



The KDM Dairy Report – June 8th, 2007

Bullish Fundamentals:

- Cash Market: Cheese made big gains for the week but showed some weakness on Thursday and Friday, while butter finished lower. Blocks were up 9¢ from last Friday to settle at \$1.97¼/lb and barrels finished 2¢ higher at \$1.93/lb. Barrels traded as high as \$1.98/lb earlier in the week and blocks hit \$1.98¾/lb. Butter lost 4¼¢ settling at \$1.50¼/lb. 6 loads of blocks, 8 barrels and 9 cars of butter exchanged hands.
- After several weeks of modest declines, the NASS [dry whey price increased](#) slightly this week. In the weekly survey, dry whey increased 0.8¢ to average 76.3¢/lb. Nonfat dry milk gained 1.1¢ to \$1.80/lb and butter was up 0.6¢ to \$1.47/lb. Reflecting recent strength in the cash markets, both blocks and barrel cheese made strong moves higher. 40-lb blocks moved 4.3¢ higher to average \$1.70/lb while barrels were \$1.72/lb, up 5.8¢.
- Sales of fluid milk were strong in April, according to Dairy Market News. Consumption was [2.2% higher](#) than April 2006 and were led by sales of flavored whole and skim milk, 2%, 1% and skim milk.
- Fluid Milk & Cream Review reports that many producers in the Southeast have now converted to rBST-free status, and processors are anticipating [more will follow suit](#) by late summer.
- Milk production in California continues to decline from its seasonal peak and supplies of dairy quality hay [remain tight](#). Prices are firm, running \$185-205 delivered. Ice cream production is ramping up, consuming a fair amount of cream and limiting butter churning.
- Dry whey stocks in the Central region are growing, but warehouses are [holding them with confidence](#) even at record prices, according to Dairy Market News. Handlers anticipate firmer prices later this year due to an expected drop in the milk supply and strong interest in dairy proteins.
- Dairy Market News reports the Western nonfat dry milk market remains very firm. Extra loads are easily cleared and there are reports of milk being [shifted from cheese production into the dryer](#).
- The cheese market is firm in the Midwest, according to Dairy Market News. A sizeable reduction in cheddar/natural American supplies from a large plant has some of their customers scrambling to obtain product from other sources. Operations with butter/powder facilities are keeping them full [at the expense of cheese](#) as milk receipts begin to decline seasonally.
- Dairy Market News reports that as more Western cheese buyers become convinced cheese might be short this summer and fall, more firms are [getting what cheese they can](#) when it is available. Many believe that it's possible the all-time record price of \$2.20/lb set in 2004 is attainable.
- International: Competition for milk in Western Europe is [very aggressive](#), according to Dairy Market News. The strong powder markets are pressuring plant managers to divert milk away from some manufactured products toward milk powder. International demand for most all manufactured dairy products is strong. Buyers are reluctant to pay the high prices, but don't really see the possibility of a price decrease in the foreseeable future due to the limited supply. Suppliers and handlers indicate the international supply situation remains limited and that milk production trends throughout the world are not overly positive. Output in New Zealand was up 3%, but Australia was down 7% and Argentina was off 12%. Europe's production is about even with the U.S. up only slightly.
- International: Many traders and handlers in Australia note that year-end closing stocks are the [lowest in recent memory](#), and that more suppliers than anticipated will be reaching into the upcoming production season to meet current commitments. Already, a significant portion of the milk production in the 2007-2008 season has been committed. Traders have also been surprised at the level of new buyer interest, which is looking to secure a supply source so that they do not have to go through another year of limited availability.

