

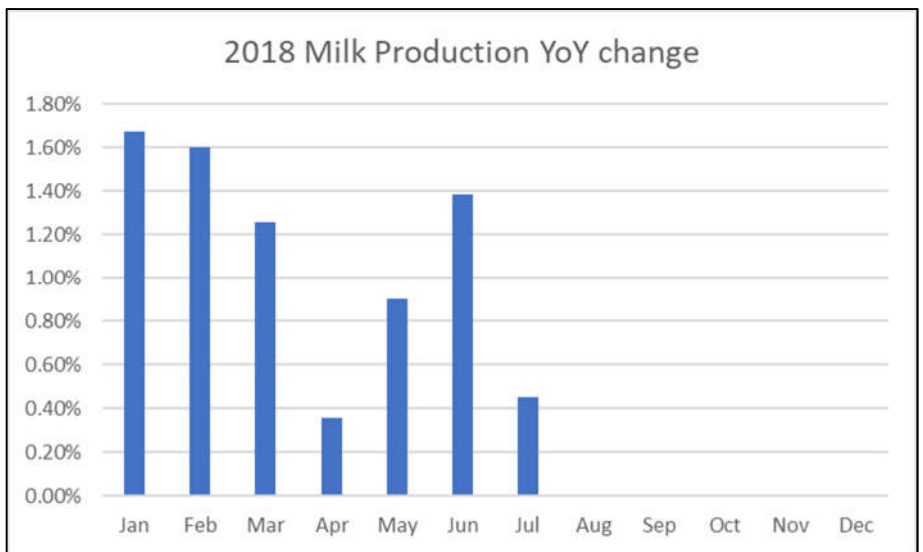
The KDM Dairy Report – August 24th, 2018

SPOT MARKET	8/17	8/24	Change	Trades
Cheddar Blocks	\$1.6550	\$1.6700	\$0.0150	12
Cheddar Barrels	\$1.6700	\$1.6000	(\$0.0700)	44
Butter	\$2.3050	\$2.2600	(\$0.0450)	13
Grade A NDM	\$0.8625	\$0.8700	\$0.0075	34
Dry Whey	\$0.4450	\$0.4800	\$0.0350	2

Futures Month	Class III 08/17	Class III 08/24	Change	Dry Whey	Dry Whey 08/24	Change	Cheese 08/17	Cheese 08/24	Change
Aug-18	\$15.01	\$15.03	\$0.02	36.200c	36.800c	0.60c	\$1.564	\$1.559	(\$0.005)
Sep-18	\$15.81	\$16.21	\$0.40	38.000c	40.225c	2.23c	\$1.637	\$1.665	\$0.028
Oct-18	\$16.02	\$16.34	\$0.32	38.750c	41.500c	2.75c	\$1.658	\$1.672	\$0.014
Nov-18	\$16.02	\$16.35	\$0.33	38.500c	41.400c	2.90c	\$1.656	\$1.676	\$0.020
Dec-18	\$15.92	\$16.19	\$0.27	38.150c	41.425c	3.28c	\$1.647	\$1.660	\$0.013
Jan-19	\$15.76	\$15.96	\$0.20	38.000c	40.025c	2.03c	\$1.634	\$1.639	\$0.005
Feb-19	\$15.69	\$15.82	\$0.13	37.300c	39.750c	2.45c	\$1.627	\$1.630	\$0.003
Mar-19	\$15.68	\$15.83	\$0.15	37.025c	38.975c	1.95c	\$1.630	\$1.630	\$0.000
Apr-19	\$15.85	\$15.95	\$0.10	36.950c	39.250c	2.30c	\$1.633	\$1.646	\$0.013
May-19	\$15.94	\$16.03	\$0.09	37.750c	39.050c	1.30c	\$1.656	\$1.657	\$0.001
Jun-19	\$16.06	\$16.09	\$0.03	38.000c	39.050c	1.05c	\$1.667	\$1.662	(\$0.005)
Jul-19	\$16.15	\$16.19	\$0.04	36.600c	39.100c	2.50c	\$1.681	\$1.681	\$0.000
12 Mo Avg	FALSE	\$16.00	\$16.00	37.602c	39.713c	2.11c	\$1.641	\$1.648	\$0.007

What's Bullish:

- Dairy cow slaughter for the week ending 08/11 totaled 60,900 head, up 6.3% vs. the same period a year ago.
- Livestock Slaughter Report: 239,600 dairy cows were removed from the milking herd in July, up 6.1% vs. a year ago, and the highest July total since 2013.
- Milk Production Report: U.S. milk output in July was up just 0.4% (see graph), coming in under most analyst expectations. In addition, cow numbers declined 8,000 head from the prior month, putting the herd at its lowest level since Oct.
- Fluid Milk Northeast: Milk production is level to lower as the humid and rainy weather is taking a toll of cow comfort. Class I sales are steady to higher as bottlers are pulling milk to fill schools' needs before the new school year. Mid-Atlantic milk production is fairly lower. Some operations are not receiving enough milk for full production as Class I is taking the majority for schools' pipelines.
- Fluid Milk Southeast: Milk off the farms is still dropping. Bottlers are receiving heavy milk loads for schools' needs. In addition, some manufacturers purchased extra milk loads from other regions to fill current needs. Florida's milk production is leveling off as the hot temperatures and heavy rainfall affect cow comfort. Class I sales are higher as schools have been filling pipelines.
- Fluid Milk Central: Fluid milk supply reports vary from tight to balanced in the upper Midwest. Bottling facility intake increases, primarily due to schools, are creating a ripple effect on intake facilities outside of bottling. Cheesemakers are reporting the amount of spot load offers are diminishing compared to recent weeks.
- Butter Northeast: Lower milk yields and cream prices that prompt sales above churning still limit overall production rates in the Northeast. To satisfy rather steady market demand, some butter plants are meeting customers' needs while fusing light churning and micro-fixing activities. Labor Day needs are tracking to pick up and buyers are searching the market for Q4 butter acquisitions.
- Dry Whey Northeast: Prices moved up on both ends of the series this week, as market participants are purchasing at increased prices. In the region, supplies are overall tight, and some manufacturers are not offering additional spot loads to buyers. Northeastern dairy contacts report sourcing for dry whey in the Midwest. Additionally, some Northeastern buyers are purchasing from resellers in other regions to meet their current needs. Dry whey demand is strong as buyers are purchasing regular spot loads with little to no pushback on pricing. The market undertone is firm.
- Dry Whey Central: Prices shifted up on the bottom of the mostly price series and top of the range. Contacts are confident in the near-term market tone. Supplies are tight, while a number of contacts are suggesting the recent recall in the upper Midwest has reduced availability regionally and has sent up an alert to buyers/end users. The market tone is steady to bullish.
- Dry Whey West: Prices for dry whey inched up. According to some market participants, the whey market is somewhat tight worldwide, compelling some buyers to settle for higher prices in order to fulfill their immediate needs. Domestic and international requests are both solid. Sellers say that they are receiving a lot of inquiries for dry whey in the spot market. Some of those requests cannot be promptly met due to limited spot load accessibility. The baking sector orders are also picking up. Some purchasers/end-users are looking to lock in Q4 2018 and Q1 2019 contracts to safeguard dry whey coverages for future usages.
- NDM Northeast: Prices adjusted higher based on active cash trading and index pricing. An unexpected increase in demand from a foreign buyer, Mexico, heightened interest in the domestic marketplace as well, driving the current price jump. Dryer schedules are still active, but runs are well below capacity at some plants, as milk clearing into the South meets challenges due to the level of trucker availability.
- NDM Central: Prices increased on a busy trading week. Contacts point out that domestic low/medium heat NDM is a value when compared to global skim milk powder prices, and a heavier amount of shipments have headed into Mexico recently. Although spot trades have not reached this level, there are \$.90 offers being reported. Currently, market sentiment is bullish.



- NDM West: Compared to the previous week, the market tone seems to be firming as spot prices inch up. As reported by some NDM processors, the market is strengthening due to seasonally lower farm milk production and stable interest from customers. In other words, the current NDM availability is below the existing steady demand from buyers/end users. A good part of NDM supplies is committed thru future contracts for the rest of the year and the first quarter of 2019. Having said this, trading activity in the cash market is light to moderate as NDM supplies are becoming tight. Meanwhile, requests from Mexico are strong as farm milk output is down in that country, while most schools are filling pipelines. Back to the U.S., the domestic interest from the bakery industry is good as the fall/winter baking season approaches. Drying schedules for condensed skim milk are considerably lower compared to the past spring flush season.
- Cheese Northeast: Cheese plants are receiving steady milk loads this week for full cheese production. However, mozzarella cheese production has increased as the demand from schools is higher. Cheese inventories are fairly stable as restaurants' orders are solid. In addition, there are reports of increased domestic demand and improving export cheese sales. Market conditions are fairly firm, as food service demand has picked up and market participants are gearing up for the Labor Day holiday.
- Foreign Cheese: Cheese output in the EU continues to be flat to declining due to lower milk supply availability. In Germany, France, and the United Kingdom, the three principal milk producing countries of the EU, milk production has decreased by 1% according to the latest weekly data. Cheese prices stand still at a higher level. Cheese stocks are unchanged from a week ago. Sales are solid. Overall, the cheese market tone is firm.
- Cheese Midwest: Mozzarella, provolone, and curd orders have been strong or strengthening, while cheddar/specialty producers have seen slowdowns. This week, however, orders are steady to stronger across the board. Pizza cheesemakers are citing new and returning college students as a primary factor in their continued demand upticks, not to mention an overall bump in dining out activity. Some specialty cheesemakers are beginning to ramp up production ahead of the holiday season. Cheese market tones are mostly bullish.
- CWT accepted offers of export assistance to sell 101,413 lbs of Cheddar and Monterey Jack cheeses, 220,462 lbs of butter, and 211,644 lbs of whole milk powder. The product has been contracted for delivery in Asia, South America and the Middle East from August-December 2018.

