

The KDM Dairy Report – October 12th, 2018

SPOT MARKET	10/12	10/19	Change	Trades
Cheddar Blocks	\$1.6100	\$1.4975	(\$0.1125)	17
Cheddar Barrels	\$1.3600	\$1.2675	(\$0.0925)	34
Butter	\$2.2500	\$2.2600	\$0.0100	42
Grade A NDM	\$0.8675	\$0.8725	\$0.0050	7
Dry Whey	\$0.5625	\$0.5750	\$0.0125	2

Futures Month	Class III 10/12	Class III 10/19	Change	Dry Whey 10/19	Dry Whey 10/19	Change	Cheese 10/12	Cheese 10/19	Change
Oct-18	\$15.61	\$15.55	(\$0.06)	44.025c	44.000c	(0.02c)	\$1.580	\$1.574	(\$0.006)
Nov-18	\$15.76	\$15.53	(\$0.23)	45.650c	47.475c	1.83c	\$1.582	\$1.549	(\$0.033)
Dec-18	\$15.80	\$15.51	(\$0.29)	46.150c	48.225c	2.08c	\$1.585	\$1.542	(\$0.043)
Jan-19	\$15.76	\$15.42	(\$0.34)	44.800c	46.300c	1.50c	\$1.595	\$1.550	(\$0.045)
Feb-19	\$15.75	\$15.49	(\$0.26)	42.550c	44.325c	1.78c	\$1.610	\$1.570	(\$0.040)
Mar-19	\$15.84	\$15.66	(\$0.18)	40.200c	42.500c	2.30c	\$1.629	\$1.595	(\$0.034)
Apr-19	\$16.00	\$15.87	(\$0.13)	38.850c	40.700c	1.85c	\$1.650	\$1.628	(\$0.022)
May-19	\$16.00	\$15.96	(\$0.04)	37.675c	38.950c	1.28c	\$1.660	\$1.646	(\$0.014)
Jun-19	\$16.05	\$16.02	(\$0.03)	37.300c	37.775c	0.48c	\$1.670	\$1.661	(\$0.009)
Jul-19	\$16.21	\$16.22	\$0.01	36.975c	37.400c	0.42c	\$1.690	\$1.685	(\$0.005)
Aug-19	\$16.40	\$16.40	\$0.00	37.250c	37.275c	0.02c	\$1.705	\$1.708	\$0.003
Sep-19	\$16.55	\$16.59	\$0.04	37.225c	36.775c	(0.45c)	\$1.720	\$1.725	\$0.005
12 Mo Avg	\$15.98	\$15.85	(\$0.13)	40.721c	41.808c	1.09c	\$1.640	\$1.619	(\$0.020)

What's Bullish:

- Milk Production Report: USDA revised cow numbers significantly lower going all the back to June. The July number dropped by 17,000 head, with a 21,000 head revision lower for Aug. The milking herd at the end of Sep declined another 12,000 head from Aug, to 9.367 million head, putting it down 32,000 head vs. last Sep, and the lowest it's been since Feb 2017. Milk per cow, however, increased 30 lbs, leaving Sep milk production up 1.3% vs. a year ago. Both cow numbers and total milk production were below most analyst expectations.
- Dairy cow slaughter for the week ending 10/06 totaled 63,900 head, up 1.9% vs. the same period a year ago.
- Cheese stocks at USDA-selected storage centers declined 2% (1.6 million lbs) over the period 10/01 through 10/15.
- Fluid Milk Northeast: Milk production is level in the NE and down slightly in the Mid-Atlantic. Market participants report there is a little less available milk as Class I sales are stable. Balancing operations are receiving steady to limited milk volumes. Also, manufacturers report balancing plants are not running at capacity.
- Fluid Milk Southeast: Market participants report being short on milk as Hurricane Michael caused major damage to areas in the region. There are reports of milk being transported from other regions to cover immediate needs and as trucking availability allows. Class I sales are good as bottlers continue to request more orders. There is little to no milk in Southeast manufacturing at this time. Hurricane Michael negatively impacted Florida's panhandle and the producers in the area. Class I sales are strong, and market participants comment they do not anticipate sales moving lower anytime soon. Cream is tight.
- Fluid Milk Central: Milk shortages continue for dairy processors. Loads of milk, when trucks are available, are headed southeast into Class I production, particularly areas affected by recent hurricanes. Milk handlers also report taking calls from customers new to them, or buyers who have not sought extra milk in recent months or even years. Several Midwestern cheese producers are using internally sourced milk and report avoiding the current spot market altogether, as offers are exclusively at premiums. Reported prices were \$.50 over on the bottom and remained \$2 over Class III on the top end. However, contacts relay offers were even higher as milk is in such demand currently. Cream cheese makers continue to insert themselves in the cream tightness narrative.
- Butter: Q4 holiday orders have begun. Industry contacts note butter interest has strengthened. Strong retail orders are reducing inventories as expected.
- Dry Whey Northeast: Prices moved up on the bottom half of the price range this week. The majority of sales are clearing around the mid to high .40s due to contracted prices. Market conditions continue to be firm in the region as demand is outweighing supplies.
- Dry Whey Central: Production levels are keeping contractual needs met, but milk availability has yet to increase enough for several producers to dry additional spot loads. Brokers who buy and sell throughout the whey complex suggest higher protein blends, such as WPC 80%, are following in dry whey's wake and prices have firmed on those varieties noticeably in recent weeks. Availabilities throughout the whey complex are reported as tight. Whey market tones are bullish.
- Dry Whey West: Prices for dry whey are higher on the range and the mostly price series. Dry whey production is ongoing, following strong cheese output levels. Inventories of dry whey are tight as shown by limited spot load availability. The dry whey market tone remains strong.
- NDM Northeast: Production schedules are steady to lower at this time, as balancing operations' milk supplies are lower. Low/medium heat NDM inventories are stable to decreased as customers are working through contracted orders. Some manufacturers do not have available loads to offer on the spot market.
- NDM Central: As more milk heads to bottling and/or out of the region and dryers take on more buttermilk, there is a chance for some near-term scantiness regarding low/medium heat NDM supplies. Some producers have already relayed limited to no spot availability.
- NDM West: New trade agreements are being made between the U.S., Mexico and Canada, which in turn are mitigating the uncertainty of several participants in the domestic/international NDM market. Consequently, NDM/SMP exports to Mexico are inching up and are expected to continue growing for the rest of Q4. Back to western U.S., some NDM customers want to settle Q1 2019 contracts as soon as possible in anticipation of prices going higher during the first quarter of 2019.
- Cheese Northeast: Cheese makers report milk availability has been tighter this past month. Cheese inventories are steady to lower at this time, and some market participants would like to build up supplies. Mozzarella and provolone cheese domestic demand is stable and cheddar cheese domestic interest is fair.
- Cheese Midwest: Italian and American style cheese producers are facing demand upticks at a time when spot milk prices are solely at a premium. Reported spot milk prices ranged from \$.50 to \$2.00 over Class III. Thus, cheese producers have relayed nonfat fortifying is at its peak. Some Midwestern cheesemakers report their nonfat stocks are down to a bare minimum. Barrel producers, particularly those in isolated areas, who are

in search of spot milk are unable to take on loads at the premiums offered. Production in some plants has shifted away from barrels. Some cheese contacts foresee an uptick in barrel market prices this fall.

