



## The KDM Dairy Report – August 31<sup>st</sup>, 2007

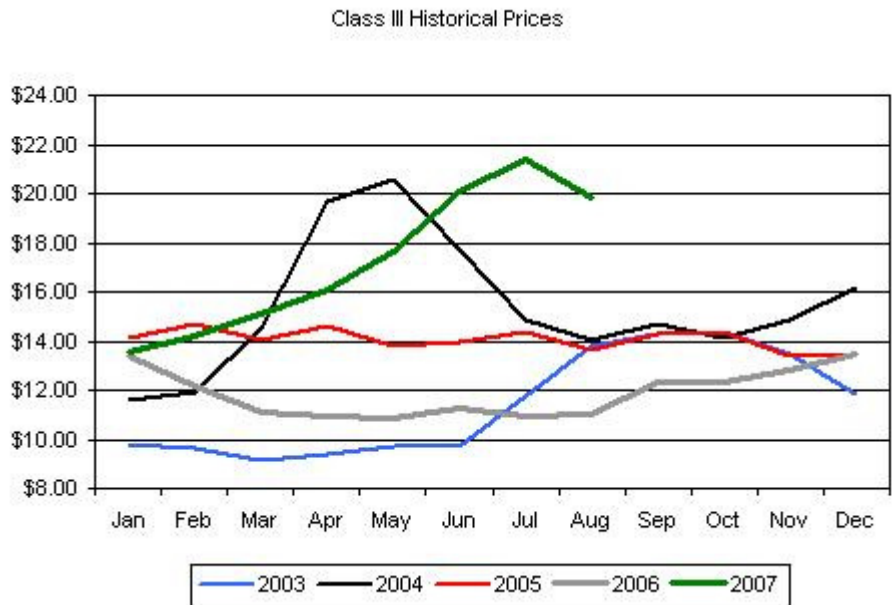
### Bullish Fundamentals:

- Cash Market: Bidders were aggressively looking for blocks this week in the spot market, pushing the price up 10¼¢ to \$2.07½/lb, but got nothing for their efforts. Barrels came along for the ride, gaining 7¾¢ to \$2.01/lb on sales of 10 loads for the week. Butter was unchanged at \$1.42¼/lb on sales of 10 cars.
- Commercial Disappearance: Use of American cheese in June was up just 0.1%, but use of all other cheeses was up 3%, according to USDA numbers released this week. Use of butter in June was up 4.7% while [use of milk in all products was up 1.4%](#). Of special interest, Dairy Market News on Wednesday pointed out that total cheese commercial disappearance (demand) in the second quarter was 2.52 billion lbs, up 2.8% from a year ago, and exceeded cheese production (supply) during the period by 100 million lbs. Zowie!
- August Class III was announced today at \$19.83/cwt, an all-time historical high for August! (see chart below)
- NASS cheese prices are [starting to climb again](#), following recent cash strength. Blocks increased 2.5¢ from last week to reach \$1.91/lb and barrels were up 1.2¢, also at \$1.91/lb. Butter fell 6.5¢ to average

Futures Month	Friday 08/31 Close	Friday 08/24 Close	Change	5-yr Average	Top 3rd Price
Sep-07	\$20.22	\$19.76	\$0.46	\$13.11	\$13.99
Oct-07	\$19.87	\$19.04	\$0.83	\$13.19	\$13.98
Nov-07	\$18.73	\$17.92	\$0.81	\$12.88	\$13.86
Dec-07	\$17.90	\$17.30	\$0.60	\$12.92	\$14.01
Jan-08	\$16.80	\$16.16	\$0.64	\$12.50	\$13.33
Feb-08	\$16.04	\$15.60	\$0.44	\$12.53	\$13.21
Mar-08	\$15.91	\$15.53	\$0.38	\$12.78	\$13.50
Apr-08	\$15.71	\$15.41	\$0.30	\$13.09	\$14.31
May-08	\$15.60	\$15.38	\$0.22	\$13.14	\$14.49
Jun-08	\$15.62	\$15.43	\$0.19	\$12.54	\$13.63
Jul-08	\$15.73	\$15.55	\$0.18	\$12.25	\$13.16
Aug-08	\$15.75	\$15.55	\$0.20	\$12.41	\$13.34
Sep-08	\$15.89	\$15.63	\$0.26	\$13.11	\$13.99
Oct-08	\$15.41	\$15.28	\$0.13	\$13.19	\$13.98
Nov-08	\$15.20	\$15.02	\$0.18	\$12.88	\$13.86
Dec-08	\$15.04	\$14.93	\$0.11	\$12.92	\$14.01
<b>Sep-Dec Avg</b>	<b>\$19.18</b>	<b>\$18.51</b>	<b>\$0.68</b>		
<b>2008 Avg</b>	<b>\$15.73</b>	<b>\$15.46</b>	<b>\$0.27</b>		

\$1.38/lb and dry whey continued its fall, losing 3.3¢ to 57.9¢/lb, but nonfat dry milk was 1.1¢ higher at \$2.08/lb.

- Dairy Market News reports the cheese market in the Midwest to be steady to firm. Cheese makers are losing milk to bottlers and yields are still at low summer levels. Bulk cheese buyers have been finding [tight to short supplies](#) of pepper jack, colby/jack, provolone, mozzarella and even cheddar.
- Western cheese buyers are not happy about current price levels, but they are [buying anyway](#) for fall needs, according to Dairy Market News. Prices have never been this high this late in the summer, so buyers are only purchasing what's needed so as not to have too much cheese on hand. At the same time, cheese makers are trying to limit production in an effort to not build their own inventories with the currently high milk prices.