What's Bearish:

- Cold Storage Report: Butter and cheese stocks in cold storage at the end of July both increased 3% YoY.
- This week's GDT auction saw the price index decline 3.6%, led by butter (-8.5%) and AMF (-6.9%). Cheddar cheese fell 4.7% to a U.S. equivalent \$1.58/lb.
- Fluid Milk Southwest: Milk production in California has increased more than expected in recent weeks. Although educational institutions continue to pull in more loads of milk, milk supplies are sufficient for the usages of all market participants. Processing capacities are adequate, and manufacturing plants are running somewhat below full capacity. Although milk components are still low, they have improved from a few weeks ago.
- Fluid Milk Pacific Northwest: Milk yield continues to be solid, but manufacturers don't have any issues managing the volume of milk available to them. Schools' demand for milk has augmented in the past two weeks as they fill their pipelines. Overall, milk supplies are in good balance with sales. In the mountain states of Idaho, Utah, and Colorado, milk supplies persist on being long.
- Butter Central: Churn activity is increasing this week. Cream prices are in a fairly sharp downturn, as school bottling has put more milkfat back on the market. Retail sales remain healthy according to contacts, while bulk butter is reportedly widely available.
- Butter West: The butter market has been showing a weaker price trend in recent days. Buyers seem to have their needs satisfied for the current term. Most contractual loads are moving as planned. Butter output is steady to slightly increasing because cream stocks are loosening more.
- Cheese West: Cheese sales appear mixed with some buyers reporting steady orders while others say that requests are seasonally up. Barrel cheese demand seems to be more active than block cheese. Cheese orders from the food service sector have somewhat augmented as pizza processing is taking more cheese than usual. Stocks remain profuse for many varieties of cheese. Cheese marketers continue to report that U.S. cheese is facing strong competition in international markets.

Recommendation:

Block cheese put in its highest price since May, while cow numbers in the U.S. declined to their lowest level in 9 months. Many schools are open or will be shortly, so the amount of milk available for manufacturing is on the decline. Meanwhile, cheese operations are reporting a noticeable increase in orders for mozzarella and other pizza cheeses. On Monday, details of the \$12 billion farm bailout will be revealed, including how much will be allocated towards dairy and in what form (direct payments to farms, surplus product purchases, etc.). But it was Monday's Milk Production Report that really set the tone for the week. Output came in below expectations while we saw a significant month-to-month drop in cow numbers. Is this the beginning of a trend? All eyes will be on next month's report to see if the trend accelerates or this was an anomaly. Solid slaughter numbers reported later in the week helped put Class III futures in the green to stay. Producers should be wary over how high the market may go from here. We still have record cheese stocks in storage. Demand and exports are going to need to pick up even more for prices to head a whole lot higher. As we recommended in prior weeks, perhaps futures prices in the upper \$16's, representing \$1.70+ cheese, should be sold in Q4. That would necessitate another 50+ cents to the upside from today's settlement. Producers who purchased call options while prices were lower should get sell orders in place. The first half of 2019 settled at a \$15.94 average today. We still think that is too low, based on current fundamentals and cost of production. We would hold off selling any milk at that level. Finally, dry whey is tight and heading higher. This could play a role in lifting Class III prices going forward, as each penny move equates to 6 cents in the Class III formula. Even a nickel higher move by Oct/Nov would add 30 cents to Class III. Dry whey futures made a solid move higher this week as well. Next week will be key to see if this rally continues to run or fizzles out. Have a great weekend!

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