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The KDM Dairy Report – May 16th, 2008

What's Bullish:

Futures Month	Friday 05/16 Close	Friday 05/09 Close	Change	5-yr Average	Top 3rd Price
May-08	$18.09	$17.97	$0.12	$14.50	$15.85
Jun-08	$19.90	$19.48	$0.42	$14.54	$15.63
Jul-08	$20.40	$20.12	$0.28	$14.66	$15.57
Aug-08	$20.40	$20.35	$0.05	$14.47	$15.40
Sep-08	$20.55	$20.45	$0.10	$15.14	$16.02
Oct-08	$20.15	$20.20	($0.05)	$14.78	$15.58
Nov-08	$20.09	$20.12	($0.03)	$14.75	$15.73
Dec-08	$20.02	$19.97	$0.05	$15.09	$16.18
Jan-09	$19.55	$19.53	$0.02	$14.40	$15.24
Feb-09	$19.17	$19.15	$0.02	$14.00	$14.69
Mar-09	$19.18	$19.10	$0.08	$14.55	$15.28
Apr-09	$18.78	$18.77	$0.01	$15.61	$16.83
May-09	$18.78	$18.75	$0.03	$14.50	$15.85
Jun-09	$18.73	$18.75	($0.02)	$14.54	$15.63
Jul-09	$18.78	$18.75	$0.03	$14.66	$15.57
Aug-09	$18.83	$18.82	$0.01	$14.47	$15.40
Sep-09	$18.85	$18.87	($0.02)	$15.14	$16.02
Oct-09	$18.65	$18.60	$0.05	$14.78	$15.58
Nov-09	$18.60	$18.60	$0.00	$14.75	$15.73
Dec-09	$18.60	$18.58	$0.02	$15.09	$16.18
May-Dec	**$19.95**	**$19.83**	**$0.12**		
2009 Avg	**$18.88**	**$18.86**	**$0.02**		

- Cash Market: Cheese buyers seem to have an insatiable appetite as they punched prices through the $2 barrier. Blocks ended the week 8¼¢ higher to close at $2.08/lb and barrels gained 5¢ to settle at $2.03/lb. Despite the steady but persistent bidding, only 3 blocks and 3 barrels exchanged hands as sellers still seemed reluctant to part with product. Spot butter increased 3¢ on 4 trades to close at $1.50, it's highest close since August 7th, 2007.
- Livestock, Dairy & Poultry Outlook Report: USDA's monthly look at domestic ag markets remains largely positive for the dairy sector. Milk production continues to rise, despite higher feed costs, however, 2009 production is expected to increase by only 0.9% and cow numbers are expected to fall by 35,000 head. Exports are forecast to stay strong in 2009 as milk production increases in Europe will largely go for domestic consumption, and dairy product availability from Oceania remains limited. A lower valued dollar should make the U.S. an increasing source of global dairy products, especially cheese. Cheese prices are expected to stay firm in 2008 as milk is moving to butter/powder operations because cheese production capacity is limited. USDA predicts cheese will average $1.85/lb in 2009.
- Most Class III components were up again in this week's NASS survey, as they continue to play catch-up with the cash market. 40lb cheddar blocks increased 3.3¢ to average $1.93/lb, while 500lb barrels jumped 5.3¢ to $1.91/lb. Butter gained 4.3¢ to average $1.41/lb and nonfat dry milk increased 3.3¢ to $1.31/lb. Dry whey was the only component lower, falling 0.3¢ to average 26.4¢/lb.
- Butter stocks at CME-approved warehouses were up 5.7 million lbs this week, but the increase was less than the 8.6 million lbs added a year ago. The affect of this is that stocks on hand trail last year's total by more than 7.5 million lbs.
- Milk production in California is steady to down slightly, as quota programs continue to impact milk intakes at the processor level. In the Pacific Northwest, crops are very slow to develop with hay harvest 2-3 weeks behind normal.
- Dairy Market News reports demand for cheese in the Midwest at the food service level is steady to improved as vacation locations build supplies for Memorial Day weekend and also for wedding/graduation season. Natural American 40# blocks are tight to short, with 640's a little more plentiful. 40# blocks are not the preferred package size for export, but international interest is taking them anyway due to a lack of alternatives.
- Western cheese is available, but supplies are not considered burdensome at all, according to Dairy Market News. The cheese market remains on the tight side, as domestic buyers are looking for any extra cheese in an attempt to stock up.
- Dairy Market News reports butter orders are excellent for current needs and future coverage, as buyers desire to have some extra stocks on hand going into the fall sales period. End users are placing orders now for mid to longer range needs and placing butter into storage programs.
- The Central nonfat dry milk market is firm, as plant output is mostly committed on anticipated production. This is limiting new spot sales, according to Dairy Market News. Interest in high heat NDM has improved, but these offers can't be filled due to tight supply. Contributing to the tight supplies, the Foreign Ag Service reported that Q1 exports of nonfat dry milk were up 73.5% compared to 2007.
- International: Export sales are slowing as prices eclipse $2/lb, however, the Foreign Ag Service announced this week that exports of cheese and curds for Q1 totaled 73.2 million lbs, 54% over last year. The total exported accounted for 3% of U.S. cheese production for the period. Cheddar cheese exports were up 175.5% at 15 million lbs.

