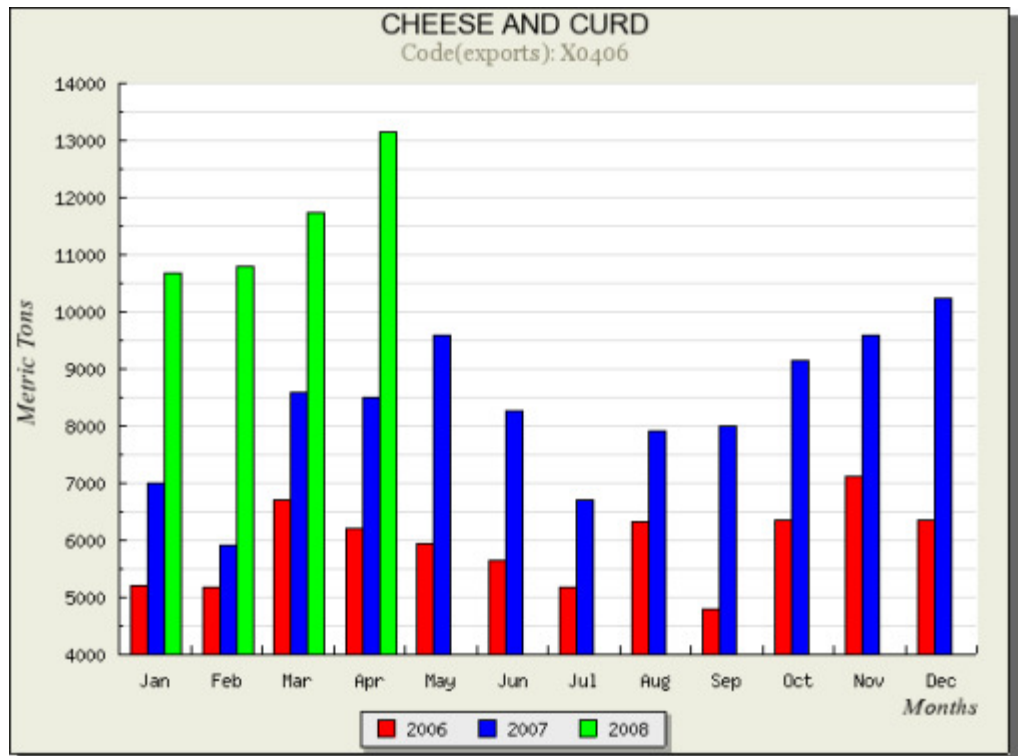


**The KDM Dairy Report – June 13<sup>th</sup>, 2008**

**What's Bullish:**

- World Ag Supply & Demand Report: USDA's monthly look at world ag markets includes a reduction in their milk production forecasts for 2008 and 2009 due to the effect of higher feed prices impacting milk per cow. They also dropped cow numbers slightly in 2008 in light of the CWT herd retirement program. Tight supplies of dairy products and competition between export and domestic markets are expected to result in strong prices. Cheese is now expected to average \$1.96 lb in 2008, up 11½¢ from last month's prediction. Class III milk is forecast to avg \$18.35/cwt, up \$1.10/cwt from last month.
- Most Class III components were up in this weeks NASS survey, including strong moves for cheese. U.S. 40-lb blocks averaged \$2.15/lb, up 9.1¢ while 500-lb barrels jumped 7.8¢ to \$2.22/lb. Nonfat dry milk averaged \$1.36/lb, up 2.3¢ and dry whey increased 0.5¢ to 27.6¢/lb, but butter decreased 0.2¢ to \$1.47/lb.
- Weekly cold storage numbers for the period 06/01 through 06/09 reflect a 2% drop in both cheese and butter stocks.
- Dairy cow slaughter numbers for the week ending 05/31 were still slightly above a year ago, with 38,800 head culled vs. 37,100 last year. YTD, slaughter numbers are up 10,000 head vs. a year ago.
- Butter stocks at CME-approved warehouses fell by a strong 5 million lbs during the week ending 06/07, compared to only a 660,000 lb drop a year ago. The weekly decline was the largest so far this year. Stocks on hand are now down 20 million lbs, or 14% vs. last year at this time.
- Heat and humidity was in full force in the Mid-Atlantic and South-eastern states this week, with temps as high as 104 recorded. Fluid Milk & Cream Review reports the unseasonably high temps have resulted in smaller load sizes received at plants, beyond what was expected. Florida shipped out 49 fewer loads of milk this week vs. last.
- Hay is being rationed in the Pacific Northwest, according to Fluid Milk & Cream Review. Quality is often below expectations as cut hay got rained on, later cut hay got more mature, and drying conditions have been poor. Hay prices are moving higher due to the limited new hay or silage options for dairy cows.

