

The KDM Dairy Report – July 3rd, 2008

What's Bullish:

- Cash Market: Blocks saw their first increase in several weeks as the blood-letting in the cash market finally stopped. Blocks closed up ¼¢ for the week, to settle at \$1.92¼/lb today. Barrels, however, did finish lower, losing 5½¢ to close at \$1.87½/lb. This corrected the inverse block/barrel spread from last week. Buyers were busy, picking up 15 loads of blocks and 3 barrels. Spot butter made steady gains, increasing ¾¢ to \$1.55¼/lb on 7 trades.
- Fluid Milk & Cream Review reports milk output in much of the Southwest is declining. Hotter weather, higher humidity, rBST usage declines, base plans, feed ration changes, and time in milk, are all influences affecting the milk flow. High and increasing feed costs remain a big factor and on the forefront of decision making; some producers are paying \$290/ton for dairy quality hay delivered.
- Weekly cold storage numbers indicate a strong butter drawdown in June. For the period 06/01 through 06/30, butter stocks at USDA selected storage centers fell 15%, or 5.6 million lbs. Cheese stocks declined 2%, or 2.3 million lbs.
- Butter on hand at CME-approved warehouses fell by 4.7 million lbs for the week ending 06/28, leaving 110.8 million lbs available. That compares to an increase of 553,000 lbs during the same period a year ago. Total butter inventories are now down 24% vs. last year at this time.
- Dairy Market News reports overall butter demand in the Midwest is very good. Domestic buyers continue to place steady orders, while retail feature activity is attracting strong consumer buying interest. Churning activity is lower as cream volumes continue to be absorbed by Class II operations.
- Western cream demand from ice cream and other soft product manufacturers is very strong, according to Dairy Market News. As a result, butter production is slowing. Japan put out a tender for current butter with a very short delivery period, with the U.S. the most likely source. Finally, butter continues to be pulled out of storage. Peak inventories probably occurred in week 21 of this year, while they peaked last year at week 30. Stocks continue to decline earlier and at a faster rate than is the norm for recent years.
- Western cheese buyers that have been on the sidelines during the recent price drop will need to replenish inventories shortly, according to Dairy Market News. They've been waiting for a bottom, and some think we are close to putting it in. Additional domestic demand was noted at the end of last week and also early this week, while the 35¢ fall in cheese prices should improve export interest.
- CWT accepted 10 export assistance bids this week, according to a news release on their web site. 418,000 lbs of cheddar cheese will be headed to the Netherlands, 105,600 lbs of butter will go to Japan, 205,700 lbs of butter to Egypt, 205,700 lbs of butter to Morocco, 118,800 lbs of butter to Singapore and 102,850 lbs of butter for export to Libya and Poland.
- Grains: This week's crop report was bearish for corn, bullish for beans, yet both made large weekly gains. July soybean meal is trading over \$440/ton, and over \$420/ton through August, 2009.
- International: Dairy Australia reported this week that dairy exports during the 2007/2008 milking season were down 17% vs. the prior year. Individually, butter exports were down 21.1% and cheddar exports were down 6.4%.
- International: It's winter in New Zealand and temperatures have been colder than normal, while moisture has not been abundant in dairy areas. Some producers anticipate the colder winter will slow the start of the upcoming milk production season. In Australia, lack of moisture is also a major concern. Farmers are hoping for additional rainfall to help winter crops and to establish pastures for the upcoming season. Catchment basins remain greatly depleted as well.

Futures Month	Thursday 07/03 Close	Friday 06/27 Close	Change
Jul-08	\$18.31	\$18.38	(\$0.07)
Aug-08	\$19.12	\$19.08	\$0.04
Sep-08	\$20.39	\$20.03	\$0.36
Oct-08	\$20.30	\$20.02	\$0.28
Nov-08	\$20.30	\$20.00	\$0.30
Dec-08	\$20.34	\$20.00	\$0.34
Jan-09	\$19.70	\$19.46	\$0.24
Feb-09	\$19.59	\$19.52	\$0.07
Mar-09	\$19.52	\$19.39	\$0.13
Apr-09	\$19.55	\$19.45	\$0.10
May-09	\$19.65	\$19.58	\$0.07
Jun-09	\$19.81	\$19.66	\$0.15
Jul-09	\$20.08	\$20.00	\$0.08
Aug-09	\$20.37	\$20.28	\$0.09
Sep-09	\$20.50	\$20.47	\$0.03
Oct-09	\$20.50	\$20.54	(\$0.04)
Nov-09	\$20.41	\$20.41	\$0.00
Dec-09	\$20.35	\$20.42	(\$0.07)
Jul-Dec	\$19.79	\$19.59	\$0.21
2009 Avg	\$20.00	\$19.93	\$0.07

What's Bearish:

- NASS dairy prices, used to calculate Class III settlement prices, were mostly lower this week. U.S. 40-lb blocks averaged \$2.06, down 8.7¢ from last week, while 500-lb barrels also lost 8.7¢ to \$2.09/lb. Butter and nonfat dry milk were up slightly to average \$1.47/lb and \$1.36/lb respectively, but dry whey continued to lose ground, decreasing 0.1¢ to average 27.6¢/lb.

- Fluid Milk & Cream Review report Class I sales are lower in the Central region, as high retail prices and sluggish food service sales impact demand. Manufacturing milk demand is steady at best, as plants will take some time off over the holiday weekend. Temps have been conducive for milk production, with volumes just slightly lower in the upper Midwest.
- Cheese production remains near peak levels in the Midwest, and plant offerings have increased, according to Dairy Market News. Bulk cheese demand was lower and mozzarella interest was lighter due to slower, summer pizza sales.
- Dairy Market News reports cheese stocks are fully adequate in the Northeast, and demand is seasonally slow to fair. Cheese plants continue to manufacture cheese for current demand, but are not building inventory.
- Fluid Milk & Cream Review reports there is plenty of milk in much of the Eastern region of the country. In the Northeast, plants are being offered milk from other areas, and there is almost too much available. The reduction in fluid demand, along with adequate production is keeping Florida a milk surplus state. 154 loads were shipped out this week.
- International: Milk production is declining seasonally in Europe; however, product is available for buyer interest, according to Dairy Market News, while international sales activity is quiet.

Recommendation:

After losing over 35¢ in the last few weeks, blocks appear to have found at least some temporary support as buyers became the aggressors. That's not to say we couldn't see more cheese show up next week, but it did prompt a rally today that could have been largely short-covering. While we still have plenty of milk in the Midwest and Northeast, it is getting hotter everywhere else and milk receipts are declining. It doesn't appear that Western cheese buyers have a lot of depth of inventory, which could prompt additional cash buying next week. Near term, we could see more pressure on prices, but the rubber band is getting stretched tighter and tighter. Like last week, we would not recommend selling 2008, but instead, go after 50-60¢ PUT options. The grain market is simply amazing. After a bearish crop report in which corn traded limit down (30¢), corn promptly traded nearly limit up a day later, before calmer trading prevailed. Both corn and beans are trading with striking distance of new record highs, with some in the industry thinking beans have the potential for another \$2/bu higher. 2009 milk contracts rallied, perhaps based on the perception that production costs are only going to get more expensive next year. We continue to recommend leaving 2009 contracts alone.

Note: Our offices will be closed Thursday afternoon and Friday in observance of Independence Day. Have a great 4th of July, celebrating the blessing of freedom we enjoy in our country!

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