and France, are quite tight. Demand is strong from food retailers, bulk consumers, individual consumers, and exports. A number of plants are behind in deliveries. Cheese stocks in aging programs are also at a lower than desired level. Getting stocks up to a more comfortable level is not expected in the short term. Mozzarella stocks are noted to be in short supply.
 - International: Australian dairy officials expect the new dairy season will be positively driven by strong export demand. In particular, demand from China for skim milk powder and whole milk powder is expected to be very good. Japan is expected to be a significant buyer for cheese and butter. Even so, current weather conditions are of increasing concern to dairy producers, as possibly leading to higher input costs. The untypically hot and dry autumn in some hay and grain growing areas has led to higher prices. Hay supplies have begun to be drawn down. Drought is increasingly a concern.

What's Bearish:

- Cold Storage Report: American cheese stocks at the end of May were 1% lower than a year ago, but total cheese stocks were 6% higher and butter stocks 8% higher. The 76.9 million lbs of total cheese and 25.2 million lbs of butter in storage at month end are the highest in history.
- Milk Production Report: U.S. milk output in May increased 0.8% vs. a year ago. More significantly, after seeing slight declines in the herd size since January, May saw a slight increase of 2,000 head from April, while April was revised 2,000 head higher from the last report. Gains were led by the West, with CO up 11.6%, KS up 9.7% and TX up 6.6%.
- Butter stocks in cold storage at USDA-selected storage centers are up 2% over the first 18 days of June.
- This week's GDT auction saw the dairy price index decline 1.2%, the second consecutive drop. Cheddar cheese fell 3.6% to a U.S. equivalent \$1.74/lb.
- Fluid Milk Northeast: Milk production is steady with output on the heavy side. Manufacturing supplies are long, with discount milk pricing taking place. Bottling orders are declining.
- Fluid Milk Central: Contacts are pointing out milk volume declines in single-digit percentages in the south. But those yield decreases do not represent the entirety of the Central region. For instance, Wisconsin cheesemakers continue to report plentiful discounted spot milk offers. As cheese producers are feeling the effects of market bears, and as most school breaks are underway, Midwestern milk handlers are facing a growing number of difficulties in locating homes for current supplies of milk.
- Fluid Milk Pacific Northwest: Although much of the region is coming off the peak of spring flush, pockets have seen a slight uptick in milk volumes the last few weeks due to favorable cow comfort weather. Manufacturers report components are up and so are the subsequent cheese yields. Processors say they are not able to push as much milk through the plant, and with less milk going into school bottling there are a few distressed

loads available. Milk production in the mountain states of Colorado, Utah and Idaho is strong. Manufacturers report no problems getting the milk they need for processing.

- Butter: In the West, production has been driven by ample amounts of affordable cream, while some processors begin to sell off some cream in the spot market. In the Central region, butter making varies by plant as some manufacturers continue microfixing, while others are taking on heavier loads of cream. In the East, butter operators report steady output, but cream supplies are reported as becoming less accessible. Nationwide, retail and food service buying interest is mostly fair/good.
- Dry Whey Central: International trade issues are a primary topic of discussion this week in the entire dairy industry, with whey hardest hit by the news because of the heavy influence China has on the U.S. whey market. Currently, whey buyers and end users have taken a step back from the spot market during arguably one of the quietest spot trading week of the year. One positive factor is that whey inventories are still tight.
- Dry Whey West: The market tone is unsettled after the announcement of impending Chinese trade issues with U.S. whey and other dairy products. China is the largest export market for U.S. whey. In the previous weeks, there had been a firming trend for dry whey. Industry contacts say inventories are still tight and domestic demand is solid. However, with added market uncertainty and softening in the cash and futures whey markets, buyers think the market will soften and are in no rush to buy more than is needed.
- NDM Northeast: The market appears sluggish this week as relationships with some global trade partners appear to have entranced NDM buyer/sellers, stymying market activity levels. Considering the likelihood of existing market factors fronting increased supplies and a price decline, manufacturers and processors are gaging the possibilities. Inventories are fair to heavy.
- NDM Central: As market prices continued their descent following international trade news that has affected the entire dairy commodity complex, low and medium heat NDM market tones are very shaky. Undoubtedly, buyers and end users are looking to hold off and bide their time.
- NDM West: Prices have been consistently declining for the past five weeks. The market undertone is unsettled, and sellers are concerned about trade agreements and maintaining/increasing their international market share. Supplies are plentiful to meet all needs.
- Cheese Northeast: Milk intake into cheese vats was slightly lower this week, but overall, spot milk remains abundant in the area. Cheese production is steady. Provolone and mozzarella are running at full production, despite slower demand from schools and the restaurant industry. Italian cheese inventories are long and increasing, waiting for the school year to pick up in August. The recent trade news from China have concerned some contacts about how the cheese market will be affected.
- Cheese Midwest: Cheese demand is fairly steady, but contacts are anxious regarding the growing CME block to barrel price gap, tariff related trade pushback and tumbling market prices. Cheese plant managers are more apprehensive regarding taking on any extra milk, hence spot milk discounts continue into week 25 at \$3 to \$4 under Class. Inventories are also mixed by variety, but process cheesemakers are shifting some production to manage growing stocks. The near-term market tone is somewhat dim.
- Cheese West: Cheese inventories, especially for barrels, are heavy. Domestic demand is mixed. While branded retail sales are stable, processors say food service and commodity cheese sales have slowed. In addition, industry contacts are forecasting weaker international sales due to trade issues and uncertainties of the market. Dairy contacts are concerned that reduced demand from key markets may create surpluses of cheese. Some manufacturers are shifting from blocks to barrels in an effort to find a home for the available milk. Market observers suggest this shift in production, coupled with languid demand and plenty of barrels on the CME, has created a wide price spread between blocks and barrels. With plenty of cheese offers, buyers are in no rush to fill their inventories.

Recommendation:

Fear over the effects of a trade war with our biggest cheese destination (Mexico) and dry whey destination (China), continued to pressure the markets this week. In addition, bearish Cold Storage and Milk Production reports will only weigh on the market next week. We traded a massive amount of barrel cheese in this week's spot market. Buyers came out of the woodwork once prices fell below \$1.30/lb, but even that couldn't help it finish on the low for the week. The block-barrel spread is now 20½¢, and with barrel production picking up and inventory growing, it's more likely that the gap will at least narrow, with block cheese coming down. Front month futures were clobbered in response to the weak spot market and bleak fundamental picture. Can it get any worse? Yes. Current spot prices work out to just \$13.70 Class III. With July futures just finishing their first pricing week, today's settlement at \$14.66 is still carrying quite a bit of premium. Front month futures still look heavy from here. That said, with sub-\$16 milk in nearly every futures month through next May '19, we would expect herd liquidations to increase dramatically (sadly). There is also the chance that the tariff situations could be negotiated and ended sooner rather than later. Having just had record exports in April, any news of that sort would most certainly trigger a strong rally. Market sentiment too may play a role. When everyone, or nearly everyone thinks the only direction is down, it's usually about when markets bottom and start rising. Producers who bought July-Aug puts the past few weeks have been rewarded. Operations with milk sold in Q4 at prices higher than current futures, have a genuine opportunity to buy cheap upside risk protection should the "dairy crisis" get resolved. Until then, it looks like uncertainty will reign, and markets do not like uncertainty. Keep pressing on.

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