| Futures Month   | Friday 06/13 Close | Friday 06/06 Close | Change          | 5-yr Average | Top 3rd Price |
|-----------------|--------------------|--------------------|-----------------|--------------|---------------|
| Jun-08          | \$20.20            | \$20.15            | \$0.05          | \$14.54      | \$15.63       |
| Jul-08          | \$19.68            | \$20.55            | (\$0.87)        | \$14.66      | \$15.57       |
| Aug-08          | \$20.32            | \$21.03            | (\$0.71)        | \$14.47      | \$15.40       |
| Sep-08          | \$20.89            | \$21.24            | (\$0.35)        | \$15.14      | \$16.02       |
| Oct-08          | \$20.75            | \$20.89            | (\$0.14)        | \$14.78      | \$15.58       |
| Nov-08          | \$20.65            | \$20.68            | (\$0.03)        | \$14.75      | \$15.73       |
| Dec-08          | \$20.57            | \$20.60            | (\$0.03)        | \$15.09      | \$16.18       |
| Jan-09          | \$20.29            | \$20.05            | \$0.24          | \$14.40      | \$15.24       |
| Feb-09          | \$20.04            | \$19.47            | \$0.57          | \$14.00      | \$14.69       |
| Mar-09          | \$19.93            | \$19.50            | \$0.43          | \$14.55      | \$15.28       |
| Apr-09          | \$20.02            | \$19.39            | \$0.63          | \$15.61      | \$16.83       |
| May-09          | \$20.10            | \$19.25            | \$0.85          | \$16.19      | \$17.54       |
| Jun-09          | \$20.15            | \$19.37            | \$0.78          | \$14.54      | \$15.63       |
| Jul-09          | \$20.11            | \$19.33            | \$0.78          | \$14.66      | \$15.57       |
| Aug-09          | \$20.40            | \$19.50            | \$0.90          | \$14.47      | \$15.40       |
| Sep-09          | \$20.52            | \$19.50            | \$1.02          | \$15.14      | \$16.02       |
| Oct-09          | \$20.44            | \$19.50            | \$0.94          | \$14.78      | \$15.58       |
| Nov-09          | \$20.00            | \$19.22            | \$0.78          | \$14.75      | \$15.73       |
| Dec-09          | \$20.10            | \$19.22            | \$0.88          | \$15.09      | \$16.18       |
| <b>Jun-Dec</b>  | <b>\$20.44</b>     | <b>\$20.73</b>     | <b>(\$0.30)</b> |              |               |
| <b>2009 Avg</b> | <b>\$20.18</b>     | <b>\$19.44</b>     | <b>\$0.73</b>   |              |               |



- Butter demand in the Central region remains at fairly good levels, according to Dairy Market News. Export orders continue to be filled, and firm international prices and lack of supply should encourage future buyer interest. Some

butter producers wonder if they have stock or potential future production that will be sufficient to not jeopardize U.S. the supply/demand balance for the second half of the year.

- The Western nonfat dry milk market remains firm, according to Dairy Market News. Offerings are often tight and available in only single or low multiple load levels. Domestic demand is fair, but export interest is moving better.
- According to the Foreign Ag Service, exports of butter and milkfat through the first four months of 2008 totaled 72.3 million lbs, 7.4 times more than the same period in 2007.
- Exports of cheese and curd during the month of April totaled 29 million lbs, according to the Foreign Ag Service, an increase of 55% from April 2007 (see chart above). YTD, cheese and curd exports total 102.2 million lbs, also 55% higher than a year ago.
- Nonfat dry milk and skim milk powder exports Jan-Apr 2008 totaled 313.6 million lbs, up 77% from the 177.1 million lbs exported during the same period in 2007, according to the Foreign Ag Service.
- Grains: Corn pushed into new record high territory as the December contract settled at \$7.65/bu, November beans finished at \$15.31/bu and July meal sat at \$409.20/ton. Continued deterioration of the new crop due to flooding and generally wet and cold weather was the primary mover.

#### **What's Bearish:**

- Cash Market: Block cheese prices were sharply lower as buyer interest wanes. Blocks lost 12¢ for the week, settling at \$2.04/lb, but barrels were unchanged at \$2.15/lb. 16 loads of blocks did exchange hands, but sellers appeared more aggressive, and buyers defensive. No barrels were traded, leaving the spread in an inverted position. Butter was down just a ¼¢ to close at \$1.47¾/lb in slow trade of 4 cars.
- Dairy Market News reports the Midwest cheese market remains under pressure, as buyers delay orders until prices settle or decline further. June Dairy Month promotions have been minimal on cheese, and some customers have cut back their committed volumes due to slower sales.
- Dry whey exports Jan-Apr were 125.3 million lbs, down 29.7% compared to the same period a year ago, according to the Foreign Ag Service.
- Western cheese handlers are noting subdued buyer interest due to slower export interest and a fall in domestic demand after cheese prices surged to record highs. More cheese is available, especially blocks, while interest in barrel is fair.
- Fluid milk sales fell 0.7% in April 2008 compared to 2007, according to Dairy Market News. The decline in consumption was led by reduced sales of whole milk and flavored whole milk.
- Class I sales in the Midwest remain sluggish as remaining schools close, according to Fluid Milk & Cream Review. Surplus milk diversions are heavy and handlers continue to have problems clearing supplies. Spot loads of milk are still available below class while milk intakes continue to be near peak levels in the upper region of states.
- Plants in California, Arizona, New Mexico and the Pacific Northwest are all running on active to heavy schedules, according to Fluid Milk & Cream Review. Milk production and fat content are drifting lower, but fluid demand is down as well, as school and college needs cease.

#### **Recommendation:**

Markets don't go up forever. Last week, the Dairy Market News cheese updates portrayed a very tight market, with "buyers for every load". However, this week we suddenly have more product available! That's how the cheese market goes, and we've seen it before. It only takes one load that nobody wants to send prices lower. While we're not at that type of scenario yet, it does appear we could see some more substantial downside before this correction is done. Word from industry contacts tell us cheese sales have slowed, with talk of \$1.80 cheese a potential in the near term. Cheese buyers could come in on Monday and prove us wrong, but in the mean time, we would pay up for decent protection in July and August. Enter orders to buy the July 19.50 PUT for 50¢ on up to 75% of your production. This will yield an effective floor of \$19.00 base price for your milk. Also enter orders to buy the August 19.25 PUT for 50¢ on up to 50% of your production. We're still not willing to sell milk here, especially considering what's going on in the grain markets and a real hay shortage. A customer in NM this week ran some numbers based on probable feed prices and came up with \$20/cwt to break even in 2009. While these months will probably head lower if cheese falls apart in the near term, they still look fairly safe from completely blowing out to the downside, ending this week in a net gain despite the drop in the spot cheese market.

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