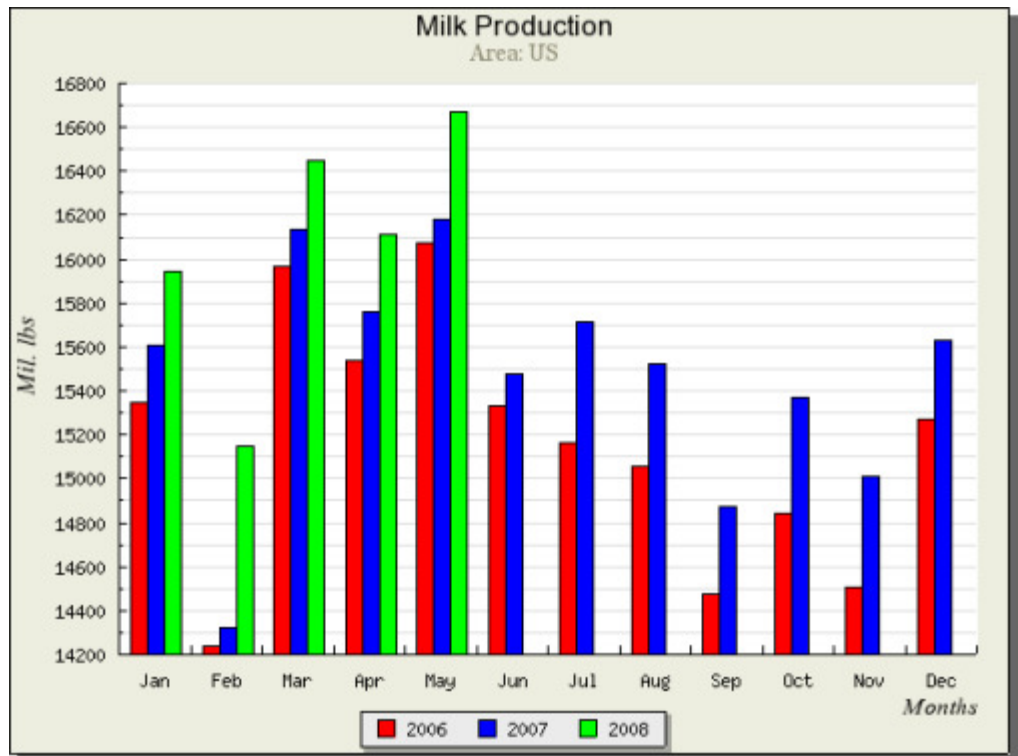


The KDM Dairy Report – June 20th, 2008

What's Bullish:

- Livestock, Dairy & Poultry Outlook Report: USDA expects milk production in 2009 to increase by only 0.5% as cow numbers decline slightly from 2008, and milk per cow increases are limited by soaring feed costs. Dairy exports in 2009 are still expected to be strong, but perhaps down from 2008, as competitors recover international market share. As a result, USDA has increased their Class III price projection for 2009 by 29¢/cwt from last month, to \$17.59/cwt, and increased their cheddar cheese prediction by a penny, to \$1.84/lb.
- NASS cheese prices were up again this week as the survey lags the recent decline in the cash market. 40-lb blocks averaged \$2.21/lb, up 5¢ from last week and 500-lb barrels gained 1.1¢ to \$2.23/lb. Dry whey managed a tiny 0.1¢ gain to average 27.8¢/lb, however, butter decreased 2.1¢ to average \$1.45/lb and nonfat dry milk lost 3.1¢ to \$1.33/lb.
- Dairy cow slaughter for the week ending 06/07 was up 3,100 head compared to the same period a year ago. 44,600 head were culled.
- Butter continues to fly out of storage. For the week ending 06/14, a net 5.7 million lbs were pulled from CME-approved warehouses, leaving 119 million lbs left. During the same week a year ago, there was a net gain of 149,000 lbs and total stocks of 145.1 million lbs.
- Hot weather over much of the Eastern region of the country had a few Class I plants scrambling to obtain milk, according to Fluid Milk & Cream Review. 4 days of temps in the high 90's have diminished output a bit sooner than normal, and the trend over the next several months is expected to be toward lower milk supplies until the first weeks of August. Cream prices are strong due to the dip in milk production and solid demand for ice cream.
- Heat over much of the West is affecting milk production there too. Fluid Milk & Cream Review reports California is experiencing triple digits over much of the region with little relief at night. Feed costs, including alfalfa, continue to stress dairy farmers. Production is also under stress in Arizona as they too have temps in the 100's, and nights are not cooling much. In the Pacific Northwest, hay growers continue to struggle with the first cutting; the harvest is 2-4 weeks late and the tonnage is not there. Weather has not helped, with much of the crop getting wet or old or both. Quality is poor and prices continue to move higher.
- Butter production is not keeping pace with needs, according to Dairy Market News. Demand for cream is increasing, impacting churning activity from coast to coast. This week's decline of butter at CME warehouses is the largest this year, with significant volumes heading to international destinations.

