

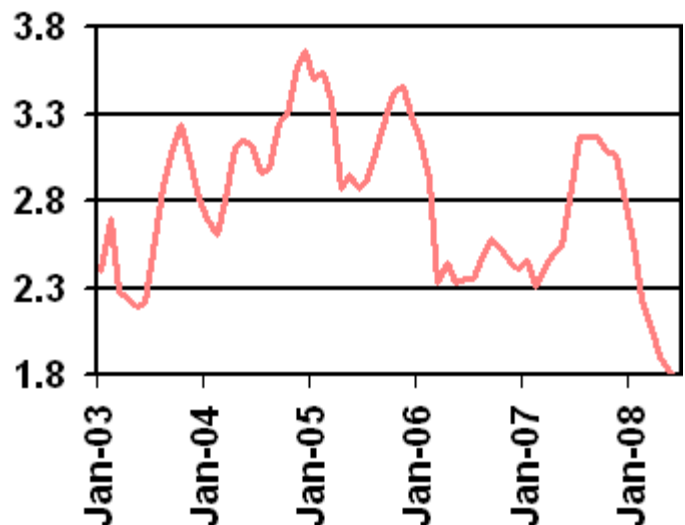
The KDM Dairy Report – June 27th, 2008

What's Bullish:

- Ag Prices Report: The Jun milk to feed ratio fell to a new record low of 1.78 (see chart below), down from 1.83 last month and 2.88 in June 2007.
- Both cheese and butter stocks were lower at USDA selected storage centers, according to the Weekly Cold Storage Report. For the period 06/01 through 06/23, both cheese and butter stocks declined by 2.4 million lbs, representing a drop of 2% for cheese and 6% for butter.
- Butter stocks at CME-approved warehouses fell 3.8 million lbs for the week ending 06/21, leaving 115.5 million lbs on hand. Last year at this time saw an increase in stocks by 675,000 lbs and total stocks of 145.6 million lbs.
- Dairy cow slaughter for the week ending 06/14 was up slightly vs. a year ago. 43,700 head were culled compared to 40,100 during the same period in 2007.
- Fluid Milk & Cream Review reports cream supplies are in very short supply through much of the Eastern region of the country. Milk production in the Northeast has tapered due to recent hot weather and supplies are adequate to tight. In the Mid-Atlantic, milk output in some areas is down significantly in both volume and butterfat content.
- Hot temps in California are putting more stress on the dairy herd, according to Fluid Milk & Cream Review, however, plants are still running close to capacity levels. Cream seems to be the story across the country, as the Western cream market has, "tightened dramatically" since last week. Class II manufacturers are willing to pay whatever it takes to get the cream they have to have to continue to operate, and they are being forced to bid the cream away from a firming butter market. Rumors of much higher prices are noted. Local hay harvest is now "summer hay" that is lower in quality. In the Pacific Northwest, some cheese plants are looking for additional cream supplies to supplement their vats, while dairies are now paying \$250/ton for hay and approaching or exceeding \$18/cwt cost of production.
- Butter demand is strong for this time of year, and fresh production is not keeping pace with needs, according to Dairy Market News. Some butter producers would like to generate fresh stocks, but instead are choosing to sell their cream to Class II operations at favorable returns. In the last five weeks, butter stocks have declined by 18.4 million lbs, the largest decline for this early in the year on record. Some handlers are concerned about the drawdown of inventories at earlier and faster rates than anticipated.
- Commercial Disappearance: Commercial use of butter in April was up a stunning 51.5%, and nonfat dry milk use was up 42.1%, according to USDA statistics. And after a drop in March, commercial use of American cheese was up 1% vs. last year, however, Total cheese use fell 5.7%. Finally, use of milk in all products was up a solid 3.6%.
- Ethanol and DDG: Some ethanol plants are cutting back production, which will reduce the amount of DDGs available to dairies as feed supplement.

Futures Month	Friday 06/27 Close	Friday 06/20 Close	Change
Jun-08	\$20.27	\$20.20	\$0.07
Jul-08	\$18.38	\$18.77	(\$0.39)
Aug-08	\$19.08	\$19.81	(\$0.73)
Sep-08	\$20.03	\$20.62	(\$0.59)
Oct-08	\$20.02	\$20.60	(\$0.58)
Nov-08	\$20.00	\$20.52	(\$0.52)
Dec-08	\$20.00	\$20.48	(\$0.48)
Jan-09	\$19.46	\$20.00	(\$0.54)
Feb-09	\$19.52	\$20.00	(\$0.48)
Mar-09	\$19.39	\$19.88	(\$0.49)
Apr-09	\$19.45	\$20.07	(\$0.62)
May-09	\$19.58	\$20.20	(\$0.62)
Jun-09	\$19.66	\$20.16	(\$0.50)
Jul-09	\$20.00	\$20.38	(\$0.38)
Aug-09	\$20.28	\$20.58	(\$0.30)
Sep-09	\$20.47	\$20.74	(\$0.27)
Oct-09	\$20.54	\$20.60	(\$0.06)
Nov-09	\$20.41	\$20.40	\$0.01
Dec-09	\$20.42	\$20.41	\$0.01
Jun-Dec	\$19.68	\$20.14	(\$0.46)
2009 Avg	\$19.93	\$20.29	(\$0.35)

