

The KDM Dairy Report – September 14th, 2007

Bullish Fundamentals:

- World Ag Supply & Demand Report: USDA continues to find the current state of the dairy industry in good shape. Despite increasing their milk production forecast in response to strong milk prices, they expect tight supplies of alfalfa hay will moderate growth in output per cow in 2008. Demand is forecast to remain strong and keep prices near record levels in 2008, due to [tight world dairy supplies](#).
- NASS surveyed cheese prices continue to [play catch-up](#) to the cash market as 40-lb blocks jumped 3.2¢ to reach \$1.98/lb and 500-lb barrels gained 3.5¢ to average \$1.97/lb. Nonfat dry milk tacked on a modest 0.8¢ to average \$2.06/lb.
- For the first time since April, the weekly dairy cow slaughter topped 50,000 head. 51,000 head were culled for the week ending 09/01, compared to 49,800 during the same period last year. Possible cause? A lot of dairies went off rBST in August; perhaps [low-enders are finally being retired](#), despite high milk prices.
- Fluid Milk & Cream Review reports demand for milk in the Southeast [still exceeds supply](#). This week, 390 loads were shipped in, compared to 367 last week and 345 during the same period a year ago.
- In California, [milk output has not rebounded](#) as much as expected from the recent heat. This has eased stress on local processing facilities and allowed for some plant maintenance, according to Fluid Milk & Cream Review. Some contacts speculate the feed quality is partly to blame.
- Current cheese milk [demand exceeds the supply](#) in Wisconsin, according to Fluid Milk & Cream Review. Milk receipts are steady to slightly lower, so extra volumes remain limited in spite of strong interest.
- Dairy Market News reports stocks of Western whey are [being reduced on improved exports](#), as sellers try to lighten inventory. By marketing product either side of 40¢, they are seeing much more buy interest.
- Demand for Midwest cheese is steady to improved this week despite the high prices, surprising some packagers, according to Dairy Market News. Mozzarella supplies are tightening with [extra loads disappearing](#) quickly. Some operations are cutting barrel production and switching to blocks.
- Some Western cheese [buyers are getting nervous](#) about finding enough cheese to cover fall needs, according to Dairy Market News. Higher prices have slowed demand, but not enough to hold buyers back from getting needs covered.
- Economy: The Euro reached a record high against the dollar on Tuesday, as economists predict a drop in U.S. interest rates by the Fed is forthcoming. Stronger foreign currencies are a boon to U.S. exports.
- International: Little has changed in two weeks since the last update. According to Dairy Market News, milk volumes in Europe remain insufficient for total needs. Cheese demand is strong and supplies are limited for winter buyer interest. Butterfat is tight, so buyers are supplementing stocks via purchases from the U.S. With the Euro hitting multi-year highs against the U.S. dollar, prices are expected to push even higher for the limited dairy end products available. Handlers indicate internal European demand is growing, so [stocks are expected to remain short](#) for the foreseeable future.

| Futures Month | Friday 09/14 Close | Friday 09/07 Close | Change | 5-yr Average | Top 3rd Price |
|--------------------|--------------------|--------------------|-----------------|--------------|---------------|
| Sep-07 | \$20.10 | \$20.29 | (\$0.19) | \$13.11 | \$13.99 |
| Oct-07 | \$18.75 | \$20.07 | (\$1.32) | \$13.19 | \$13.98 |
| Nov-07 | \$17.81 | \$18.73 | (\$0.92) | \$12.88 | \$13.86 |
| Dec-07 | \$17.46 | \$17.97 | (\$0.51) | \$12.92 | \$14.01 |
| Jan-08 | \$16.73 | \$16.90 | (\$0.17) | \$12.50 | \$13.33 |
| Feb-08 | \$15.98 | \$16.15 | (\$0.17) | \$12.53 | \$13.21 |
| Mar-08 | \$15.88 | \$15.90 | (\$0.02) | \$12.78 | \$13.50 |
| Apr-08 | \$15.70 | \$15.70 | \$0.00 | \$13.09 | \$14.31 |
| May-08 | \$15.61 | \$15.65 | (\$0.04) | \$13.14 | \$14.49 |
| Jun-08 | \$15.70 | \$15.65 | \$0.05 | \$12.54 | \$13.63 |
| Jul-08 | \$15.81 | \$15.70 | \$0.11 | \$12.25 | \$13.16 |
| Aug-08 | \$15.87 | \$15.73 | \$0.14 | \$12.41 | \$13.34 |
| Sep-08 | \$15.99 | \$15.88 | \$0.11 | \$13.11 | \$13.99 |
| Oct-08 | \$15.58 | \$15.44 | \$0.14 | \$13.19 | \$13.98 |
| Nov-08 | \$15.41 | \$15.23 | \$0.18 | \$12.88 | \$13.86 |
| Dec-08 | \$15.25 | \$15.10 | \$0.15 | \$12.92 | \$14.01 |
| Sep-Dec Avg | \$18.53 | \$19.27 | (\$0.73) | | |
| 2008 Avg | \$15.79 | \$15.75 | \$0.04 | | |

