

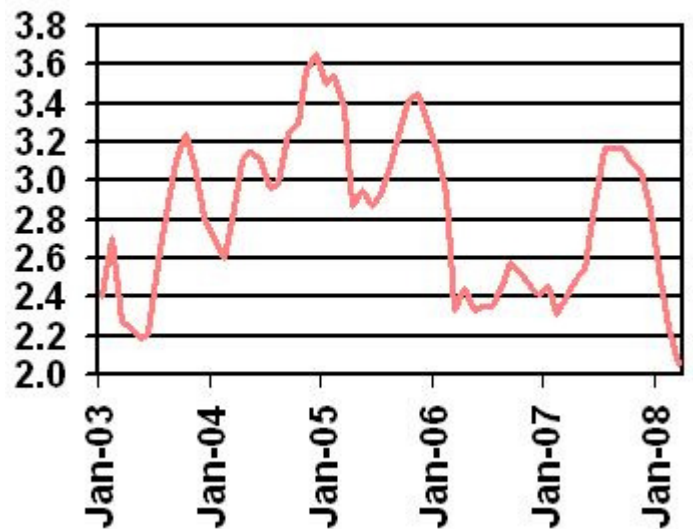
The KDM Dairy Report – March 28th, 2008

What's Bullish:

- Commercial Disappearance: Use of dairy products got off to a [strong start in January](#). American cheese use in January was up 5.7% vs. a year ago, according to USDA statistics, and use of total cheese was up 4.4% for the same period. Butter use was up a strong 22%, nonfat dry milk use up 19.8% and use of milk in all products was up 7.9%.
- Ag Prices Report: The milk-feed ratio fell to 2.05 in March, down from 2.24 in Feb, according to USDA figures released today. That's the [lowest in more than 23 years](#), since the ratio was first calculated by USDA in January, 1985 (see graph below).
- Cash Market: Ok, prices didn't move much, but buyers appeared very willing to own product as 11 blocks and 14 barrels exchanged hands for the week. Blocks went as low as \$1.79/lb on Tuesday, but ended Friday at \$1.81/lb, up 1¢ for the week. Barrels finished 2½¢ lower at \$1.75/lb. Butter traded 8 times and lost 2¾¢ for the week to settle at \$1.36/lb.
- Dairy Market News reports the western whey powder market continues to strengthen. Both export and domestic [interest is improving](#), with inventories in better balance. Buyers appear more willing to have extra powder on hand at this time.
- Western nonfat dry milk is getting much harder to find from all sources, according to Dairy Market News. Manufacturers indicate inventories are in much better balance and stocks are generally committed. Domestic sales are improving and [export interest is going unfilled](#).
- Nonfat dry milk is suddenly tight in the Central region as well. Dairy Market News reports current [supplies are tight to short](#), with most producers fully committed. Most of the product is going for export.
- Current, natural American cheese remains [tight in the Midwest](#), according to Dairy Market News. Recent lower cheese prices have encouraged buyers to add to aging programs.
- Western natural cheese demand is good and offerings are in close balance, according to Dairy Market News. Multi-load orders are taking a few weeks to put together, and [export sales have picked up](#).
- International: Dairy producers in New Zealand are stating that conditions are the [driest they have ever seen](#). Drought conditions are being reported in over 50% of the dairy regions on the north island, with annual output now expected to be down as much as 3% from a year ago. Dry conditions continue as well in Australia, with milk output expected to trail last season by 5%. With very little that can help at this point in the milking season, farmers are reducing milkings per day and drying cows off early. Existing stocks are fully committed, with some handlers indicating outside sources may be needed to fulfill total commitments.