Futures Month	Friday 06/08 Close	Friday 06/01 Close	Change	5-yr Average	Top 3rd Price
Jun-07	\$20.03	\$20.16	(\$0.13)	\$12.54	\$13.63
Jul-07	\$20.78	\$20.74	\$0.04	\$12.25	\$13.16
Aug-07	\$19.80	\$19.78	\$0.02	\$12.41	\$13.34
Sep-07	\$19.40	\$19.15	\$0.25	\$13.11	\$13.99
Oct-07	\$18.47	\$18.35	\$0.12	\$13.19	\$13.98
Nov-07	\$17.70	\$17.69	\$0.01	\$12.88	\$13.86
Dec-07	\$17.25	\$17.30	(\$0.05)	\$12.92	\$14.01
Jan-08	\$16.68	\$16.55	\$0.13	\$12.50	\$13.33
Feb-08	\$15.75	\$15.69	\$0.06	\$12.53	\$13.21
Mar-08	\$15.61	\$15.54	\$0.07	\$12.78	\$13.50
Apr-08	\$15.50	\$15.54	(\$0.04)	\$13.09	\$14.31
May-08	\$15.30	\$15.35	(\$0.05)	\$13.14	\$14.49
Jun-08	\$15.49	\$15.49	\$0.00	\$12.54	\$13.63
Jul-08	\$15.55	\$15.53	\$0.02	\$12.25	\$13.16
Aug-08	\$15.70	\$15.65	\$0.05	\$12.41	\$13.34
Sep-08	\$15.92	\$15.85	\$0.07	\$13.11	\$13.99
Oct-08	\$15.50	\$15.33	\$0.17	\$13.19	\$13.98
Nov-08	\$15.25	\$15.12	\$0.13	\$12.88	\$13.86
Dec-08	\$15.00	\$14.91	\$0.09	\$12.92	\$14.01
May-Dec Avg	\$19.06	\$19.02	\$0.04		
2008 Avg	\$15.60	\$15.55	\$0.06		

Bearish Fundamentals:

- Cheese [stocks jumped](#) during the last week of May, according to the Weekly Cold Storage Holdings report. For the period 05/01 through 06/04, 5.7 million lbs of cheese are added to inventory, a gain of 4%. Butter stocks were also up 4% with an increase of 1.1 million lbs.
- Weekly slaughter numbers continue to [barely outpace](#) last year's levels. 41,600 dairy cows were culled during the week ending 05/26, compared to 39,000 during the same week a year ago.
- Florida continues to increase its milk exports. Fluid Milk & Cream Review reports 300 loads of Grade A milk left the state this week, compared to 234 last week and only 130 last year at this time.
- Class I [demand continues to slow](#) in the Central region as most remaining schools close for the summer, according to Fluid Milk & Cream Review. Interest in spot loads of manufacturing milk has been spotty and offerings have been slightly heavier this week.

Recommendation:

Three words could help keep prices at these high levels longer than currently anticipated: global, global, global. International demand is the key to sustaining prices (see International bullets above). Consider the following quotes from USDA's European and Oceania overviews this week:

"European traders continue to report that an international tender might be issued in the near future looking for milk powders along with other manufactured dairy products. The big question is, where will product for this tender be sourced? Most traders feel that Europe will be able to acknowledge a portion, but will probably not be able to fully fill the need."

"Cheddar cheese markets and prices are firm. The milk and cheese production season has now ended in Oceania, thus orders are being filled from inventories that are the lowest in recent memory. Some handlers and suppliers indicate that they will need to reach into new production to fulfill current commitments and are cautious about making additional future commitments. In most instances, future cheese production is fully committed and a significant portion of the first half of the upcoming milk production season with inquiries quite active for second half commitments."

What impact is this likely to have on our market? What might our domestic milk production need to be to satisfy this demand? It would appear to us that foreign buyers will need to continue sourcing product from the USA to meet their needs in 2007 and 2008 and that this is likely to keep our domestic dry whey and nonfat dry milk prices substantially higher than historic norms for the foreseeable future.

On the home front, there is some gamesmanship going on in the Class III market. We've sprinted higher in the cash cheese market but buyers appear to be catching their breath and seem unwilling at this point to push prices higher. Cheese sellers have taken advantage of this and began offering loads near the end of the week. Some dramatic intraday downticks have been seen in the front month contracts, only to be brought nearly back up by the end of the day. Buyers don't appear to be convinced the offers are serious and seem happy to own milk on any dips 30-50 cents lower. We could see more weakness in cheese in the coming days, but our sources believe \$2 cheese will be a reality at some point. Stick with PUT options July-Dec and leave 2008 alone for now. We still believe it's wise to buy insurance and get a floor under your milk. When the market does decide to turn decisively lower, it WILL come as a surprise to everyone, including us. Buy your protection while you can.

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