The KDM Dairy Report – June 15th, 2007

Bullish Fundamentals:

Futures Month	Friday 06/15 Close	Friday 06/08 Close	Change	5-yr Average	Top 3rd Price
Jun-07	$20.06	$20.03	$0.03	$12.54	$13.63
Jul-07	$21.58	$20.78	$0.80	$12.25	$13.16
Aug-07	$20.75	$19.80	$0.95	$12.41	$13.34
Sep-07	$20.55	$19.40	$1.15	$13.11	$13.99
Oct-07	$19.48	$18.47	$1.01	$13.19	$13.98
Nov-07	$18.35	$17.70	$0.65	$12.88	$13.86
Dec-07	$17.64	$17.25	$0.39	$12.92	$14.01
Jan-08	$16.90	$16.68	$0.22	$12.50	$13.33
Feb-08	$16.00	$15.75	$0.25	$12.53	$13.21
Mar-08	$15.70	$15.61	$0.09	$12.78	$13.50
Apr-08	$15.60	$15.50	$0.10	$13.09	$14.31
May-08	$15.40	$15.30	$0.10	$13.14	$14.49
Jun-08	$15.50	$15.49	$0.01	$12.54	$13.63
Jul-08	$15.60	$15.55	$0.05	$12.25	$13.16
Aug-08	$15.70	$15.70	$0.00	$12.41	$13.34
Sep-08	$15.88	$15.92	($0.04)	$13.11	$13.99
Oct-08	$15.48	$15.50	($0.02)	$13.19	$13.98
Nov-08	$15.26	$15.25	$0.01	$12.88	$13.86
Dec-08	$15.05	$15.00	$0.05	$12.92	$14.01
Jly-Dec Avg	$19.73	$18.90	$0.83		
2008 Avg	$15.67	$15.60	$0.07		

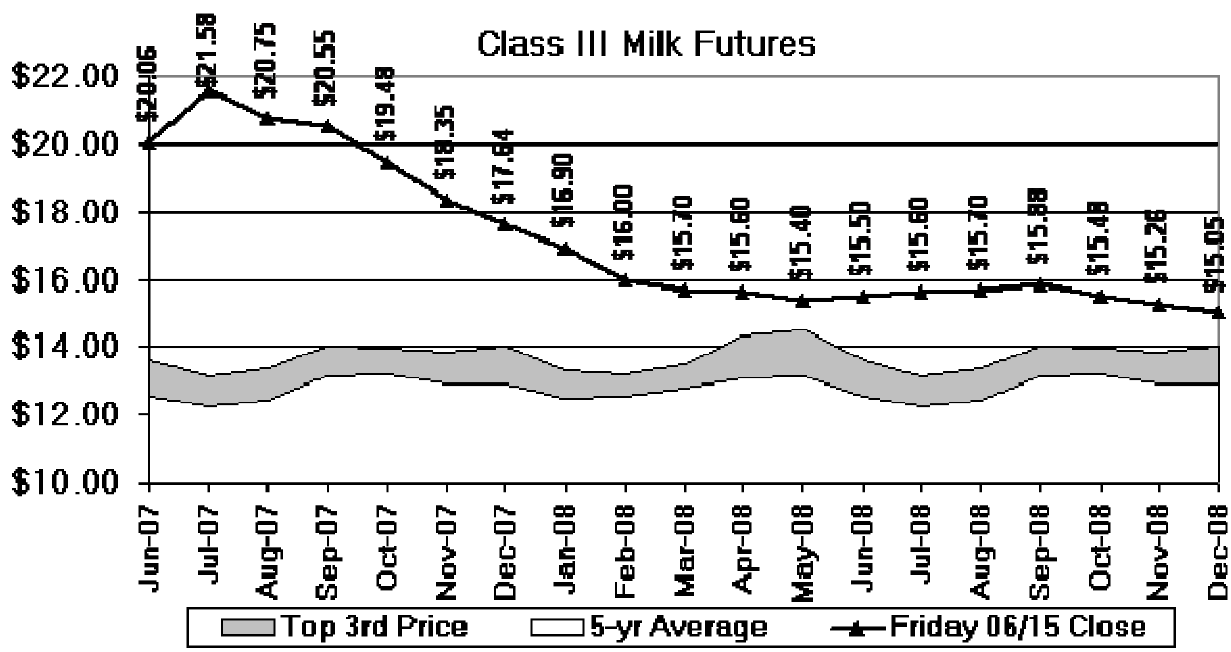
- World Ag Supply & Demand Report: USDA's monthly look at the world ag sector reports strong demand for dairy products and limited international supply will continue to support higher prices. As a result, they increased their price forecasts across the board. Class III milk in 2007 is now expected to average $17.50/cwt, up $1.20/cwt from last month's forecast, and 2008 is predicted to average $16.40/cwt, up $0.40/cwt. In addition, the nonfat dry milk price forecast was increased 23½¢/lb from last month.
- Yesterday, the European Union announced they would end all subsidies on dairy exports within days. The subsidies were introduced nearly 40 years ago, but strong internal demand and higher world prices have rendered them unnecessary, according to the EU Ag Commission.
- NASS surveyed cheese prices made strong gains this week as they follow the cash market by about two weeks. 40-lb blocks increased 5.9¢ to average $1.76/lb and 500-lb barrels were up 9.2¢ to $1.81/lb. Butter averaged $1.52/lb, up 4¢ from last week and nonfat dry milk gained 10.4¢ to $1.91/lb. Dry whey was the lone loser, giving back last week's gain; it dropped 0.7¢ to 75.6¢/lb.
- Cash Market: Cheese continued to march higher, eclipsing the $2 barrier, but momentum slowed at week's end. Blocks settled at $2.00/lb, up 2¾¢ for the week, while barrels notched a more impressive 12¢ gain to close at $2.05/lb. Butter lost ground for the first time in weeks, dropping 2¼¢ to $1.48/lb on aggressive trade. 27 cars of butter exchanged hands while only 7 loads of blocks and 4 loads of barrels traded in cheese.
- Butter stocks at CME-approved warehouses fell by 659,000 lbs for the week ending 06/09, compared to a 739,000 lb gain during the same week a year ago. Total inventory on hand now stands at 145 million lbs, which is 12.1 million lbs less than last year.
- Milk production in the Mid-Atlantic region is dropping, but demand from bottlers has been on the strong side, according to Fluid Milk & Cream Review. In the Southeast, milk receipts are trending rapidly lower as summer heat and humidity take their toll on production. At the same time, there is concern about feed quality and availability due to reduced first crop hay yields. Florida exported 93 fewer loads of milk this week compared to last week, and Class II demand is strong, pulling cream from butter production.
- Milk cows drying up with no replacements coming in is the biggest factor in California's declining milk production, according to Fluid Milk & Cream Review. Fresh cows could come on line in July, but summer weather could impact initial output. In New Mexico, output is steady but below last year the lingering affects of recent wet weather and high feed costs.
- The Western nonfat dry milk market remains firm, according to Dairy Market News. Manufacturers are able to service contracted loads, but additional spot loads are limited.
- Dairy Market News reports the dry whey market is mixed but still potentially firm. Some stocks are building, but production is trending lower seasonally partly due to shifting milk out of cheese production and into butter/powder operations. Jan-Apr whey exports were up 22% from last year, reflecting strong international demand.
- Regular bulk buyers that have slowed purchasing in light of $2 cheese, have been partially offset by other buyers trying to replace loads of natural American blocks and 640's that were sourced from a large plant that recently reduced production. Aged cheddar has become a bargain compared to current cheese and some aging programs are being raided early.
- In the Western region, Dairy Market News reports some milk is leaving cheese plants and heading to butter/powder operations because of better returns, and this is having an impact in the short run on national cheese prices.