- Current cheese is available in the area, but not in heavy volumes. Contacts are starting to wonder if these high cheese prices are now likely to hold through the fall demand season.
- 602 loads of Grade A milk made their way into the Southeast region of the country this week, according to Fluid Milk & Cream Review. That's up from 550 last week and way above last year at this time when 394 loads were imported. Balancing plants in some locations have [little milk to process](#) into manufactured products as Class I needs siphon milk away. Heat stress has affected production and more declines in are probable. At the same time, orders for rBST-free milk are higher than in past years as more retailers in the South make that their only offering.
- In the Central region of the country, milk continues to be pulled to Missouri, Kentucky and beyond. Class I demand is up as schools prepare to open, reducing the amount of milk available for manufacturing, leaving more demand than

supply. As a result, cheese [supplies are expected to tighten](#) by a reduction in production, just as demand improves seasonally.

- Hotter weather has finally entered California and the effects are [beginning to impact the milk flow](#), according to Fluid Milk & Cream Review. Some receivers are seeing drops in milk intakes and load weights, while at the same time, bottlers are seeing good orders as the majority of schools reopen on Tuesday.
- Weekly cold storage numbers are showing there was [solid demand](#) for butter and cheese in August. For the period 08/01 through 08/27, butter stocks at USDA selected storage centers were down 2% and cheese stocks were down 3%.
- A number of firms in the U.S. are now able and willing to [make 82% butter for foreign markets](#), according to Dairy Market News. Some sales and shipments have started to occur, and with stocks of butter in Europe short and production ending for the season, it appears that the demand is there for them to buy more U.S. butter
- International: European milk production is winding down but demand is winding up, according to Dairy Market News. Competition for milk for both drinking and manufacturing needs is tight; cheese demand is picking up, and although butter/powder supplies are short, some milk is moving to cheese production to build inventories for winter. The shortfall in butter is being supplemented with 80% and 82% unsalted butter being [imported from the U.S.](#) without CWT assistance. Butter producers in the U.S. say they are getting more involved with generating butter supplies for the international market, with Europe being a major buyer.
- International: The new milking season has just begun in New Zealand, with Australia about ready to start, but already, manufactured dairy product stocks for the first half of the current production season [have been fully committed](#), according to Dairy Market News. Suppliers and customers are now working on second half needs.

#### **Bearish Fundamentals:**

- The export market is moving surplus loads of whey from the market, but supplies remain burdensome, according to Dairy Market News. Feed buyers are picking up a load here and there, but [reduced demand for dairy protein](#) in feed products is keeping movement light.
- Weekly dairy cow slaughter numbers [continue to slack off](#) as strong milk prices encourage retaining animals longer. For the week ending 08/18, 44,600 head were culled, compared to 47,400 head during the same period last year.
- Butter stocks at CME-approved warehouses continues to [exceed last year's levels](#) by a growing amount. A little over 3 million lbs were pulled from storage during the week ending 08/25, but last year nearly 8 million lbs were removed. That leaves 142 million lbs on hand, compared to a year ago when stocks were at 124 million lbs.
- International: The European whey market is weak and prices are expected to [continue to fall](#), according to Dairy Market News. Stocks of powder are available, and heavy cheese production is expected to make whey offerings even heavier.

#### **Recommendation:**

The cheese market is again proving it is king when it comes to influencing Class III milk futures. It appears we're not as much in a demand driven rally as we are in a supply crunch. The past two Cold Storage Reports have indicated a year-to-year fall in American cheese stocks, while the past two Dairy Products Reports have shown a year-to-year drop in American cheese output. Add those two together and we shouldn't be surprised by this week's Commercial Disappearance numbers that show use of American cheese outstripped supply. Cheese makers have had little incentive to make cheese due to tight margins and have wanted to avoid building their own inventories of \$1.90+ cheese. Cheese buyers have held off making fall purchases, hoping for a drop in price. Heat in the Southeast has been drawing milk out of the Midwest, schools are set to open and milk components are at seasonal lows, impacting yields. It seems we're once again in a "perfect storm" where suddenly buyers are realizing the price is not going their way and are reluctantly buying anyway to get covered for fall/holiday needs. The problem is, there's very little out there and with strong Class I demand due to school openings, it may be hard to satisfy demand for a while. Certainly not all is good news. Dry whey continues to tumble with no bottom in sight yet. That will help cheese makers' margins and encourage production. The economy is still vulnerable so the demand equation has not been settled. In addition, we could see the cheese market go too high and kill demand. All told, however, we're quite encouraged about Q4 2007 and Q1 2008. We prepared to take some risk management action in September, though. Cheese buying for the holidays will not last forever, and past history has told us that most of the buying finishes by the end of Sept of beginning of Oct. There may be some fantastic opportunities in the next 2-3 weeks to either market some milk or get floor price insurance via PUT options. At this point, we are pulling our 15.00 floor, 17.00 ceiling rec. for Q1 2008. If the market moves substantially higher over the next few weeks, we may be able to get a 16.00 floor by 18.00 ceiling for about the same price. Call us next week for PUT targets for Q4!

**Note:** Our office will close at noon on Friday and will be closed all day on Monday in observance of Labor Day.

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