

**The KDM Dairy Report – December 21<sup>st</sup>, 2018**

SPOT MARKET	12/14	12/21	Change	Trades
Cheddar Blocks	\$1.4075	\$1.3900	(\$0.0175)	0
Cheddar Barrels	\$1.3100	\$1.2950	(\$0.0150)	4
Butter	\$2.1900	\$2.2050	\$0.0150	15
Grade A NDM	\$0.9400	\$0.9400	\$0.0000	3
Dry Whey	\$0.4500	\$0.4900	\$0.0400	1

Futures Month	Class III 12/14	Class III 12/21	Change	Dry Whey	Dry Whey 12/21	Change	Cheese 12/14	Cheese 12/21	Change
Dec-18	\$13.80	\$13.84	\$0.04	46.825c	46.725c	(0.10c)	\$1.377	\$1.381	\$0.004
Jan-19	\$14.22	\$14.28	\$0.06	46.250c	47.100c	0.85c	\$1.425	\$1.427	\$0.002
Feb-19	\$14.65	\$14.50	(\$0.15)	44.775c	45.925c	1.15c	\$1.477	\$1.454	(\$0.023)
Mar-19	\$15.06	\$14.87	(\$0.19)	43.000c	44.800c	1.80c	\$1.534	\$1.500	(\$0.034)
Apr-19	\$15.52	\$15.41	(\$0.11)	41.425c	44.500c	3.08c	\$1.584	\$1.555	(\$0.029)
May-19	\$15.75	\$15.79	\$0.04	40.525c	43.500c	2.98c	\$1.617	\$1.602	(\$0.015)
Jun-19	\$15.95	\$16.04	\$0.09	40.850c	42.500c	1.65c	\$1.639	\$1.631	(\$0.008)
Jul-19	\$16.25	\$16.34	\$0.09	40.950c	42.500c	1.55c	\$1.670	\$1.659	(\$0.011)
Aug-19	\$16.47	\$16.53	\$0.06	40.275c	42.250c	1.98c	\$1.693	\$1.683	(\$0.010)
Sep-19	\$16.67	\$16.66	(\$0.01)	40.025c	41.500c	1.48c	\$1.710	\$1.700	(\$0.010)
Oct-19	\$16.54	\$16.58	\$0.04	40.000c	40.750c	0.75c	\$1.703	\$1.700	(\$0.003)
Nov-19	\$16.43	\$16.50	\$0.07	40.000c	40.750c	0.75c	\$1.697	\$1.693	(\$0.004)
<b>12 Mo Avg</b>	<b>\$15.61</b>	<b>\$15.61</b>	<b>\$0.00</b>	<b>42.075c</b>	<b>43.567c</b>	<b>1.49c</b>	<b>\$1.594</b>	<b>\$1.582</b>	<b>(\$0.012)</b>

