

**The KDM Dairy Report – January 18<sup>th</sup>, 2008**

**Bullish Fundamentals:**

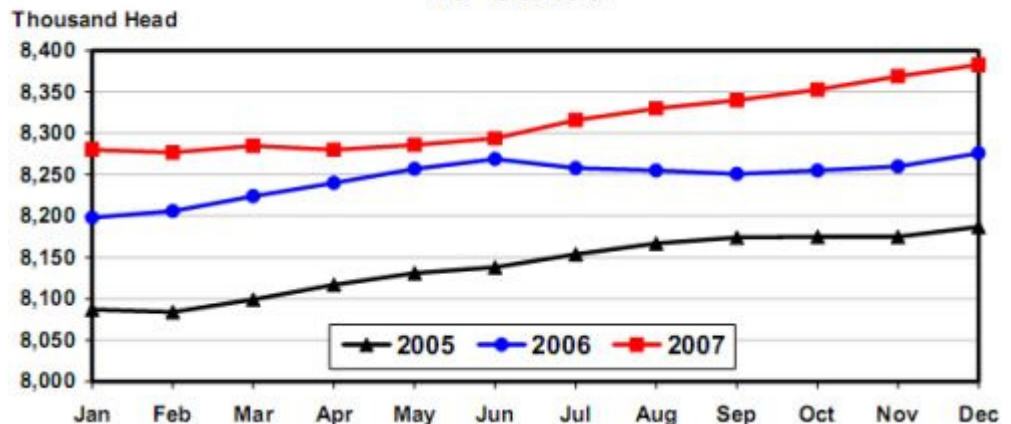
- Livestock, Dairy & Poultry Outlook Report: Higher feed costs as well as tight supplies of alfalfa hay are expected to keep the milk-feed ratio [below 2.50 for most of 2008](#), according to USDA. However, replacement heifer imports from Canada are brisk, and a younger herd in 2008 is expected to push milk production up 2.3% above 2007. But cheese prices are forecast to average \$1.69/lb, relatively high by historical standards because cheese exports are expected to remain strong, stocks are moderate and production is limited.
- Florida became a [milk deficit state again](#), as 69 loads of Grade A milk were shipped in to the state this week, vs. 16 loads exported last week. Fluid Milk & Cream Review reports strong bottler orders throughout the Eastern region of the U.S. as fluid sales are steady to strong.
- Butter exports through the first 11 months of 2007 were [up 232%](#) vs. the prior year, according to the Foreign Ag Service. The Netherlands and Belgium/Luxemburg imported 23 million lbs, compared to nothing in 2006.
- Although inventories are now building, butter [demand is fairly active](#), according to Dairy Market News. Surplus cream offerings are trending lower as interest in Class II products such as cream cheese, sour cream and other cream based snack products develop for Super Bowl Sunday.
- International: Dairy Market News reports buying interest in Europe remains slow post the holiday period, but recently traders are reporting prices have stabilized and even started climbing. They note a [firmness in the market](#) is starting to develop, and that buyers are traders are returning as a result.
- International: Recent hot and dry weather in both New Zealand and Australia is pressing milk production downward, according to Dairy Market News. New Zealand production is estimated to be at 77% of the annual peak and thus far in January, milk output is lower than projected. Milk production in Australia is down 7.9% for the first five months of the milking season. Handlers note that the potential for faster than anticipated milk production declines [could significantly alter](#) second half manufacturing projections. Stocks of dairy end products are in close balance with needs and very little is available for spot buyer interest.

Futures Month	Friday 01/18 Close	Friday 01/11 Close	Change	5-yr Average	Top 3rd Price
Jan-08	\$19.28	\$19.30	(\$0.02)	\$12.50	\$13.33
Feb-08	\$17.15	\$17.85	(\$0.70)	\$12.53	\$13.21
Mar-08	\$16.85	\$17.20	(\$0.35)	\$12.78	\$13.50
Apr-08	\$16.37	\$16.55	(\$0.18)	\$14.14	\$15.36
May-08	\$16.42	\$16.34	\$0.08	\$14.50	\$15.85
Jun-08	\$16.51	\$16.50	\$0.01	\$14.54	\$15.63
Jul-08	\$16.66	\$16.60	\$0.06	\$14.66	\$15.57
Aug-08	\$16.77	\$16.72	\$0.05	\$14.47	\$15.40
Sep-08	\$16.96	\$16.88	\$0.08	\$15.14	\$16.02
Oct-08	\$16.70	\$16.43	\$0.27	\$14.78	\$15.58
Nov-08	\$16.54	\$16.27	\$0.27	\$14.75	\$15.73
Dec-08	\$16.48	\$16.22	\$0.26	\$15.09	\$16.18
Jan-09	\$16.30	\$16.10	\$0.20	\$12.50	\$13.33
Feb-09	\$16.28	\$16.10	\$0.18	\$12.53	\$13.21
Mar-09	\$16.20	\$16.13	\$0.07	\$12.78	\$13.50
Apr-09	\$16.20	\$16.10	\$0.10	\$14.14	\$15.36
May-09	\$16.25	\$16.10	\$0.15	\$14.50	\$15.85
Jun-09	\$16.25	\$16.10	\$0.15	\$14.54	\$15.63
<b>2008 Avg</b>	<b>\$16.89</b>	<b>\$16.91</b>	<b>(\$0.01)</b>		
<b>Jan-Jun 2009</b>	<b>\$16.25</b>	<b>\$16.11</b>	<b>\$0.14</b>		