- International: Exports of butter and milkfat for Q1 totaled 51.7 million lbs, up 900% vs. 2007, according to the Foreign Ag Service. Butter exports accounted for 11% of total production for the period. The top buyer was Russia at 15.3 million lbs. During the same period in 2007, Russia imported no butter.
- International: Japan is suffering from a shortage of butter, and continues to look for more supplies, according to Dairy Market News. They imported about 60,000 lbs of U.S. butter a year ago, but have already imported 1 million lbs this year.

What's Bearish:

- As U.S. cheese and butter prices close the gap with international prices, export interest has started to decrease.
- For the first twelve days of May, cheese stocks at USDA selected storage centers were up 3%, or 3.3 million lbs.
- Dairy Market News reports March fluid milk sales at 4.7 billion lbs were down 3.4% compared to March 2007. Sales of organic whole milk, 2%, 1% organic low fat and butter milk increased, but sales of whole milk, flavored milk and skim were all down.
- Weekly dairy cow slaughter numbers show we're falling further behind last year. For the week ending 05/03, 46,000 head were culled, compared to 47,200 during the same period a year ago.
- Class I interest in the Central region is often slow as schools begin to shutter for the summer, according to Fluid Milk & Cream Review. Surplus milk continues to clear at a discount, with some offers well below class.
- Bottler demand is lower than anticipated in the Northeast, but milk receipts continue to climb, according to Fluid Milk & Cream Review. Some handlers are concerned that plant capacities will be stretched during the Memorial Day weekend, and the weeks to follow, as schools end classes.
- Dairy Market News reports some butter producers are questioning how long international sales will continue as the price of U.S. butter increases. In addition, 13-15 million lbs of butter per week are clearing to Europe's storage program, some of which will become available in August.
- A weaker undertone is developing in dry whey, according to Dairy Market News. Domestic demand is steady, but export sales have slowed as some pushback on prices has occurred. Production is heavy and inventories are in good shape. Exports of dry whey in Q1 2008 were down 26% compared to a year ago, according to the Foreign Ag Service.
- Economy: Crude oil pushed to a new record high today, hitting $127.82/bar. Analysts at Goldman Sachs are forecasting crude oil to hit $140/bar in the second half of the year. The rise in energy and food costs is weighing on the minds of Americans, as the Consumer Sentiment reading for May fell to its weakest reading since June 1980.

Recommendation:

Like the law of gravity, there's no argument anymore about the positive impact exports are making on U.S. dairy prices. The case is settled. The Foreign Ag Service this week revealed 1st quarter export numbers and they were stunning. We had a 900% increase in butter exports which totaled 11% of total production and a 54% increase in cheese exports which accounted for 3% of total production. Nonfat dry milk exports over the same period were up 73.5%. And the good news is that the trend is likely to continue well into, if not through 2009. Cheese production capacity is not increasing in the U.S., while at the same time we have, "…chronic shortages of milk and dairy products in most countries of the world", according to Rabobank dairy analyst Tim Hunt. India's growing middle class numbers 300 million, more than the entire population of the U.S., and along with other Asian countries like China, are improving their diets with more dairy products. This increased demand is ramping up sales of dairy exporting countries, but some of them, like New Zealand, are reaching limits in how quickly they can grow their milk production. This bodes well for the U.S. It's not all good news. The U.S. economy is still struggling, and the prospect of $140/bar crude oil (oil were competing for with these same growing countries) this year has consumers in a foul mood. Global recession remains the biggest bear on milk prices, but has so far remained in hibernation. But beware the bear! We entered a slug of orders this week for the July-Oct 18.00 PUT options and got….. nothing. Despite futures prices $2.00-2.50/cwt higher, options sellers just wouldn't let them go. That tells us there is still a considerable amount of "correction" nervousness out there, and we agree. However, we're recommending you stick with this order again for next week, as we're just not willing to pay any more for them. Ok, you've been asking in more frequency, so we'll put out our very first 2009 recommendation, which you can probably already guess. DON'T SELL! USDA predicts cheese will average $1.85/lb in 2009. That works out to about $17.88 Class III, and 2009 futures currently average $18.88. Considering USDA is usually wrong and nearly always too low, and in light of our thoughts on the continued impact of exports, we think selling with a possible downside risk of $1.00/cwt is not wise. The upside risk is MUCH higher than the downside risk in 2009, in our opinion. The cost of producing milk in 2009 does not appear to be going down from 2008 and the bloated farm bill looks veto proof which should ensure feed costs remain elevated. With the prospect of much higher diesel and energy dependent fertilizer costs, you might need $20/cwt in 2009 to cash flow.