**What's Bullish:**

- Livestock Slaughter Report: 268,000 dairy cows were removed from the milking herd in November, up a strong 9.8% from a year ago, and the highest Nov total since 2012.
- Cold Storage Report: Strong drawdowns in both butter and cheese stocks were seen from Oct to Nov. Butter holdings at the end of Nov declined a whopping 77 million lbs, leaving stocks down 3% vs. a year ago, and down 33% from Oct. Cheese stocks are still huge, up 7% vs a year ago, but holdings were trimmed 17 million lbs from Oct.
- Milk Production Report: November milk output was up just 0.6% in the U.S., below most analyst expectations. Cow numbers declined 8,000 head from the prior month, putting the herd at 9.36 million head, the lowest it's been since Jan 2017, and 38,000 head fewer than a year ago.
- Dairy cow slaughter for the week ending 12/08, totaled 65,600 head, up 5.3% vs. the same period a year ago.
- Butter stocks at CME-approved warehouses declined 17% (4.2 million lbs) over the period 12/01 through 12/17.
- Fluid Milk Southeast: Class I sales are surprisingly strong and outpacing milk production. Even with schools closing, market participants are not seeing much of a decrease in bottling orders currently. Some manufacturers continue to heavily receive milk loads from other areas to fill orders. This is unusual for some manufacturers as they have never received other regions' milk loads this late in the year.
- Fluid Milk Central: Some intake plant managers have relayed concern regarding their respective 2019 outlooks, as a number of them are concerned about dairy farmers exiting the industry after current feed rations are exhausted. Farm milk yields are tighter than in recent years. Fluid milk handlers relay this year has been less daunting than previous years in securing homes for milk loads. Cheese plant managers report variances in milk availability, likely due to location. Some have suggested milk is not at the levels they expected.
- Dry Whey Central: Market tones have begun to trend toward the positive. Lighter autumnal whey production and stronger higher protein powder markets have some suggesting the trend may not be short-lived. Availability is mixed, with some contacts suggesting Q1 tightness.
- Dry Whey West: Industry contacts suggest demand is steady and manufacturers, working through what stocks they do have, have kept inventories moderately tight. Some manufacturers are opting to produce other whey protein products in lieu of dry whey.
- NDM Northeast: Price for low/medium heat NDM has mostly firmed as buyers show a willingness to purchase at high end prices. NDM supplies are currently balanced to tight.
- NDM Central: Availability is tightening as prices are moving up. Buyers reported taking on loads produced in Q1/Q2 at above \$.90. They also suggest Mexican buyers remain a factor in keeping markets bullish. Current stocks are moving well through contracts and/or spot markets. The overall NDM market tone is bullish, with healthy expectations for next year.
- NDM West: The market seems to be strengthening as shown this week by the rising price trends both on the range and the mostly price series. Inventories are generally in good balance with orders although some processors report a small tightness in their holdings. Due to the urgency in fulfilling a short-term need, a small group of customers bought low/medium heat nonfat dry milk at higher prices, giving an extra boost to the top of the price range. Sales to Mexico and other international markets are good, aided by a weaker value of the dollar.
- Cheese Midwest: Demand reports are mixed. Some cheddar demand is seasonally slower, but mozzarella/other pizza cheese producers suggest orders are steady to better than expected. A number of contacts have suggested milk was less available than expected. Some cheesemakers suggest their inventories are scant. Cheese markets are slowly beginning to show promise after a resoundingly bearish late fall.
- Foreign Cheese: Cheese on the EU is in high demand for the holiday season. Sales are extensive for sliced cheese and other cheese types across all sale channels. In addition, price discussions for the next quarter are currently underway. Inventories are hardly adequate to satisfy all requests.
- CWT accepted 14 offers of export assistance to sell 1.821 million lbs of Cheddar and Monterey Jack cheeses and 3.097 million lbs of whole milk powder. The product will be delivered during the period from December 2018 through June 2019.
- This week's GDT auction saw the dairy price index increase 1.7%. Gains were led by butter up 4.9% and AMF up 4%. Cheddar cheese finished 2.2% higher to a U.S. equivalent \$1.48/lb.
- International: In the EU, concerns remain that the weather impacts several months ago on hay and grain will be a drag on milk production well into the first half of 2019. The poorer quality feed, diminished quantities and higher price will take a toll. It has been noted that contracting for European produced cheese and butter for 2019 delivery is more advanced than at this time in recent years. Interest in finalizing skim milk powder contracts is accelerating, also due to expectations of increasing prices. Internal European demand for cheese is extremely high. Manufacturers continue to maintain aggressive production schedules to keep up with late year demand. Buyers now seeking to order for near term delivery are almost always turned away empty handed. Stocks in cold storage are being drawn upon to keep up with orders. Prices in Italy for hard Italian cheese varieties have moved up significantly since mid-November.

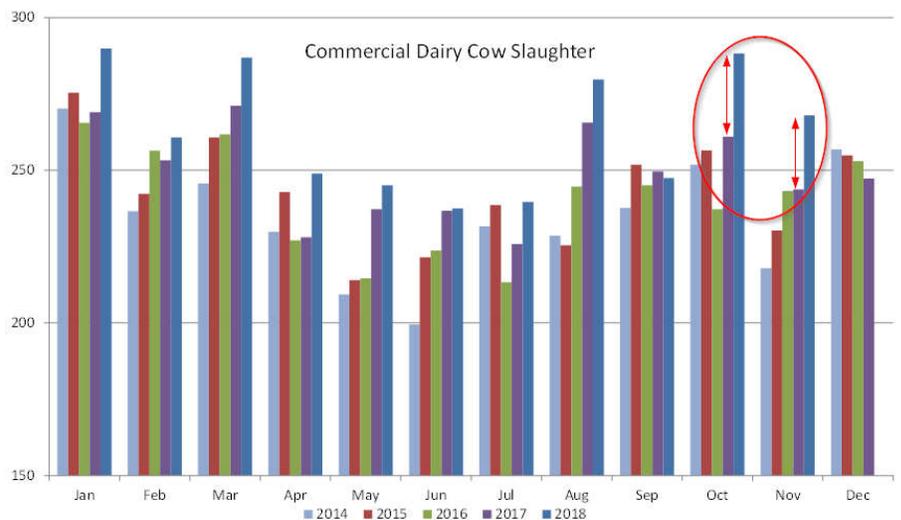
- International: Access to reasonably priced supplies of feed and hay remain a concern among many dairy farmers in Australia. Producers in the North have limited new season hay available. Many depend on hay trucked from other areas. It continues to be a season lagging milk production levels last year, with little encouragement of any significant change.