**Bearish Fundamentals:**

- Cash Market: Cheese buyers tried to put up a front in today's cash market, buying 11 loads, but sellers were too strong, pushing the price down another nickel with 6 additional offers on the board at the close. For the week, blocks lost 20¢ to close at \$1.65/lb. Barrel selling was not quite as intense, but they still shed 17¾¢ to settle at \$1.80¼/lb. 4 loads of barrels traded for the week. Butter is still forming a bottom, but lost a penny to settle at \$1.22/lb with 3 cars trading hands.

**Monthly Milk Cows  
23 States**



- Milk Production Report: December milk production in the 23 major dairy states was up 3.1% in December, according to USDA. That number was below most expectations, but [14,000 cows were added](#) to the herd since November, and are now 107,000 more than in December 2006. For the year, milk production was up 2.1% for all 50 states. Leaders by percentage gain in Dec were CO up 8.3%, ID up 8.2%, AZ up 6.3% and TX up 6.1%. CA was up 4.5% and surprisingly, WI was up only 1.3%.
- Milk supplies in the Central region are well above year ago levels, according to Fluid Milk & Cream Review. Spot loads of surplus milk are being discounted \$1 to \$3 below class. Weakness in nonfat dry milk prices has handlers now trying to [keep cheese plants full](#) at the expense of butter/powder operations.
- Processing capacity remains an issue in California as strong milk production is creating a strain on the system. Fluid Milk & Cream Review reports timely processing of the milk supply is a problem, so some surplus milk is [moving to calf ranches](#) and other animal production facilities.
- Recent declines in the cash market have cheese buyers [delaying orders](#), waiting for prices to settle or decline further, according to Dairy Market News. Cheese offerings have increased and many coolers still contain some extra cheese produced during the yearend holiday period. Nonfat dry milk has declined enough in price to make it attractive for cheese plants to boost yields.
- The Central dry whey market is weak as [offerings are heavy](#), according to Dairy Market News. Buyers are aware of the weak undertone and are tentative in making purchases. Prices in the Central region ranged as low as 30¢/lb to 38¢/lb this week.
- Just like dry whey, Dairy Market News reports the nonfat dry milk market remains weak as well. Product offerings are heavy and discounts are being applied to stimulate buyer interest. Prices in the Western region ranged from \$1.40/lb to \$1.55/lb. Production is still trending upwards due to the increasing milk supply, so stock levels are [high and increasing](#).
- In the first 14 days of the New Year, cheese [stocks are up](#) 1% and butter stocks up 14%, according to USDA weekly cold storage numbers.
- Weekly dairy cow slaughter for the first week of 2008 [were fewer](#) than in 2007. 43,100 head were culled compared to 44,800 during the same week last year.
- Economy: The stock market has taken an absolute pounding the past two weeks, with the Dow suffering multiple triple digit losses. President Bush announced a [\\$145 billion economic plan](#) in the form of tax rebates this morning, but the street quickly discounted it and the market continued to fall. The prevailing feeling is that the U.S. is headed toward, if not already in, recession.

### **Recommendation:**

Front month futures took a hit this week as more cheese showed up at the exchange. Blocks cheese has fallen off a cliff, losing more than 50¢/lb in the last two weeks. With cheese buyers waiting for a bottom and barrels still above \$1.80/lb, it points to further weakness next week, with more likelihood that barrels will now need to drop to close the inverted spread. Despite falling 70¢ this week, the Feb contract remains vulnerable if barrels drop next week and could easily be pricing below \$17/cwt should that happen. However, futures buyers have been steady Feb buyers on the way down, perhaps trying to position themselves for the next cheese rally. While the market remains as unpredictable as ever, we're not sure that's going to happen for a bit. Word from our contacts indicates cheese orders have slowed while extra cheese made during the holidays is waiting to clear. At \$1.65 blocks, however, buyers may start to pick up loads for aging programs which need to be filled over the coming months. And despite the front months being pounded this week, the 2008 average lost only a penny as many of the back months and 2009 contracts saw double-digit gains. The futures markets appear to be predicting a bear market over the next several weeks or possibly months, followed by a significant recovery in the last half of the year. With little relief in grain prices, \$16 milk for 3-4 months could cause a lot of pain, especially in federal orders with a negative basis. But this presents some opportunities. First, in the front months, we would look to sell Feb at 17.50 or higher, but then immediately get call option coverage to protect your upside. Target to buy Mar – May 18.00 CALLs for an average of 25¢ each, then sell in to them on a market rally. For those of you that have already made marketing decisions and sold through your plant, the next few weeks could provide a great opportunity to purchase CALL option coverage to protect your forward contracts. Psychology will play in to this as well. Unfortunately, a lot of producers watching the market move lower will get depressed and "sell at the bottom"; resist doing this! Instead, use it as an opportunity to buy those CALL options!

**Note:** Our office will be close on Monday in observance of Martin Luther King Jr. day. All financial markets are closed.

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