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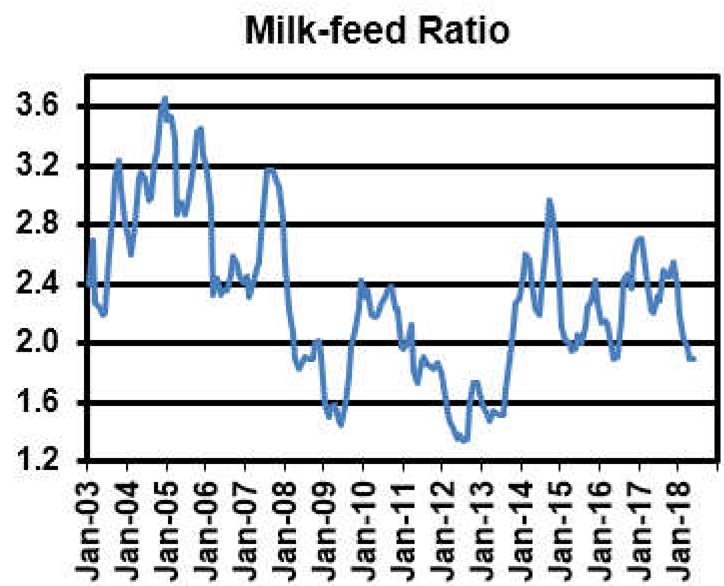
The KDM Dairy Report – June 29th, 2018

SPOT MARKET	6/22	6/29	Change	Trades
Cheddar Blocks	$1.4900	$1.5550	$0.0650	5
Cheddar Barrels	$1.2850	$1.3900	$0.1050	80
Butter	$2.2900	$2.2675	($0.0225)	26
Grade A NDM	$0.7625	$0.7475	($0.0150)	18
Dry Whey	$0.3975	$0.4075	$0.0100	2

Futures Month	Class III 06/22	Class III 06/29	Change	Dry Whey	Dry Whey 06/29	Change	Cheese 06/22	Cheese 06/29	Change
Jun-18	$15.25	$15.27	$0.02	30.800¢	30.750¢	(0.05¢)	$1.619	$1.619	$0.000
Jul-18	$14.66	$14.60	($0.06)	32.650¢	32.775¢	0.13¢	$1.549	$1.542	($0.007)
Aug-18	$15.36	$15.34	($0.02)	32.000¢	33.175¢	1.18¢	$1.627	$1.612	($0.015)
Sep-18	$15.93	$15.95	$0.02	31.350¢	32.475¢	1.13¢	$1.682	$1.681	($0.001)
Oct-18	$16.02	$16.06	$0.04	31.675¢	31.150¢	(0.53¢)	$1.695	$1.700	$0.005
Nov-18	$15.92	$16.00	$0.08	30.975¢	31.025¢	0.05¢	$1.691	$1.695	$0.004
Dec-18	$15.83	$15.90	$0.07	30.250¢	31.050¢	0.80¢	$1.682	$1.683	$0.001
Jan-19	$15.73	$15.82	$0.09	30.025¢	30.175¢	0.15¢	$1.677	$1.675	($0.002)
Feb-19	$15.73	$15.80	$0.07	30.000¢	30.025¢	0.02¢	$1.678	$1.675	($0.003)
Mar-19	$15.74	$15.77	$0.03	30.000¢	30.500¢	0.50¢	$1.680	$1.675	($0.005)
Apr-19	$15.82	$15.86	$0.04	31.000¢	31.000¢	0.00¢	$1.690	$1.688	($0.002)
May-19	$15.96	$15.91	($0.05)	31.900¢	31.900¢	0.00¢	$1.697	$1.696	($0.001)
12 Mo Avg	$15.66	$15.69	$0.03	31.052¢	31.333¢	0.28¢	$1.664	$1.662	($0.002)

What's Bullish:

- Ag Prices Report: The May milk-feed ratio came in at a low 1.9, unchanged from April (see graph), signaling herd/milk expansion should be muted to declining.
- Cheese stocks at USDA-selected storage centers declined 7% (5.7 million lbs) over the period 06/01 through 06/25.
- Dairy cow slaughter for the week ending 06/16 totaled 55,000 head, up 2.6% vs. the same period a year ago.
- Fluid Milk Sou theast: Milk output is decreased as the humid weather has an impact on current cow comfort. The majority of milk loads are clearing to bottling orders. In Florida, milk production is declining, but loads are being sourced to fill Southeastern processing needs. Some manufacturers report the demand for cream is strong as customers are taking their regular contracts and looking for extra spot loads.
- Fluid Milk Southwest: In California, fluid milk demand increased this week, mostly due to the upcoming holiday. Class II sales going into ice cream manufacturing plants increased. Milk production is generally flat. However, milk components are dwindling. Arizona milk output is downward trending. Hotter weather in the triple digits during the day is contributing to a slowdown in production level. Milk production is generally past the peak season in New Mexico. Plant managers are able to manage milk loads without any major issue. This week, output has declined. Class II sales have surged in view of the looming holiday.
- Dry Whey Northeast: Prices in the East have increased on the price range. Market participants are purchasing the majority of loads in the low to mid $0.30s as manufacturers are not offering spot loads at lower prices. Moreover, some buyers are purchasing spot sales at higher prices due to the strong demand for specific brands. With milk output heavy in the Northeast and cheese processing strong, overall whey powder production is active. Supplies are tight with reports from manufacturers communicating inventories are just starting to become a little more available than recently.
- Foreign Cheese: Cheese export sales from Germany to Southern Europe are lively. Mozzarella is in great demand. Cheese stocks remained at lower levels. In Germany, production is ongoing. However, due to a decline in milk components and milk volumes delivered, the likelihood for an expansion of current production to meet increasing demand is limited. Prices for sliced cheese continue to be firm. For July contracts negotiations, cheese sellers are demanding and enforcing higher prices.



What's Bearish:

- Butter stocks in cold storage at USDA-selected storage centers are up 2% over the first 18 days of June.
- Fluid Milk Northeast: Milk off the farms in the region is fairly heavy to dropping off a bit as warm temperatures hovered over the area. Manufacturers are busy as milk supplies are available. Class I sales are steady to a tad lower as some bottling facilities are cancelling milk loads. Mid-Atlantic milk production is fairly level. Some operations do not have enough milk for processing needs, although other plants are taking milk loads at capacity.
- Fluid Milk Central: Fluid milk and cream remain readily available for various uses. Milk bottlers are slow to take on milk with schools on break. Additionally, Class III plant managers are taking a step back from the spot milk market as uncertainty in cheese/whey markets is crimping production. With a mid-week holiday, and several manufacturers shutting down for an extended weekend, milk and cream discounts are expected.
- Fluid Milk Pacific Northwest: Favorable weather continues to support cow comfort and strong milk production. Manufacturers have plenty of milk to fill most processing needs. A few distressed loads are available in the region. Milk handlers are working to find homes for any extra load ahead of the Fourth of July holiday to keep the number of surplus loads to a minimum. Milk production in the mountain states of Idaho, Utah and Colorado is strong.
- Butter: In general, throughout the country, the demand for butter varies from steady to weak as summer heat increases. Cream volumes remain available for butter churning even during the peak of ice cream making. However, in the East, the demand for cream is strong and is reducing

churning production schedules in some processing plants. Conversely, in the west region, some manufacturers are willing to sell off some cream spot loads to ice cream makers in lieu of making butter. Nationwide, butter stocks are steady to building.