### What's Bearish:

- Fluid Milk Northeast: Milk production is relatively flat to slightly increasing. Class I sales are down this week, as educational institutions are closing for the holiday. There are expectations that balancing operations will receive higher milk volumes in the near future.
- Fluid Milk Southwest: California milk production is even to up this week. Educational institutions are also closed for the holidays. As the result, Class I sales are currently down. In general, milk yield is even to increasing. In Arizona, processing plants are running at full capacities and taking good volumes of milk. Milk supplies are increasing and seem to be higher than demand. In New Mexico, cheese production schedules have increased to handle the additional manufacturing milk volumes. Overall, milk production is trending higher.
- Fluid Milk Pacific Northwest: There is plenty of milk for processing and the additional milk made available from school bottling is forcing milk handlers to implement their planned adjustments for the season. In the mountain states of Idaho, Utah and Colorado, milk production is strong. Industry contacts say components are steady and have not come down much from seasonal highs. Distressed loads of milk are more prevalent in the northern parts of the region. As a result, some milk loads are getting pushed into neighboring states. Some farmers have lost access to markets. A few farms have liquidated rather than face further financial stress.
- Butter: With more cream supplies available for churning, butter output is active throughout the country. Butter manufacturing is transitioning from print to bulk. Print butter processing is slowing as holiday retail orders decrease. In general, butter inventories are steady to building into cold storage.
- Dry Whey Northeast: Some market participants are finalizing their last spot load purchases of the year. However, other market participants have sufficient inventories to meet their current needs. Dry whey production is steady to slightly higher due to more milk clearing into cheese production. Moreover, there are some expectations of increased cheese production during the holidays. Inventories are fairly balanced in the East right now. The demand is stable, but there are some reports of demand weakening in the near future.
- Cheese Northeast: Manufacturers are receiving more milk this week, as bottlers have decreased their milk orders. A few operations are running full up until the holiday. Cheese production is fairly strong. While inventories are steady to increasing due to more milk available in the region. Trading activity is steady to lower as many market participants' needs are met for the end of the year.
- Cheese West: Sales have been solid leading up to the winter holidays. However, the window for shipping holiday orders has mostly closed, and industry contacts say the supply chain is full. With the passing of the large chunk of holiday demand, manufacturers are wondering from where any lift in sales may come. Demand from mozzarella has been strong, and lower market prices have generated more interest from international buyers. Inventories are quite heavy, however. With plenty of milk on hand, market participants expect cheese production to continue to be strong. That may make it difficult for the industry to reduce the stockpiles of cheese in the near future.
- International: New Zealand seasonal milk production has been exceptional this year. Expectations remain for seasonal milk production to be up nicely from last season. Even some factors chipping away at the magnitude of this season's increase are not expected to take the outcome down too much at this point where the seasonal high production is in the past.

### Recommendation:

Spot NDM settled at its highest price since June 2017, while spot dry whey has regained its footing and is nearly back to the 50¢ level. Spot butter is still largely range-bound, but after this afternoon's Cold Storage Report was released, we wouldn't be surprised to see a strong bid for butter next week and into the New Year. With high inventories and holiday ordering over, cheese lost ground this week. However, if NDM, dry whey and butter continue to show strength, we wouldn't be surprised to see some support for cheese prices in the coming weeks. The bottom line is there appears to be an acceleration in cutting cow numbers (see chart). Besides the anecdotal stories we're hearing from dairy producers about full cattle trucks and long lines to unload, USDA slaughter numbers are jumping. We have data through Nov now, but we all know Dec will also be a high cull month, and probably even bigger than Nov. As operations continue to



struggle financially, once food rations run out, we could see culling increase further. We think it's starting to get the market's attention. While prices in the first part of the year finished lower this week, the 2<sup>nd</sup> half of 2019 was mostly higher. The job of the futures market is "price discovery", and anticipation of where prices will be. Though we still have a mountain of cheese, you can bet that prices will strengthen even more sharply in the latter 2019 contracts, **before** our cheese inventory problem is fixed, if the milking herd continues to decline at an accelerating pace. That said, there are a lot of other factors that may influence price, including milk output in the EU, trade negotiations, the economy, etc. We continue to recommend upside risk protection for producers that have milk locked in with their plant and/or futures contracts. We still maintain the upside risk is more than the downside risk, June-Dec 2019.

**Note:** There will be no KDM Dairy Report next week. We wish you and your families a very Merry Christmas and Happy New Year!

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