

The KDM Dairy Report – March 14th, 2008

What's Bullish:

- World Ag Supply & Demand Report: USDA adjusted their Class III forecast higher from last month. Despite predicting more milk from more cows this year, they [increased their cheese price](#) forecast, from \$1.67/lb last month to \$1.77½/lb this month. The adjustment moves the Class III forecast higher as well, from \$15.80/cwt to \$16.45/cwt.
- Western cheese buyers are [aggressively looking for product](#) in order to take advantage of the recent price drop, according to Dairy Market News. But they're having little luck in finding the cheese that they need, especially when more than one load is needed. Buyers continue to have minimal stocks on hand, while manufacturers have very little uncommitted cheese. Overall cheese demand is very good, and with product in close balance to tight, some contacts think another upward move in cheese prices could start.
- NASS dry whey prices saw their [first weekly rise since mid December](#). The weekly survey had dry whey at 24.7¢/lb, up 1.1¢. Nonfat dry milk increased 2.4¢ to \$1.27/lb, and butter was up 3.8¢ to \$1.21/lb. Cheese prices were higher as well, with blocks averaging \$2.05/lb, up 5.6¢, and barrels rising 3.5¢ to \$2.00/lb.
- Dairy cow slaughter for the week ending 03/01 was a [strong 52,300 head](#), according to USDA.
- Butter stocks at CME-approved warehouses [fell contra-seasonally](#) for the week ending 03/08. A net drawdown of 500,000 lbs was reported, compared to an increase of 3 million lbs during the same week last year.
- Fluid Milk & Cream Review reports most coops and proprietary plants in the state of California have, or soon will have, some form of [milk base plan](#) in place for their dairy producers (you heard it here first!). Heavy milk supplies and lack of processing capacity are the main reasons for implementation.
- Butter [demand is strong](#) in the Central region, according to Dairy Market News. Retail outlets are preparing for the upcoming Easter/Passover holidays, and heavy promotions are expected to clear strong volumes of print butter. Food service orders are somewhat stronger, as eating establishments prepare for the holiday.
- Butter exports in January were [up more than 1,300%](#), according to Dairy Market News. 14.2 million lbs were shipped out of the country, compared to less than 1 million lbs a year ago. The export total accounted for more than 8% of January's record butter production. And Tuesday's Daily Dairy Report indicated the overall value of U.S. dairy exports for the month was [up 114.4%](#) vs. last year, at \$323.3 million.
- Cash Butter: Spot traded butter continued to make incremental gains, rising 3¢ this week to close at \$1.35¼/lb. Bids went unanswered for the week as no trades were reported.
- January cheese and curd exports totaled over 23.5 million lbs, up 52% vs. January 2007, according to the Foreign Ag Service. The amount exported was [almost 3% of total cheese production](#) in January. The top five buyers were Mexico, Korea, Japan, Canada and Australia.
- Dairy Market News reports Western dry whey inventories are in [much better shape](#) than they were a few weeks ago. Current buyer interest has improved has also improved.
- Western nonfat dry milk production is still heavy, but producers indicate demand has improved and [sales volumes have increased](#), according to Dairy Market News. More stock and nearby production has been committed to both domestic and export accounts.
- International: Some moisture has returned to New Zealand, but milk handlers feel that output will probably not be able to recover, according to Dairy Market News, and production in Australia trailed last year's levels for the first seven

Futures Month	Friday 03/14 Close	Friday 03/07 Close	Change	5-yr Average	Top 3rd Price
Mar-08	\$18.03	\$18.07	(\$0.04)	\$12.78	\$13.50
Apr-08	\$16.86	\$17.10	(\$0.24)	\$14.14	\$15.36
May-08	\$16.91	\$17.07	(\$0.16)	\$14.50	\$15.85
Jun-08	\$17.00	\$17.11	(\$0.11)	\$14.54	\$15.63
Jul-08	\$17.18	\$17.18	\$0.00	\$14.66	\$15.57
Aug-08	\$17.36	\$17.35	\$0.01	\$14.47	\$15.40
Sep-08	\$17.52	\$17.50	\$0.02	\$15.14	\$16.02
Oct-08	\$17.32	\$17.29	\$0.03	\$14.78	\$15.58
Nov-08	\$17.32	\$17.25	\$0.07	\$14.75	\$15.73
Dec-08	\$17.36	\$17.24	\$0.12	\$15.09	\$16.18
Jan-09	\$17.40	\$17.23	\$0.17	\$14.40	\$15.24
Feb-09	\$17.34	\$17.13	\$0.21	\$14.00	\$14.69
Mar-09	\$17.25	\$16.90	\$0.35	\$12.78	\$13.50
Apr-09	\$17.25	\$16.80	\$0.45	\$14.14	\$15.36
May-09	\$17.30	\$16.86	\$0.44	\$14.50	\$15.85
Jun-09	\$17.38	\$16.80	\$0.58	\$14.54	\$15.63
Jul-09	\$17.30	\$16.88	\$0.42	\$14.66	\$15.57
Aug-09	\$17.30	\$16.92	\$0.38	\$14.47	\$15.40
Sep-09	\$17.35	\$16.89	\$0.46	\$15.14	\$16.02
Oct-09	\$17.32	\$16.90	\$0.42	\$14.78	\$15.58
Nov-09	\$17.28	\$16.90	\$0.38	\$14.75	\$15.73
Dec-09	\$17.28	\$16.95	\$0.33	\$15.09	\$16.18
Mar-Dec 2008	\$17.29	\$17.32	(\$0.03)		
2009 Avg	\$17.31	\$16.93	\$0.38		

