

**The KDM Dairy Report – June 6<sup>th</sup>, 2008**

**What's Bullish:**

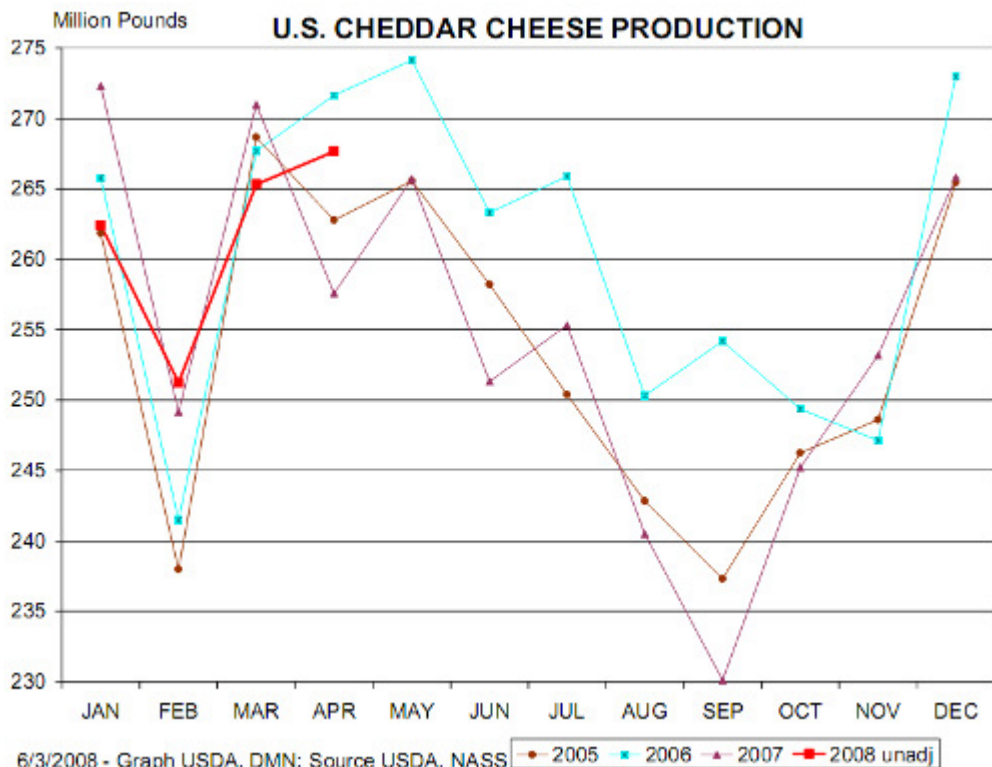
- CWT announced on Tuesday there 5<sup>th</sup> [herd retirement program](#) commencing immediately. Bids are due by June 30<sup>th</sup>. They will be reviewed in early July, with cow removal set to begin after mid-July. There is no target on how many cows will be removed, and unlike previous retirement programs, regional limits will not be utilized.
- Butter stocks at CME-approved warehouses declined again this week, leaving net inventories [15.8 million lbs below](#) last year's levels at this time.
- Weekly dairy cow slaughter for the week ending 05/25 was 45,400 head, [up 3,800 head](#) from the same period a year ago.
- Cheese supplies in the Midwest remain tight, despite seasonally heavy cheese production, according to Dairy Market News. Buyers are reluctant to make more than fill-in purchases at current prices, but that may change as they eye the potential affects of the CWT announcement this week. Buyers are able to purchase a load or two, but [multi-load volumes are hard to find](#). Cheese makers continue to limit production to just committed orders.
- Dairy Market News reports Western cheese buyers continue to look for cheese and are generally not complaining about current prices, as simply finding enough cheese is much more of a concern. If more cheese were offered, they would buy it, but apparently [June cheese is already booked](#), and the first cheese available is in early July.
- Weather is warming out East and milk production is [easing off peak levels](#), according to Fluid Milk & Cream Review. Plants are busy, but not like a week or two ago, as they are now able to accommodate production. Butterfat content is beginning to drop, as both heat and ration adjustments, in response to higher feed costs, affect output.
- Fluid Milk & Cream Review reports milk base plans have curtailed milk shipments out of state, and processing plants are running along planned levels. Cost of production issues continue to concern milk producers in the state, while a drought declaration for the state has been signed by the governor. Output in New Mexico is being hampered by hot weather and cream is tighter as [demand from ice cream accounts increases](#). In the Pacific Northwest, plants are not running quite as full as they were before Memorial Day, as outside offers of surplus milk have declined, leaving mostly local milk to process. First cutting hay in the region is 2-3 weeks behind, which means many growers will not get a last cutting in at the end of the growing season. But the need for hay is at a peak as old crop supplies are nearly exhausted.
- Churning activity is still seasonally active across the country, but [cream supplies have tightened](#), according to Dairy Market News. The decline in cream offerings is a result of improved Class II demand and a drop in cream skimmed from school milk programs as the school year ends.
- Grains: Continued wet, cold weather and an energy rally combined to push grain prices significantly higher this week. Rain drenched major grain producing states, threatening corn yields and delaying already late bean planting. Dec corn rallied to a new intra-day contract high at \$6.90½/bu, before settling back down to \$6.76/bu. Beans are over \$14/bu through 2011. As producers work on getting 2009 feed under contract, their bills will be much higher than in 2008.
- International: Germany, a major milk producing country, is in the midst of a milk strike, as farmers there have been protesting low prices by dumping milk and feeding it to their young stock. The strike has been in effect for over a week now, and retailers are starting to feel the squeeze as [shortages are being reported](#). Milk output is strong in the rest of Western Europe, leading most traders and milk handlers to believe the strike will have minimal overall impact, unless it continues for an extended period of time. However, despite current high milk output, stocks of manufactured dairy products are in tight balance.
- International: Dairy Australia reported this week that cheese output in April was [down 5.5%](#) vs. last year, and down 3.4% YTD. Butter output was up 8.6%, but YTD is still down 8.3%. Exports of all dairy products originating from

