

The KDM Dairy Report – July 20th, 2018

SPOT MARKET	7/13	7/20	Change	Trades
Cheddar Blocks	\$1.5600	\$1.5200	(\$0.0400)	7
Cheddar Barrels	\$1.4225	\$1.2700	(\$0.1525)	41
Butter	\$2.2250	\$2.2500	\$0.0250	8
Grade A NDM	\$0.7550	\$0.7850	\$0.0300	13
Dry Whey	\$0.4175	\$0.4200	\$0.0025	0

Futures Month	Class III 07/13	Class III 07/20	Change	Dry Whey 07/20	Dry Whey 07/20	Change	Cheese 07/13	Cheese 07/20	Change
Jul-18	\$14.27	\$14.19	(\$0.08)	33.475¢	34.000¢	0.52¢	\$1.506	\$1.495	(\$0.011)
Aug-18	\$14.84	\$14.61	(\$0.23)	32.500¢	35.775¢	3.28¢	\$1.574	\$1.534	(\$0.040)
Sep-18	\$15.26	\$15.42	\$0.16	32.400¢	35.775¢	3.38¢	\$1.617	\$1.614	(\$0.003)
Oct-18	\$15.49	\$15.87	\$0.38	31.500¢	35.025¢	3.53¢	\$1.643	\$1.661	\$0.018
Nov-18	\$15.51	\$15.96	\$0.45	31.000¢	34.700¢	3.70¢	\$1.651	\$1.669	\$0.018
Dec-18	\$15.49	\$15.86	\$0.37	31.450¢	34.225¢	2.78¢	\$1.643	\$1.659	\$0.016
Jan-19	\$15.40	\$15.68	\$0.28	30.325¢	33.200¢	2.88¢	\$1.641	\$1.646	\$0.005
Feb-19	\$15.34	\$15.56	\$0.22	30.025¢	33.300¢	3.28¢	\$1.642	\$1.642	\$0.000
Mar-19	\$15.38	\$15.48	\$0.10	30.000¢	32.900¢	2.90¢	\$1.648	\$1.640	(\$0.008)
Apr-19	\$15.55	\$15.67	\$0.12	30.300¢	32.700¢	2.40¢	\$1.658	\$1.655	(\$0.003)
May-19	\$15.70	\$15.71	\$0.01	30.475¢	32.425¢	1.95¢	\$1.676	\$1.668	(\$0.008)
Jun-19	\$15.85	\$15.91	\$0.06	32.200¢	32.425¢	0.22¢	\$1.693	\$1.687	(\$0.006)
12 Mo Avg	FALSE	\$15.49	\$15.49	31.304¢	33.871¢	2.57¢	\$1.633	\$1.631	(\$0.002)

What's Bullish:

- Dairy cow slaughter for the week ending 07/07 totaled 47,100 head, up 6.8% vs. the same period a year ago.
- Livestock Slaughter Report: 237,500 dairy cows were removed from the milking herd in June, up just 0.34% vs. a year ago, but the highest June total since 2009.
- Fluid Milk Northeast: Milk volumes off the farms are lower. Overall, the humidity has taken ahold of milk production and volumes have decreased. Processors report having a better balance with milk and processing needs. Class I sales are lower in the Northeast, however Class II and III had an uptick in sales. Mid-Atlantic milk output is lower currently. Balancing operations are receiving mixed milk volumes, as some facilities are below full capacity. Some milk is moving into other parts of the region for production demands.
- Fluid Milk Southeast: Milk production decreased this week due to hot temperatures. Bottlers are clearing heavy milk volumes. In addition, with lower milk production, bottlers are taking on extra milk loads as the components in milk are lower. Florida's heat index has been over 100 degrees currently and taking a toll on cow comfort. Milk output has dropped this week. Some market participants report Class I sales had a slight uptick as bottlers requested more milk loads for their production needs. Cream demand is strong, as market participants are willing to purchase to fulfill production needs. Current cream loads are steady to short as milk production is down and the fat components are less. Condensed skim conditions have strengthened compared to past months as milk production is lower and fewer loads are leaving the East. The demand has picked up and some market participants report no discounts are being offered.
- Fluid Milk Central: Recent heatwaves throughout the Midwest and South Central have substantially syphoned milk production within the region. Bottled milk demand remains fairly flat. However, bottlers are preparing for a busier time near term as some schools will reopen within a month, particularly in the southern area of the region. South Central production/components are taking a thumping, as temperatures regularly hit 100 degrees plus. Cheesemakers have reported calling for milk, as opposed to the recent norm of receiving calls. Most Class III spot milk prices ranged from \$.50 under to \$1.00 over Class. Cream prices are on the rise, as ice cream manufacturers remain in the mix.
- Fluid Milk Southwest: The recent heat wave is impacting California milk production. After several weeks of warm temperatures, industry contacts suggest milk intakes are in good balance with processing needs. Milk handlers say they may need to reach out further into the Western region to cover all requests from processors. Weather forecasters predict warm temperatures to remain for at least the next ten days. Arizona milk production continues to drop due to heat and monsoonal activity. Industry contacts say milk intakes are down compared to last month. Contacts expect more rains and high temps to continue into the weekend and beyond. Milk production in New Mexico edged slightly lower.
- Butter Northeast: Tight cream supplies are forcing butter manufacturers to compete with ice cream needs. Processors seeking additional loads of cream, in spot markets, are discovering that multiple loads are very limited to butter plants. Butter supplies remain adequate for filling near term customer commitments, but food service and retail sectors continue to see well represented volumes exchanging hands. Meanwhile, some private label brands are aggressively pursuing their butter needs.
- Butter Central: Cream in butter churns is becoming a rarity this week. As cream prices continue their upward climb, butter churners are taking a step back from the market. Some butter producers are returning cream to the spot market in lieu of churning. Hence, production schedules are limited.
- Dry Whey Northeast: Prices moved higher on both sides of the range, because of buyers purchasing spot loads at premiums along with manufacturers not offering loads at a discount this week. Inventories are balanced to limited, and market participants are actively receiving their regular contracts. In addition, many individuals are searching to obtain extra spots and are willing to buy at high prices. Interest is currently healthy and market participants report not hearing any pushback about firming prices. Despite concern over trade policies in some international markets, the undertone is stable and market participants are looking towards the future to create new opportunities with international trading partners.
- Dry Whey Central: Heat and humidity across the Midwest are giving producers difficulties drying whey, making the process slower. In addition, stunted milk supply from the heat has slowed down cheese production. As a result, manufacturers are finding it hard to fulfill contractual needs, and all the while spot orders continue to come in. Whey demand is strong due to tight inventories. Some exporters continue moving dry whey into China despite the 25% tariff increase, with both parties splitting additional costs.
- Dry Whey West: Prices moved higher at the bottom of the range and at both ends of the mostly price series. Some industry contacts say they are having trouble selling whey, not because of demand, but because they are having trouble getting enough whey to meet customer needs. Currently, demand has outpaced production.
- Cheese Northeast: Milk output is seasonally lower as the humidity decreases cow comfort, but many cheese plants are clearing milk supplies near to capacity for processing needs. Provolone and cheddar cheese orders are steady to slightly picking up as market participants report customer demand is marginally increasing after much trade concern. Mozzarella demand is currently slow, but cheese makers report orders will increase

once educational institutions are back in session. Overall cheese inventories are long, yet with lower milk production, a few reports suggest fresh cheese supplies are shorter.

- Foreign Cheese: EU cheese processing is strong, as additional milk volumes are clearing into cheese vats. However, many international buyers are actively sourcing from EU cheese suppliers. With EU cheese demand growing, supplies are steady to limited. Also, some inventories are not able to meet added requests. EU market conditions are stable, as prices are firm and export demand is strengthening.
- Cheese Midwest: Some barrel producers report slow sales this summer, but a number of other varietal cheesemakers are seeing steady to increasing sales as the summer progresses. Spot milk prices are mostly up. Cheese production varies by plant, but a growing number of cheesemakers are allotting days off as milk becomes less available.
- CWT member cooperatives accepted offers of export assistance to sell 3.949 million lbs of Cheddar and Monterey Jack cheese, 578,714 lbs of butter and 4.233 million lbs of whole milk powder going to customers in Asia, the Middle East, North Africa and Oceania. The product has been contracted for delivery in the period from July through December 2018.

