

The KDM Dairy Report – July 13th, 2018

SPOT MARKET	7/6	7/13	Change	Trades
Cheddar Blocks	\$1.5425	\$1.5600	\$0.0175	8
Cheddar Barrels	\$1.2450	\$1.4225	\$0.1775	49
Butter	\$2.1700	\$2.2250	\$0.0550	21
Grade A NDM	\$0.7725	\$0.7550	(\$0.0175)	11
Dry Whey	\$0.3900	\$0.4175	\$0.0275	7

Futures Month	Class III 07/06	Class III 07/13	Change	Dry Whey	Dry Whey 07/13	Change	Cheese 07/06	Cheese 07/13	Change
Jul-18	\$14.20	\$14.27	\$0.07	32.300¢	33.475¢	1.18¢	\$1.509	\$1.506	(\$0.003)
Aug-18	\$14.69	\$14.84	\$0.15	32.000¢	32.500¢	0.50¢	\$1.564	\$1.574	\$0.010
Sep-18	\$15.22	\$15.26	\$0.04	31.300¢	32.400¢	1.10¢	\$1.621	\$1.617	(\$0.004)
Oct-18	\$15.43	\$15.49	\$0.06	30.500¢	31.500¢	1.00¢	\$1.649	\$1.643	(\$0.006)
Nov-18	\$15.51	\$15.51	\$0.00	29.775¢	31.000¢	1.23¢	\$1.653	\$1.651	(\$0.002)
Dec-18	\$15.46	\$15.49	\$0.03	30.250¢	31.450¢	1.20¢	\$1.648	\$1.643	(\$0.005)
Jan-19	\$15.40	\$15.40	\$0.00	30.175¢	30.325¢	0.15¢	\$1.646	\$1.641	(\$0.005)
Feb-19	\$15.44	\$15.34	(\$0.10)	30.000¢	30.025¢	0.02¢	\$1.652	\$1.642	(\$0.010)
Mar-19	\$15.48	\$15.38	(\$0.10)	30.500¢	30.000¢	(0.50¢)	\$1.656	\$1.648	(\$0.008)
Apr-19	\$15.68	\$15.55	(\$0.13)	31.000¢	30.300¢	(0.70¢)	\$1.671	\$1.658	(\$0.013)
May-19	\$15.81	\$15.70	(\$0.11)	31.900¢	30.475¢	(1.43¢)	\$1.685	\$1.676	(\$0.009)
Jun-19	\$15.99	\$15.85	(\$0.14)	32.200¢	32.200¢	0.00¢	\$1.698	\$1.693	(\$0.005)
12 Mo Avg	FALSE	\$15.34	\$15.34	30.992¢	31.304¢	0.31¢	\$1.638	\$1.633	(\$0.005)

What's Bullish:

- Dairy exports in May were the third highest ever, according to USDEC, with volume up 18% compared to a year ago. Gains were led by WMP up 138% and butterfat up 121%. On a total solids basis, May dairy exports were the equivalent of 17.2% of U.S. milk production during the month.
- Dairy cow slaughter for the week ending 06/30 totaled 57,700 head, up 5.3% vs. the same period a year ago.
- Fluid Milk Northeast: Milk production in the region is declining as the weather rose to hot temperatures, which is affecting cow comfort. Manufacturers are receiving adequate milk volumes, but Class I sales are steady to higher this week coming off the holiday. Mid-Atlantic milk off the farms is also decreasing.
- Fluid Milk Southeast: Milk production is dropping off as the warmer weather affects cow comfort. Bottlers are receiving heavy milk loads for processing needs. Market participants report some manufacturing plants are not receiving any milk, as the majority of loads are clearing into Class I facilities. Florida's temperatures have been hot with thunderstorms in the afternoons. Milk output is decreasing week after week from the aftermath of the heat and humidity.
- Fluid Milk Central: Reports from late last week and early this week have been in stark contrast to much of what has been received this year. Milk supplies are tapering due to region-wide heat and humidity, along with culling and auctioning cows, as small to mid-sized Midwestern farms are amidst an exodus from the industry. This week's component percentages declined across the board. Spot milk loads bought over Class III were reported for the first time since March, and some butter makers opted out of the spot cream market due to increasing cream prices and limited availability. Ice cream production continues at near peak levels.
- Fluid Milk Southwest: In California, milk supplies are reported to be extremely tight in some areas. Recent heatwaves have created an environment uncomfortable for cows. Some buyers noted not being able to get the quantity of milk they need as spot loads of milk are limited in the market. Consequently, milk prices have somewhat increased. In recent weeks a number of dairies in California have closed while a few others have sold out to other dairies. Storms in Arizona have flooded many roads. Increased humidity in the area is also putting more stress on cows. Overall, milk production continues to drop week by week. To help with manufacturing duties, some processors in Arizona are taking in milk from states with higher output levels.
- Butter Northeast: This week, area cream interest is feeling a slight pinch due to lower off-the-farm milk volumes and reductions in butterfat content from the summer heat surge. Subsequently, some butter plants have strayed from churning schedules as cream holdings are adequate only for contractual commitments. Food service interest remains good. Although reports indicate a relaxing of domestic post-holiday demand, wholesale exports are active around the competitive butter price. For some plants, this has led to sharp declines of unsalted butter that is available for exporting.
- Butter Central: Retail butter reports are generally positive, beating summer expectations in some cases. Cream headed for the churning is becoming less available.
- Dry Whey Northeast: Prices in the region increased on the top of the range, as spot sales are trading in the mid to high \$0.30s with some buyers purchasing at premiums for specific loads. The demand is stable and market participants are buying regular loads each week. Moreover, some are sourcing for extra spot loads from manufacturers to handle customers' needs.
- Dry Whey Central: The effects from international trade conflicts have become the new reality for market participants in the dry whey industry. Some contacts relayed that there are talks of sharp discounts with buyers from China in an effort to continue trade relations and maintain market shares. Dry whey supplies are reported to be tighter than would be expected with the market seeing few offers or spare loads.
- Dry Whey West: Prices increased at the bottom of the range and at both ends of the mostly price series. Demand is steady in the domestic market. Producers serving the export market reported good demand from their customers. However, they are still concerned about trade issues that might disrupt the dry whey market activities. Dry whey production is steady, and supplies continue to be tight. Some manufacturers indicate that their holdings are not enough to satisfy all spot requests. Overall, the market undertone is strong.
- Foreign Cheese: Cheese production in the EU remains active. According to market participants, cheese was significantly more produced than other dairy products in early summer. However, cheese supplies are currently lower. Domestic and international demands are both increasing. With the recent trade issues in the U.S., more international buyers are looking for suppliers in the EU cheese market. Overall, the EU cheese market undertone is firm, and prices are higher.
- Cheese Midwest: Demand reports from Midwestern cheesemakers diverge from slow to very busy. Although Western cheesemakers are arguably the most impacted by the recent tariffs, most upper-Midwestern producers have yet to see much impact near term. Milk supplies are lessening. Spot milk premiums were reported for the first time since March. This week's spot range falls between \$.50 over to \$3 under Class III. Cheese producers report large drops in component percentages, as heat and humidity keep cows well outside of their comfort zones.

What's Bearish:

- While May dairy exports were strong, cheese exports were down 15% compared to May 2017. A 16% drop in the value of exports to Mexico may have played a role.
- Weekly cold storage numbers show both cheese and butter stocks at USDA-selected storage centers increased 2% over the period 07/01 through 07/09.
- Fluid Milk Pacific Northwest: Heat is building in the region, with some temperatures inland expected to reach into the triple digits over the next week. However, current production levels are strong, and manufacturers have had no trouble getting the milk needed for processing runs. Furthermore, although cream volumes appear to be tightening, there is still sufficient supplies of cream available for butter and Class II manufacturing. Milk supplies in the mountain states of Idaho, Utah and Colorado are long. Although the recent heat wave in Colorado has suppressed milk production, there is plenty of milk to meet most processing needs. In Idaho and Utah, milk production is still near its zenith for the year.
- Butter West: Manufacturers suggest that while some customers have their near-term butter needs covered, there are others looking for deals. Butter inventories are already adequate for most customer needs, and manufacturers do not want to see them grow much more. Processors are holding back on production, opting instead to sell cream whenever they can. There is still plenty of cream in parts of the West.
- NDM Northeast: Prices moved lower at the top of the range and bottom of the mostly series, with declines in f.o.b. cash market prices and indices adjusting lower. Spot purchases of NDM are intermittent as prices trend lower and track a potential buyers' market. Moderate declines in milk off-the-farm are having little to no impact on nonfat dry milk production rates. The export market is unsettled, as market participants pay close attention to NDM markets south of the border that bear on domestic buying/selling.
- NDM Central: Low/medium heat inventories continue to grow, as some powder dryers in the region have recently converted to solely drying condensed skim near term. The NDM market tone is uncertain, and a number of buyers are stepping back and awaiting the potentiality of heavier supplies remaining in the country.
- NDM West: Prices for low/medium heat NDM are mostly lower on light to moderate trading. The market tone is uncertain as new protectionist international trade policies emerge, especially in China and possibly in Mexico soon. According to some buyers/end users, this week, NDM cash values are more in line with the current large supply available in the market. In fact, although farm milk output is decreasing, NDM production is ongoing in the west region as relatively large condensed skim volumes continue clearing into dryers. At this point, low/medium heat inventories are sufficient to meet both contractual and spot needs.
- Cheese Northeast: Milk production is dropping off as the hotter weather takes hold of cow comfort, but supplies are adequate for processing needs in the area. Cheese plants are running full this week. Retail cheddar demand is fairly stable as the grilling season is here. Mozzarella demand is slower for this time of year. Cheese inventories in the region are stable to growing.
- Cheese West: Cheese production is ongoing and export demand is somewhat slow. Some contacts report that Mexican buyers have started to look for alternative cheese providers in the European market as import tariffs on U.S. cheese have increased. The cheese market undertone is generally unsettled, and inventories are robust. Sellers are concerned as to finding additional sale outlets to prevent a further accrual of inventories.

Recommendation:

Heat has finally rolled into the upper portions of the country and is impacting both milk production and components. It's hard to say what impact that will have in the near term, however, with the current trade war still making the headlines. The August Class III contract finished the week up 15¢, but not without a lot of volatility along the way! The following were the daily gain/loss Mon-Fri: -17, +8, +5, +35, -22. There is still plenty of milk available for processing, but both dry whey and cream appear to be on the tighter side. Dry whey futures were mostly higher this week and could continue to strengthen next week, relative to their discount to spot dry whey, which is back over 40¢/lb. The biggest mover in this week's spot market was the barrel price, somewhat unexpectedly jumping 17¾¢. These has been some news regarding a switch from barrel to block production where possible, so this, along with falling milk output, may be helping push the barrel price upward. Tariffs continue to impact the grains, with soybeans hitting a 10-year low this week. Producers should look at contracting their protein needs around these levels. It's not often you get to lock in near 10-year lows. As more of the news is digested, assuming no major new tariff announcements are imminent, the markets could stabilize and start to retrace some to the upside. Deals are being made between buyers and sellers to "split the cost" of some of the new tariffs. There's no doubt foreign buyers will look to the EU and Oceania to replace some U.S. product, but there will most likely still be much dairy trade that happens with the U.S., in spite of them. Dairy exports in May were very strong, and we would expect those levels to drop as the tariffs are implemented, but maybe not to the extent some believe. Time will tell. In the meantime, increased culling and farm liquidation is ongoing, unfortunately. At some point, supply and demand will become rebalanced. We think it could happen as soon as the 4th quarter. We wouldn't aggressively sell 2019 and would continue to protect nearby months with PUT options.

This material has been prepared by a sales or trading employee or agent of KDM Trading, Inc. and is, or is in the nature of, a solicitation. This material is not a research report prepared by R.J. O'Brien's Research Department. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that KDM Trading, Inc. believes are reliable. We do not guarantee that such information is accurate or complete and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades. © Copyright 2018 - KDM Trading, Inc. All Rights Reserved