Futures Month	Friday 06/06 Close	Friday 05/30 Close	Change	5-yr Average	Top 3rd Price
Jun-08	\$20.15	\$20.15	\$0.00	\$14.54	\$15.63
Jul-08	\$20.55	\$20.43	\$0.12	\$14.66	\$15.57
Aug-08	\$21.03	\$20.48	\$0.55	\$14.47	\$15.40
Sep-08	\$21.24	\$20.55	\$0.69	\$15.14	\$16.02
Oct-08	\$20.89	\$20.16	\$0.73	\$14.78	\$15.58
Nov-08	\$20.68	\$20.00	\$0.68	\$14.75	\$15.73
Dec-08	\$20.60	\$19.95	\$0.65	\$15.09	\$16.18
Jan-09	\$20.05	\$19.65	\$0.40	\$14.40	\$15.24
Feb-09	\$19.47	\$19.05	\$0.42	\$14.00	\$14.69
Mar-09	\$19.50	\$19.02	\$0.48	\$14.55	\$15.28
Apr-09	\$19.39	\$18.72	\$0.67	\$15.61	\$16.83
May-09	\$19.25	\$18.73	\$0.52	\$16.19	\$17.54
Jun-09	\$19.37	\$18.76	\$0.61	\$14.54	\$15.63
Jul-09	\$19.33	\$18.74	\$0.59	\$14.66	\$15.57
Aug-09	\$19.50	\$18.80	\$0.70	\$14.47	\$15.40
Sep-09	\$19.50	\$18.97	\$0.53	\$15.14	\$16.02
Oct-09	\$19.50	\$18.78	\$0.72	\$14.78	\$15.58
Nov-09	\$19.22	\$18.70	\$0.52	\$14.75	\$15.73
Dec-09	\$19.22	\$18.73	\$0.49	\$15.09	\$16.18
<b>Jun-Dec</b>	<b>\$20.73</b>	<b>\$20.25</b>	<b>\$0.49</b>		
<b>2009 Avg</b>	<b>\$19.44</b>	<b>\$18.89</b>	<b>\$0.55</b>		

Australia were down 18.3% for the period Jul-Apr, butter oil and whey seeing the biggest declines at 43.3% and 34.9% respectively.

### What's Bearish:

- Economy: The Dow fell nearly 400 points today as crude rocketed up more than \$11/barrel and unemployment numbers showed its [biggest monthly rise](#) since 1986.
- Cash Market: Cheese prices continued to ease off their highs this week as blocks gave up 7¢ to settle at \$2.16/lb today, and barrels shed 5¢ to close at \$2.15/lb. Neither buyers or sellers seemed too motivated as only 6 loads of blocks and 4 barrels exchanged hands. Butter trading was very active at 26 loads, but the price was unchanged from last week at \$1.48/lb.
- Dairy Products Report: Higher cheese prices are encouraging production. In April, Cheddar [cheese output was up](#) 3.9% compared to a year ago (see chart), and total cheese output for all varieties was up 1.4% over the same period. Butter production was up an even more impressive 14.8%. But skim milk powder put them all to shame, increasing output by an astounding 132% vs. last April. In all these instances, however, one could argue a strong export market had something to do with the higher output.
- The milk surplus situation in the Midwest may be the [worst in at least a few years](#), according to Fluid Milk & Cream Review. A couple traditional surplus milk-buying plants in Wisconsin are no longer taking extra supplies, adding to the backup. Milk handlers are making multiple calls to try to clear product, with spot loads going for -\$1.50 to -\$5.00 under class.
- Dairy Market News report Central dry whey prices continue to remain flat as producers long on whey have been [discounting](#) in order to move product.



### Recommendation:

Cheese prices fell but in response, Class III futures rallied across the board this week. The biggest gains were seen in 2009 contracts as the average rallied 55¢ to \$19.44/cwt. Wow! Could it be that commercial end-users of milk, having weathered \$20 spikes in 2007, \$2+ cheese in 2008 during the spring flush, are now thinking \$19 milk in 2009 doesn't look so bad? We can't say for sure, but the 2009 contracts did make a significant move. The market could also simply be pricing what it thinks the cost of production might be next year, with the prospect of record grain prices and a hay shortage threatening. And despite strong milk production nationally, cheese stocks remain surprisingly tight. This fall could get very interesting as it's clear now that production is coming off its peak as warmer weather moves in. As we've stated several times before, the economy and geopolitical events remain the biggest risk to the milk bull. Sharply higher energy prices and a weak economy may eventually ration demand for dairy products, but so far there is little evidence of that. We can't even begin to predict what will happen near-term, other than that we could see violent moves up or down from here on out, especially in the front months. For that reason, we continue to recommend getting coverage. Buy the July 19.25 PUT for 25¢, which yields an effective floor of \$19/cwt base price. Enter long term orders to buy Aug-Oct \$19.00 PUT options for an average of 35¢ each.

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