Milk-feed Ratio



What's Bearish:

- Cash Market: Blocks fell 4¢ for the week to settle at \$1.92/lb as sellers retained their grip on the market, dumping 13 loads. Barrels, however, actually ended up a penny to close at \$1.96/lb on just 2 trades for the week. Butter continued to march higher, gaining 4¼¢ to settle at \$1.54½/lb, with 8 cars exchanging hands.

- Current cheese interest remains light in the Midwest, according to Dairy Market News. Buyers are waiting for prices to settle before reordering. Traders think prices need to drop toward \$1.80/lb before export contracting will pick up the excess.
- Western cheese plants are processing additional surplus milk at very attractive prices, according to Dairy Market News. Offerings of current cheese are available, and more under grade cheese is also being offered. Export interest is sluggish.
- NASS cheese prices took their first decline in several weeks, as they begin to track recent losses in the cash market. 40-lb blocks lost 6.1¢ to average \$2.15/lb while 500-lb barrels fell 5¢ to average \$2.18/lb. Dry whey was down a slight 0.1¢ to average 27.7¢/lb, but nonfat dry milk increased 2.9¢ to \$1.36/lb and butter gained 1.6¢ to \$1.47/lb.
- Class I interest is light and manufacturing milk supplies remain burdensome in the Midwest, according to Fluid Milk & Cream Review. Spot loads of milk are still going for \$1.50 to \$2.50 below class, and cool weather is helping to minimize production declines from the annual peak.
- The Central dry market has a weaker undertone to it, according to Dairy Market News. Contracted loads are shipping, but spot interest has slowed. Recent price declines in other dairy protein products (cheese) may be encouraging dry whey buyers to sit out the market for a week or two.
- Dairy Market News reports Western dry whey supplies are increasing at the producer level, as domestic sales are somewhat slower and export sales are not coming in at desired volumes. Production remains heavy.
- Economy: The stock market took another pounding this week with the Dow falling 4%. It is now 20% off its high in October. Consumer confidence is down, home prices fell again this month and fuel prices continued to rise.

Recommendation:

Pay up for puts! Producer selling ramped up this week and Class III futures fell across the board. Cheese sellers in the cash market were not aggressive, but were firm, not allowing any attempts to bid the block price back up. The cheese situation remains about the same as last week, with excess product in the Midwest and more in balance on the coasts. Butter continues to show strength as a rapid, anti-seasonal drawdown pulls product from storage, while current demand exceeds production. If this continues, eventually more milk could be drawn to the churn and away from the vat. Time will tell, but we'll be keeping close tabs on the butter market. Last week we put out our first sell recommendation in a long time. With this week's sharp decline in the 2008 contracts, we're now less willing to outright sell them, but we would recommend getting PUT options bought in these months. However, because current milk production remains quite strong and the cheese market is sloppy, we could be in for another 2-4 weeks of pressure on the market, with sub \$1.90 cheese a distinct possibility, before things start to turn around. For this reason, we would attempt to buy some decent price protection, and pay up for puts! Everything's getting more expensive, and insurance for your milk is no exception. Now is not the time to get cheap on your insurance and limit yourself to 25¢ or under for a PUT option. With a bearish bias on the market in the near term, you will benefit far more by taking out better insurance with a higher premium. That way, it will kick in sooner and at a higher floor price level. For example, you could buy the July 18.00 PUT for about 20¢, yielding a 17.80 effective floor. July settled at 18.38 and would need to fall 58¢ before you started collecting. Or, you could buy the 18.75 PUT for about 50¢, yielding an 18.25 floor. Prices would only need to drop 13¢ from today's close before your insurance would kick in. Do the same for Aug-Dec, spending 50-75¢ each month for the best PUT options you can buy. We would still leave 2009 alone. Just like prices can't go up forever, they can't go down forever either. With grain prices looking very strong, we still see more risk to the upside than down.

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