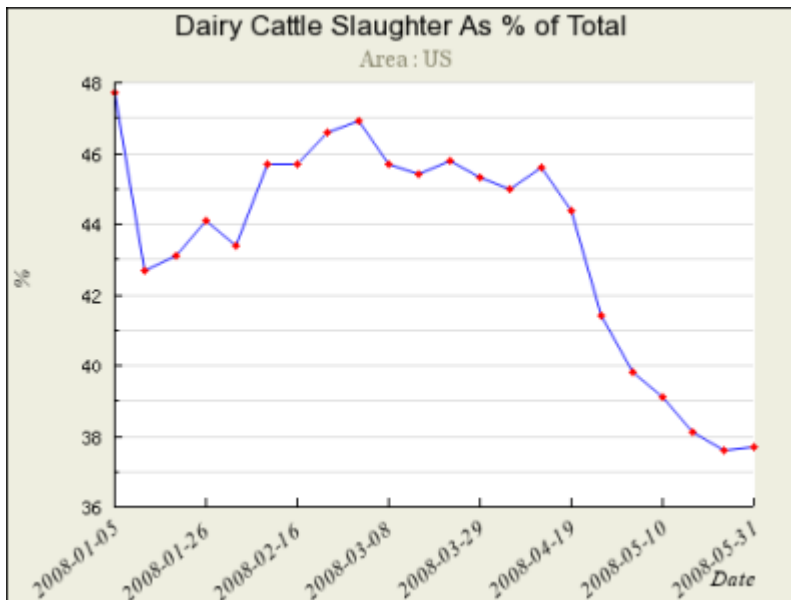
Futures Month	Friday 06/20 Close	Friday 06/13 Close	Change
Jun-08	\$20.20	\$20.20	\$0.00
Jul-08	\$18.77	\$19.68	(\$0.91)
Aug-08	\$19.81	\$20.32	(\$0.51)
Sep-08	\$20.62	\$20.89	(\$0.27)
Oct-08	\$20.60	\$20.75	(\$0.15)
Nov-08	\$20.52	\$20.65	(\$0.13)
Dec-08	\$20.48	\$20.57	(\$0.09)
Jan-09	\$20.00	\$20.29	(\$0.29)
Feb-09	\$20.00	\$20.04	(\$0.04)
Mar-09	\$19.88	\$19.93	(\$0.05)
Apr-09	\$20.07	\$20.02	\$0.05
May-09	\$20.20	\$20.10	\$0.10
Jun-09	\$20.16	\$20.15	\$0.01
Jul-09	\$20.38	\$20.11	\$0.27
Aug-09	\$20.58	\$20.40	\$0.18
Sep-09	\$20.74	\$20.52	\$0.22
Oct-09	\$20.60	\$20.44	\$0.16
Nov-09	\$20.40	\$20.00	\$0.40
Dec-09	\$20.41	\$20.10	\$0.31
Jun-Dec	\$20.14	\$20.44	(\$0.29)
2009 Avg	\$20.29	\$20.18	\$0.11



- Cheese offerings in the Western region are available, but not heavy, according to Dairy Market News. Sales activity remains at generally normal levels, and despite an increase in cheese output, inventories have not increased very much. Contacts are hoping the lower cheese price will improve foreign interest, as export sales activity had slowed recently.
- Dairy Market News reports domestic sales activity is rebounding somewhat in the Eastern region, after wholesale cheese prices retreated from their record highs of two weeks ago. Some Northeast cheese is also moving internationally. Cheese production is active, but availability of discounted loads of milk has decreased due to heat and humidity.

What's Bearish:

- Cash Market: Blocks lost 8¢ for the week to settle at \$1.96/lb while barrels corrected the spread and fell 20¢ to \$1.95/lb. 10 loads of blocks and 7 barrels exchanged hands. Butter is our star, gaining 2½¢ to settle at \$1.50¼/lb
- Milk Production Report: Milk production in May was up a surprisingly strong 3.0% (see chart above) for all 50 states, and cow numbers increased 11,000 head from April, and are up 143,000 head from a year ago. Milk per cow was up 25 lbs vs. last year. The biggest gains were seen in TX, up 14.3%, KS up 10.8%, NM up 9.7%, CO up 9.5% and ID up 9.2%. CA and WI were up 2.8% and 1.8%, respectively.
- Cold Storage Report: American cheese stocks are still below year-ago levels, but are gaining ground. May American cheese stocks were only 1% below last year's levels, after being 3-5% below for much of this year. The same is true for Total Cheese stocks, where we were also only 1% below last year. Butter inventories were down 3% from a year ago, reflecting strong internal and international demand.
- Livestock Slaughter Report: May dairy cow slaughter was 194,700, up 3,400 head from last year. However, the slaughter expressed as a percentage of the milking herd was only 2%, whereas last year the May slaughter represented 3% of the herd (see chart).
- Milk supplies remain burdensome in the Midwest, according to Fluid Milk & Cream Review. Handlers are having problems clearing extra volumes and many plant operators are not interested at taking on any extra loads. Spot milk is selling for -\$1.00 to -\$5.00 under class.
- Cheese stocks at USDA selected storage centers were up 2% for the period 06/01 through 06/16, but butter stocks were down 6%. The gain in cheese represents 2.1 million lbs.
- The cheese market is weak in the Midwest, according to Dairy Market News. Buyers are delaying orders, waiting for possible further declines, and this slowdown in demand has caused plant inventories to accumulate. Buyers are reluctant to add to cheddar aging programs, but current cheese production remains active as sizeable volumes of discounted milk are available.



Recommendation:

Cash cheese remained under pressure this week, although it wasn't a free-fall, as buyers picked up loads to make it an orderly decline. The surprise gain in milk production as well as cheese in storage gaining from prior months is likely to bring some producer selling across the complex next week. However, feed prices remain high and recent heat on both coasts could start to turn things back around. Butter may end up being a leader as it continues to make gains week after week, and inventories continue to decline. Cheese supplies appear heavier in the Midwest, but relatively in balance on both the East and West coasts. In the near term, we could continue to slide on cheese and milk supply and producer selling. If you can make money at these levels, we'd consider selling Aug-Dec outright on 25-35% of your production. At their current average of \$20.40, it means those months will need to be at \$2.20/lb cheese the entire time. We would still leave 2009 months alone. Yes, they may head lower for a time, but there is still a lot of potential for higher prices in those months.

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