- Out East, as milk supplies trend lower, a few plants are chipping away at the number of production days per week. Cheese inventories are adequate to meet existing demand, but are not building appreciably.

Bearish Fundamentals:

- The Consumer Price Index in May grew at the fastest pace in 20 months, led by a rise in gasoline and food prices, according to government figures. Economists are growing concerned that consumers will slow spending as their cost-of-living increases.
- More and more news coverage over high milk prices could slow demand. Inflation in the grocery aisle is up by more in the first six months of 2007 than in all of 2006, according to an article this week.
- Remaining schools have now closed for the summer and manufacturing plants are picking up extra milk receipts, according to Dairy Market News. Buyers are wary of putting $2 cheese into aging programs for risk of it being a money loser in the fall.
- Weekly dairy cow slaughter numbers continue to cool in light of more profitable prices. Only 37,100 head were culled during the week ending 06/02; still ahead of last year at 34,700, but the lowest weekly total so far this year, and 4,500 head fewer than the prior week.
- In the Pacific Northwest, much needed new crop hay has become available at a very high quality. This is yielding extra milk output and helping offset some of the added cost of expensive feed.

Recommendation:



Class III put in a strong week, but uncertainty prevailed the last few days as the cash cheese market found it harder to climb higher. As a result, prices faded from their highs on Tuesday as traders took profits and producers began hedging. Many anticipate a strong correction is in store, which is adding to the nervous market. Cheese has to keep climbing higher to feed the bull, but if it doesn't next week, they will be right and we will see a fall. However, the global picture still looks strong with news that the EU is dropping all subsidies for dairy exports. Some in the biz think this could add 30¢/lb to the world price for cheese, which would be supportive for Q4 and 2008 contracts. At this point, we would encourage producers to begin selling some milk if July-Dec reaches a $20 average or higher. If that hits, set your next target 30-50¢ higher. The potential for this market is $24-25 milk, so you need to be selling as the price continues to move up. Be content to leave the last $2-4 dollars of profit for someone else. In our opinion, it's not worth the risk trying to time this market, and better to get your coverage while you can. On Monday we get our May Milk Production Report which will be closely watched, since it's the first month of production after CWT got rid of 50,000 cows. It could provide support to the market if the number is bullish. But to protect against a near term correction, you should consider buying the July $20.00 PUT option for 10¢ and the August $19.00 PUT for 20¢. This is cheap insurance at a very profitable price. Do it!