months of the season. Stocks of manufactured dairy products are in close balance to short of needs, causing handlers to believe they'll need to [look to outside sources](#) to fill prior commitments.

- International: Despite a strong start to their milk production season in the EU (some areas are up 9%), stocks of manufactured dairy products in Europe are quite limited. Dairy Market News reports [warehouses are basically empty](#) from last season, and new production is still not readily available. Traders feel current prices are probably near the bottom, and expect them to firm in the future.

What's Bearish:

- Cash Cheese: Barrels plummeted 12¾¢ this week, settling at \$1.74/lb, while blocks lost 5½¢ to settle at \$1.81/lb. Sellers brought product with their offers as 17 loads of blocks and 15 loads of barrels exchanged hands.
- Weekly cold storage holdings stats reflect an [early month buildup](#) in cheese stocks. For the period 03/01 through 03/10, cheese inventories were up 8%, or 7.9 million lbs at USDA selected storage centers. Butter stocks were up 11%, or 3.9 million lbs.
- The Northeast cheese market is weaker, according to Dairy Market News. Although foodservice and retail orders are steady to higher, [cheese production is up](#), with some plants using discounted milk to increase output.
- Dairy Market News reports orders for cheese in the Midwest have slowed, as buyers wait for prices to settle at lower levels. Natural American and mozzarella [sales have slowed](#), and process interest is generally fair at best.
- Milk production is [strong in the Northeast](#), according to Fluid Milk & Cream Review. Because of the strong milk price, many dairy producers kept cows throughout the winter that would normally have been culled.
- Manufacturing milk interest in the Central region of the country is still spotty, according to Fluid Milk & Cream Review. Milk volumes are steady to higher, [with more milk available than interest](#). Many plant operators are concerned with having adequate capacity to handle patron peak milk intakes in spring.
- Fluid Milk & Cream Review reports California milk production is still very strong, as ideal weather persists over the Central Valley. In Arizona, milk output is getting a boost from good weather and cows eating the first cutting of green chop. Plants in the state are [at or near capacity](#), and some milk is being sent to nearby states to help out when possible.
- Economy: U.S. home foreclosure filings in February were [up 60%](#) vs. a year ago, according to a Reuters article yesterday. The jump higher indicates we still have not reached the peak of foreclosure activity.
- Economy: Consumer confidence in March dropped to 70.5, a [16-year low](#).

Recommendation:

The U.S. economy continues to be the biggest risk to sustained, high milk prices. Whether the slowdown will be big enough to ripple into commodities has yet to be seen, but at least some affect is likely. On the flip side, the U.S. dollar hit new lows vs. the Euro and the Yen, making our exports that much more attractive. Near term, it appears that east of the Mississippi we have plenty of cheese with more coming, while out West, buyers are scrambling for product. From talking to industry contacts, we think the short-term direction is lower for the front months as more cheese arrives at the CME, and may spill over into the last half of 2008 as well. We would recommend buying April 16.50 PUT options at 25¢ to get covered. Longer term, we are still supportive of prices; just look at what 2009 did this week, with the average jumping another 38¢ to \$17.31/cwt. That's \$1.80 cheese. The risk is growing that the second half of 2008 is affected by a slow economy. July-Dec currently averages \$17.34, which is \$1.82 cheese. We would consider selling up to 25% of your production at this level, with the idea of buying it back and taking a profit should we had down towards \$16.50. Doing a bit of selling gives you some protection from lower prices, but doesn't lock up too much of your production. Our long-term outlook is still positive, which is why we would exit the hedge early if enough profit accumulates. Call us for more info on this strategy.

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