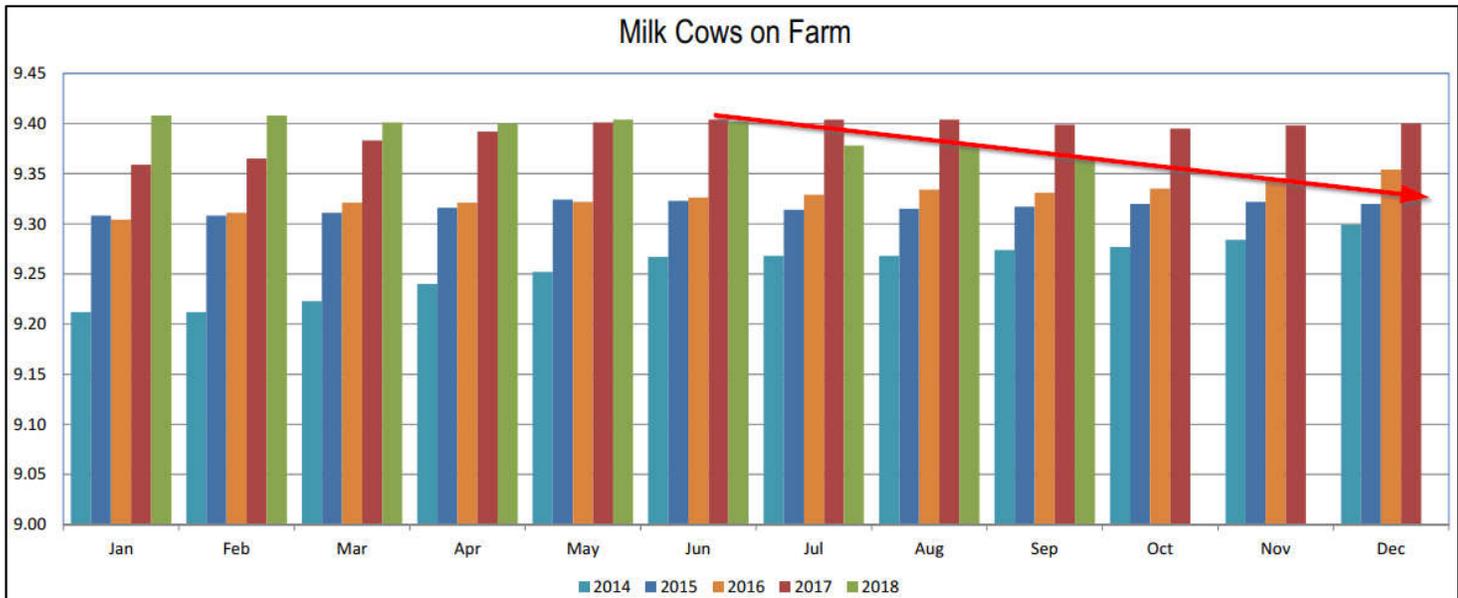
- Foreign Cheese: In Germany, the supplies of cheese are currently balanced to lower. There are some concerns that cheese provisions might not be enough in the coming weeks as cheese demand is expected to increase during the fall festivities while the future growth of cheese production is unpredictable.
- CWT accepted nine offers of export assistance to sell 1.448 million lbs of Cheddar cheese, contracted for delivery in Asia, the Middle East and North Africa for the period from November 2018 through March 2019.
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What's Bearish:

- Fluid Milk Southwest: Milk output in California is holding steady with recent weeks. Component recovery is ahead of milk volumes, giving a slight bump to butterfat and protein-based products processing. Milk supplies are enough to meet all processing requirements. Arizona farm milk production levels are gradually increasing, reflective of better weather conditions for milk cows across the state. Processing plants have sufficient capacity to handle all the milk supplies they are receiving. In New Mexico, milk production is steady to slightly up. Demand for Class III milk has noticeably increased this week. Class II usage is trending up whereas Class I intakes are down.
- Fluid Milk Pacific Northwest: Current weather patterns are comfortable for cows. Intakes and needs are balanced, as there continues to be a steady pull from bottling and dairy product manufacturing. Industry contacts say there is plenty of milk to satisfy all takers. Milk production in the mountain states of Idaho, Utah and Colorado is up a bit this week. Cow friendly fall weather is keeping milk output strong. Industry contacts also say some farms have added cows.
- Cheese West: Manufacturing schedules are active because of higher milk availability. Class III processing plants are running at or close to full capacities despite solid milk intakes from other Classes of milk. Retail and food service sales of cheese have declined slightly, but are still at a good level. The supplies of cheese vary depending on the types of cheese. Currently, barrel inventories are higher than block inventories. According to a few industry contacts, this is so because some processors are producing more domestic barrel cheese to compensate for weaker export sales.

Recommendation:

Sellers in the spot market continued to impose their will as both blocks and barrels finished the week lower. With mostly favorable reports on both cheese demand and a tighter milk supply, it's hard to know where it's all coming from, but it doesn't seem to matter as blocks dropped to a low not seen since June, and barrels fell below \$1.30/lb. Word we're hearing is that most of the barrel excess is out West, where milk is more plentiful. Today's Milk Production Report may not impact the front months much, but should be interpreted as supportive further out. USDA's cow number revisions were substantial. Presumably Oct numbers were be lower as well, if not even accelerating due to the lower milk prices ahead of us. Should the trend continue (see graph), we may finally see the milk supply drop enough to rally the 2019 Class III contracts. Producers who have hedge 2019 milk should purchase upside risk protection in the form of call options, as there seems to be more upside risk than downside going forward. Have a great weekend!



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