What's Bearish:

- Milk Production Report: Output in June in the U.S. was 1.2% higher than a year ago while the herd size was flat. Cow numbers were also unchanged from May, but neither did they decline! Milk per cow jumped 23 lbs to 1,943. Gains were led by CO up 10.7%, KS up 7.4% and TX up 6.6%.
- Weekly cold storage numbers show both cheese and butter stocks at USDA-selected storage centers increased 2% over the period 07/01 through 07/16.
- This week's GDT auction saw the dairy price index decline 1.7%. It was the fourth consecutive loss, with 9 of the most recent 11 auctions also showing declines.
- Fluid Milk Pacific Northwest: Milk production is steady to lower, but manufacturers report plenty of milk is available for processing and discounted milk can still be found. In the mountain states of Idaho, Utah and Colorado, milk production is still heavy and excess milk is flowing into surrounding states, albeit not at the volumes seen just a few weeks ago. Summer heat is starting to suppress milk production as parts of the region recede from the peak of milk production, but manufacturers say there is still plenty of milk for most processing needs.
- Butter West: Stocks are heavy, and some butter makers are more than happy to sell off excess cream rather than churn. Butter inventories have grown seasonally to the point of meeting most near-term butter needs. Industry contacts say that heat and summer vacations are cutting into retail sales, but that food service demand is strong. Some processors report sales into international markets have become more difficult as the gap between domestic butter prices and international prices have shrunk.
- Cheese West: Cheese makers report domestic demand has been lackluster and disappointing. And while export cheese demand has been stable, issues with our largest trading partners have battered U.S. cheese sales. Furthermore, other countries are entering into trade agreements that vouchsafe open market access to competitors. The scenario is disconcerting to U.S. manufacturers who also see large volumes of cheese stockpiled in U.S. warehouses. Some buyers say they get regular offers from processors but are not eager to hold more cheese than their immediate needs dictate. Despite milk intakes tightening, manufacturers have plenty of milk to feed an already active cheese production system.
- International: EU dairy officials expect milk production to increase overall for 2018 by about 1.2%. Production increases are expected to reflect very positive growth in Germany, Poland, Belgium and Italy. Cheese continues to be a very positive aspect of EU dairy processing. Returns are drawing milk to cheese plants. Observers expect overall EU cheese production to increase near 2% in 2018. While competition to increase export sales is more challenging, there is general confidence that current export dominance can be maintained and somewhat increase.

Recommendation:

Continued heat and the possibility of a trade resolution with Mexico were enough to support all but the front months in Class III this week. It's summer, so it's not surprising that milk is getting tighter and components are dropping. But we are hearing that buyers and sellers to countries in the trade war with the U.S., are working together and "splitting the difference", as we mentioned as week. With the tightening milk supply, cream is tightening as well. Butter, dry whey and NDM all finished higher in this week's spot market. Cheese, on the other hand, continued to sag, with the block-barrel spread widening once again. The 25-cent spread was most obtained by a big drop in the barrel price. With fresh cheese getting a bit snug, we don't expect block prices to drop much more, so until the barrel oversupply situation is fixed, we may just sit for awhile at this large spread. With double-digit gains for the week in the Sep-Apr contracts, a bottom could be forming as we head in to demand season. Schools in the southern regions will open soon, meaning fluid milk pipelines will need to be filled. And the start of college/pro football marks the beginning of pizza season. Producers with milk sold in these months should get more aggressive in buying some upside coverage to open up their contracts. Consider the Sep-Nov 16.50 call option at an average of 27¢ each as a place to get started.

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