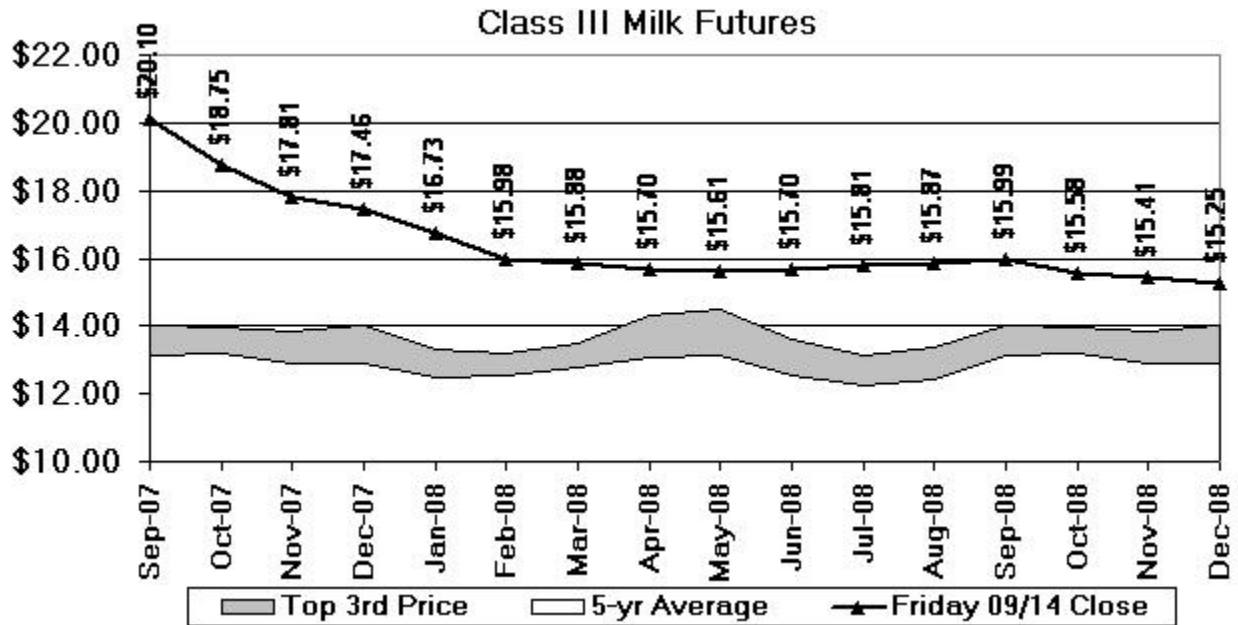
Bearish Fundamentals:

- Cash Market: Ouch! Blocks down 15¢ and barrels off 11¢ for the week. Sellers finally overwhelmed buyers and cheese prices plummeted with blocks and barrels both settling at \$1.99/lb today. 14 loads of blocks and 10 barrels exchanged hands. Growing inventories put pressure on butter prices which lost 4½¢, settling at \$1.37¼/lb. 27 cars of butter exchanged hands.
- The USDA announced today that it will reopen the U.S. border with Canada on Nov 19th to cattle imports, [including dairy heifers](#) born after March, 1999.
- While NASS cheese and nonfat dry milk prices were up this week, dry whey continued its slide, losing 4.5¢ to average 50.5¢ this week. Butter was also lower, down 2.5¢ to \$1.39/lb.

- In the Central region, dry prices were lower again this week, averaging 45¼¢, according to Dairy Market News. Although new export interest is noted, [demand is still insufficient](#) to offset burdensome supplies.
- July butter production exceeded June's production for the first time in 10 years, according to Dairy Market News. And the total output in July was the [highest in 45 years!](#) This is keeping butter buyers on the sidelines, confident that they can make purchases hand to mouth with little worry that prices will take off.
- Economy: August retail sales were up only 0.3%, in a continuing sign that the [economy is slowing](#). And crude oil has been trading near record levels, leading to higher prices at the pump. That leaves less disposable income in people's pockets and a potential drop in restaurant sales.

Recommendation:

Last week we wrote, "Again, we would strongly encourage getting PUT coverage for Q4 in the next week or two. Don't let these prices slip away!!" Unfortunately that didn't generate much of a response, and prices in Q4 fell in dramatic fashion this week. That October 19.50



PUT we bought last week for 35¢ settled today at \$1.02, and it was available this week for 30¢ before the crash. With this newsletter as the main means of communication with our customers, we attempted to emphasize some urgency with our closing comments last week, and it's left us wondering how we can improve our efforts. Going forward, when we feel a strong conviction about something and really want you to take some action, we are going to add further emphasis. Look for the words **TRADE ALERT!** We will use it sparingly, so when you see it, you'll know we think it's **imperative** to get something done.

Cheese is still tight but bottlers have things in balance for school lunch programs and more milk is finding its way to the vat. With bidders having run the cheese price within 4¢ of the record, sellers came to the market with more conviction this week, pushing prices all the way down to \$1.99/lb. Short term direction from here is hard to predict, but we would expect continued weakness to start off the week on Monday. Longer term, we still see a positive outlook, and wouldn't be surprised if the Q4 contracts gain back much of their losses....eventually. The international picture looks good, but we need to see more actual exports develop. A major coop this week announced a \$1.65 cheese contract for all of 2008, which equates to about \$16.50 Class III for the year. You'll notice that despite the fall in Q4, the 2008 average actually increased 4¢ this week (see prices above). That's encouraging, and we're hopeful that this most recent break in prices will be somewhat short lived. For Q4, we would look at buying CALL options if prices continue to head lower, and then use them to sell into if prices rally back in a few weeks. Call us for specifics. For 2008 we're still happy to be on the sidelines. Offering a \$1.65 cheese contract could be an indication that end users are more worried about higher cheese prices in 2008 than lower ones. Finally, our job is to present you with hedging opportunities and leave the decision up to you. While can never be 100% right, our aim is to help you protect your milk price. Let's work together so that when the next opportunity arrives, we're ready to take action! Have a great weekend!

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