Futures Month	Friday 03/28 Close	Thursday 03/20 Close	Change	5-yr Average	Top 3rd Price
Mar-08	\$18.00	\$17.99	\$0.01	\$12.78	\$13.50
Apr-08	\$16.87	\$16.69	\$0.18	\$14.14	\$15.36
May-08	\$17.17	\$16.97	\$0.20	\$14.50	\$15.85
Jun-08	\$17.50	\$17.02	\$0.48	\$14.54	\$15.63
Jul-08	\$17.56	\$17.08	\$0.48	\$14.66	\$15.57
Aug-08	\$17.74	\$17.25	\$0.49	\$14.47	\$15.40
Sep-08	\$17.91	\$17.43	\$0.48	\$15.14	\$16.02
Oct-08	\$17.80	\$17.26	\$0.54	\$14.78	\$15.58
Nov-08	\$17.74	\$17.26	\$0.48	\$14.75	\$15.73
Dec-08	\$17.75	\$17.25	\$0.50	\$15.09	\$16.18
Jan-09	\$17.50	\$17.10	\$0.40	\$14.40	\$15.24
Feb-09	\$17.35	\$17.03	\$0.32	\$14.00	\$14.69
Mar-09	\$17.20	\$16.96	\$0.24	\$12.78	\$13.50
Apr-09	\$17.24	\$16.91	\$0.33	\$14.14	\$15.36
May-09	\$17.23	\$16.97	\$0.26	\$14.50	\$15.85
Jun-09	\$17.19	\$17.04	\$0.15	\$14.54	\$15.63
Jul-09	\$17.24	\$17.12	\$0.12	\$14.66	\$15.57
Aug-09	\$17.28	\$17.02	\$0.26	\$14.47	\$15.40
Sep-09	\$17.28	\$17.10	\$0.18	\$15.14	\$16.02
Oct-09	\$17.15	\$17.06	\$0.09	\$14.78	\$15.58
Nov-09	\$17.10	\$17.04	\$0.06	\$14.75	\$15.73
Dec-09	\$17.13	\$17.14	(\$0.01)	\$15.09	\$16.18
Mar-Dec	\$17.60	\$17.22	\$0.38		
2009 Avg	\$17.24	\$17.04	\$0.20		

Milk-feed Ratio



- International: Demand for cheese in Oceania remains strong and stocks are starting to tighten, according to Dairy Market News. Some traders and handlers are indicating that they will be entering the next production season with [virtually no carryover](#).

What's Bearish:

- NASS cheese prices were [down substantially](#) this week. 40-lb blocks fell 8.2¢ to average \$1.92/lb while 500-lb barrels dropped 8.3¢ to \$1.89/lb. Butter managed to gain 1¢ to \$1.29/lb, while dry whey was up 0.2¢ to 24.5¢/lb and nonfat dry milk increased 3.2¢ to \$1.27/lb.
- Both [cheese and butter inventories grew](#) during the first 3 weeks in March, according to weekly cold storage numbers. For the period 03/01 through 03/24, butter stocks increased 17%, or 6.2 million lbs, while cheese stocks were up 7%, or 6.8 million lbs.
- Lower fluid sales and spring break at schools is resulting in [higher intakes at balancing plants](#) in the Southeast, according to Fluid Milk & Cream Review. Florida exported 100 loads of milk this week, compared to 62 last week, as cooler temps and low humidity are aiding cow comfort.
- Fluid Milk & Cream Review reports milk output in California is [increasing at a faster pace](#) as more new crop forage becomes available. Hay quality is good and demand is excellent, despite prices that are \$40-60/ton higher than last year. In Arizona, plants are running full and some milk offerings had to be turned away over the holiday weekend.
- Churning activity across the country is heavy, with [surplus cream offerings](#) readily available, according to Dairy Market News. Butter sales were strong leading up to Easter, but now production is expected to outpace demand.
- International: The European Union approved a proposal for a [2% increase in milk quotas](#) beginning April 1, 2008, to meet growing demand within and outside the EU, according to Dairy Market News. Milk production is strong in the region, with France up 10%.

Recommendation:

Despite more cheese coming to market this week, buyers appeared willing to buy at prices higher than the trade expected. Most expected cheese to make a run down to the \$1.65 level, but buyers didn't let that happen, at least not this week. As we head in to spring flush, we may yet see cheese head lower, but the solid buying at these levels seems to show a further retracement is less likely. Psychologically, it's a new floor as well, since buyers now see sub \$1.80 cheese as a good price. Our record low milk-feed ratio of 2.05 is impressive, although that's likely to give up some ground next month with the higher milk price. But it does tell us that milk will be expensive to produce this year, something we all know already. And the global situation still looks very supportive, with stocks in Oceania expected to make the cupboard bare by the end of their milking season in June/July. Come fall, then, we could be in quite a tight situation globally, with the world wanting to buy holiday cheese. Option activity over the past two weeks also suggests buyers wanting to own CALL options in anticipation of higher prices yet to come, and the July-Dec contracts all went up about 50¢ this week; not bad considering blocks were up only a penny and barrels were lower. Grains were sharply lower today, but made quite a recovery from last week. Continue to look at getting coverage for your feed needs as fundamentals are still very supportive. This Mon/Tue was a great opportunity to get something done with your local supplier. Our milk rec remains the same this week. Leave yourself open to higher prices, but get some kind of floor protection. Buy Jun-Oct 15.50 PUT options for an average of 16¢ each. Finally, if you already have milk sold, seriously consider buying July-Oct 20.00 CALL options for an average of 27¢. It may sound crazy, but with current inflationary pressures, milk prices this fall could go quite a bit higher than \$20, with even \$25+ a possibility. \$20.00 CALL options would be quite nice to have if that were to happen. Call us!

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