- Dry Whey Central: International trade disputes have caused a stir within the U.S. whey market and moreover the entire dairy industry. A few contacts report concern among whey exporters, as some orders are delayed due to push back from customers awaiting pending trade negotiation outcomes. As a result, to maintain international customers, some sellers are planning to split new trade costs or are looking for new trade markets altogether. Therefore, uncertainty in the market has caused buyers to observe the market instead of acquiring new stocks. However, some contacts report downgrade whey is getting cleared out. Whey inventories remain tight, but increasingly more available week to week.
- Dry Whey West: Some processors report that their sales have started to decline. With current uncertainties related to trade agreements, some international shipments have been cancelled. Many international buyers are not looking to extend coverage. Some are taking the wait and see approach until when the new tariffs become effective to get a clear sense of the market direction. There are also some beliefs that buyers might switch their purchases from dry whey to lactose
- NDM Northeast: The market is seeing the onset of weakness as prices fell in both the range and mostly series, ahead of the proposed tariff on exports. NDM production in most facilities is steady, but reports indicate milk receipts at some powder plants marginally declined. Producers' low/medium heat NDM stocks are building while the market sees no reason to buy too far ahead, as downward pressure gains momentum.
- NDM Central: Prices decreased on both the range and mostly price series. Spot market activity picked up following what has generally been a slow trading month. Buyers, however, are aware of numerous market bears, particularly where spot prices have shifted on the CME Group exchange. A growing number of Central region spot transactions have found a comfort zone in the high $.70s to $.80. Undoubtedly, regional production continues heartily as condensed skim remains readily available.
- NDM West: Prices adjusted steady to lower this week. It is important to note that starting next week, July 6, 2018, China announced it will increase its import tariffs for some dairy products from the United States, including SMP among others. Therefore, several SMP manufacturers are losing orders from that country. Consequently, there is a lot of uncertainty in the domestic NDM market. This week, NDM sales have been slow as many local NDM buyers/end users are skeptical to extend coverage further than needed. Meanwhile, low/medium heat production is active while inventories are still at elevated levels.
- Cheese Northeast: In general, milk is still heavy and many cheese plants are taking in near to capacity milk loads. Cheese production is fairly strong. Cheddar, provolone and mozzarella cheese production schedules are full as milk is available for processing needs. The demand for cheddar and Italian cheeses is currently sluggish. Current cheese market conditions have many market participants concerned about where cheese prices and demand will go.
- Cheese Midwest: The overall cheese market tone is undoubtedly shaken by a laundry list of bears: trade concerns, cold storage data and recently inconsistent barrel demand to name a few. Some Midwestern process cheesemakers have shifted production into other varieties in an attempt to limit supplies and focus on better selling/seasonal items. Mozzarella and provolone makers are anxious regarding the markets, but say demand is meeting seasonal expectations nonetheless. Milk into cheese production remains discounted, between $3 to $4 under Class. Cheese plant managers expect discounts to remain into next week, ahead of Independence Day.
- Cheese West: International cheese demand has started to decrease. With current trade issues, market participants report that some overseas customers are cancelling their contractual orders. Some U.S. cheese sellers say that they are adjusting their prices downward to maintain current contracts. Stocks, particularly for barrel cheese are plentiful. As the result, several cheese processors are shifting their output from barrels to blocks as a way to prevent barrel inventories from increasing too much.
- International: May milk output in Australia increased 2.5% vs. the prior year, according to Dairy Australia stats. That puts the current milking season, July-May, up 3.4% YTD.

Recommendation:

On Tuesday, CME cheese barrel prices hit their lowest point since July 30, 2009, settling at $1.2050. Bearish supply data from last week's Cold Storage and Milk Production reports, along with little to no progress in trade negotiations with Mexico and China and sluggish demand all worked against the market. But one doesn't often get the opportunity to buy at 9-year lows, so for the rest of the week, spot cheese prices steadily, if not even speedily climbed. After the dust settled, 80 loads had exchanged hands, and barrel cheese finished 18½¢ off the Tuesday low, with a net gain of 10½¢ for the week. Block cheese also enjoyed active bidding, settling 6½¢ higher than last Friday. Other than the mantra that low prices cure low prices, it's hard to find any other reason for this week's price strength. That said, farm debt in general is starting to make more headlines, as grain operations feel the tariff pain as well. Most grain operations are facing their 4th or 5th straight year of lower net farm income. Some banks are over-extended on agriculture loans that are not performing. With many dairy farms now also facing unpaid bills and potential bankruptcy, the rubber band is getting stretched even tighter. So far, we have not seen large herd liquidations, but the longer the trade wars rages on, the more likely it is to happen. Weather could start becoming a factor as a heatwave is now invading the Midwest, but with out a meaningful decline in milk production, there will probably still be discounted spot loads available, given sluggish demand/exports. We continue to recommend buying PUT options. Look at covering Aug and Sep to buy some time for this trade war to get sorted out. With today's strong finish in Class III futures and the potential for continued spot cheese bidding next week, premiums should begin to decline.

Note: Our offices will close at noon on Tuesday and re-open on Thursday, in observance of Independence Day.