

The KDM Dairy Report – July 11th, 2008

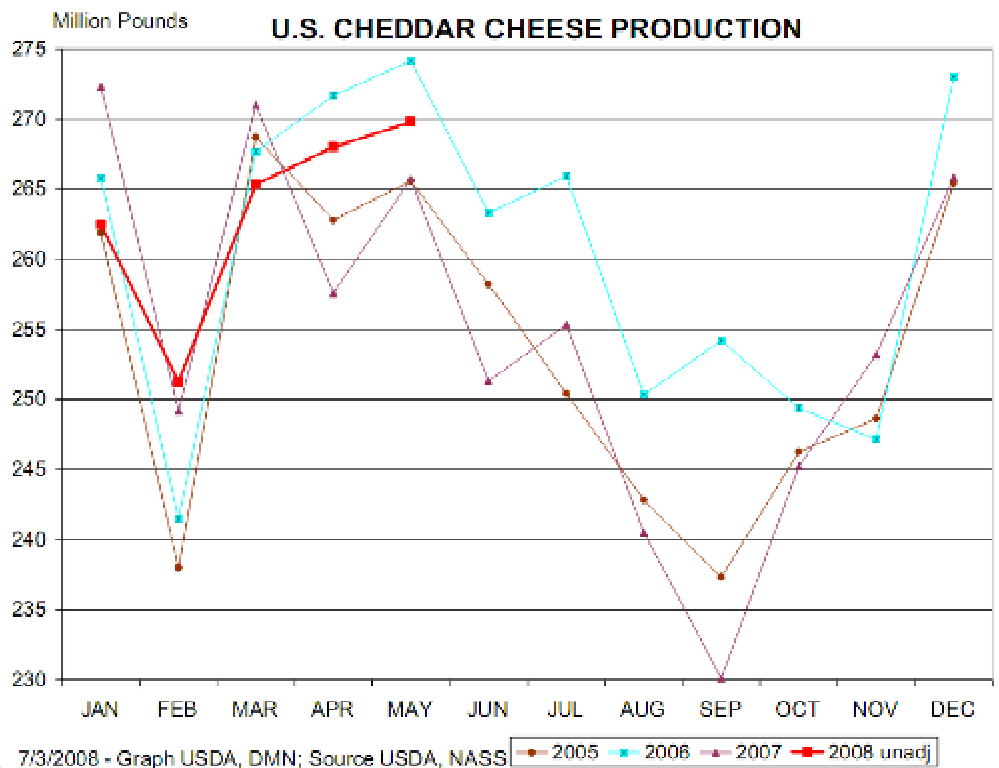
What's Bullish:

- Cash Market: A major battle in the spot cheese market between buyers and sellers occurred this week, with buyers managing to move the block price up a penny from last week, to settle at \$1.93¼/lb. Barrels inched up 4½¢ to close at \$1.92. A stunning amount of cheese traded, with 29 loads of blocks and 34 loads of barrels exchanging hands. Butter was quiet in comparison, losing a ¼¢ to settle at \$1.55/lb on 7 transactions.
- World Ag Supply & Demand Report: USDA increased their 2009 Class III price forecast by 45¢ from last month. Milk production is expected by be unchanged, but increases in higher feed prices, commercial exports and relatively strong demand were all reasons for upping their price target.
- Eastern cheese plants have cut back on production by about 10%, according to Dairy Market News. The pull-back is an effort to control inventory and produce only what is necessary to meet current demand.
- Milk receipts in California are down 3-10% at the plant level due to continued 100+ degree heat, according to Fluid Milk & Cream Review. The decline is making handling milk a little easier. Heat and humidity are elevated in Arizona and New Mexico as well, and local milk supplies are being lowered. However, milk from out-of-state is keeping plants as full as they'd like.
- Dairy cow slaughter for the week ending 06/28 totaled 43,300 head, 2,300 head more than the same period a year ago.
- Dairy Market News reports cream was more available in the Central region over the past holiday weekend, but quickly disappeared early in the current week when Class II operations resumed production following holiday abbreviated schedules. Some butter producers indicated that surplus cream over the holiday period was not as plentiful as anticipated.
- Butter stocks at CME-approved warehouses fell 2.8 million lbs for the week ending 07/05, leaving 108 million lbs on hand. A year ago at this time, total stocks were much higher at 147 million lbs.

Futures Month	Friday 07/11 Close	Thursday 07/03 Close	Change
Ju1-08	\$18.15	\$18.31	(\$0.16)
Aug-08	\$18.82	\$19.12	(\$0.30)
Sep-08	\$19.75	\$20.39	(\$0.64)
Oct-08	\$19.81	\$20.30	(\$0.49)
Nov-08	\$19.80	\$20.30	(\$0.50)
Dec-08	\$19.76	\$20.34	(\$0.58)
Jan-09	\$19.30	\$19.70	(\$0.40)
Feb-09	\$19.32	\$19.59	(\$0.27)
Mar-09	\$19.20	\$19.52	(\$0.32)
Apr-09	\$19.27	\$19.55	(\$0.28)
May-09	\$19.25	\$19.65	(\$0.40)
Jun-09	\$19.49	\$19.81	(\$0.32)
Ju1-09	\$19.78	\$20.08	(\$0.30)
Aug-09	\$20.11	\$20.37	(\$0.26)
Sep-09	\$20.22	\$20.50	(\$0.28)
Oct-09	\$20.20	\$20.50	(\$0.30)
Nov-09	\$20.08	\$20.41	(\$0.33)
Dec-09	\$20.05	\$20.35	(\$0.30)
Ju1-Dec	\$19.35	\$19.79	(\$0.45)
2009 Avg	\$19.69	\$20.00	(\$0.31)

What's Bearish:

- Dairy Products Report: Butter production in May was up 15.8% compared to a year ago, according to USDA stats. Since butter stocks are declining, this may be more a reflection of increased demand. However, more bearish are the cheese numbers, with American cheese production up 4.5% and Total cheese output up 0.5%. Cheddar cheese production was up 1.5% vs. a year ago, the second month in a row it has exceeded year ago levels in 2008 (see chart).
- NASS surveyed cheese prices took another plunge as they chase recent declines in the cash market. 40-lb blocks fell 7¢ to average \$1.99/lb and 500-lb barrels shed 10.5¢ to \$1.98/lb. Butter increased 3.6¢ to average \$1.51/lb and nonfat dry milk



was up 3.3¢ to \$1.40/lb, but dry whey decreased 0.3¢ to 27.3¢/lb.

- Dairy Market News reports in the current weak economy, consumers are still buying cheese, but looking for better value and shopping for more generic labels. The slowing of many branded products has caused slower cheese sales for the plants producing them. Plant offerings in the Midwest remain available, and producers are able to make extra orders with short lead times.
- Western cheese buyers whose stocks were on the light side starting making additional purchases this week, according to Dairy Market News. However, current production of cheese is heavy, cheap milk is available to make cheese and most operations now have cheese to sell on a regular basis as they are no longer fully contracted.
- Fluid Milk & Cream Review reports milk supplies in the Central region remain burdensome, as there has been minimal heat stress to cows so far. Class I sales are in typical slow summer mode, and spot loads of milk are being discounted from \$2 to \$5 below class in order to clear. Manufacturing plants are running on extended schedules in order to process all the milk.
- Milk supplies in the Northeast remain very heavy, according to Fluid Milk & Cream Review. The same holds true for the Southeast, with more emphasis on weaker demand, however, than excessive supply. Florida exported 226 loads of Grade A milk this week, up from 154 last week. Plants are carrying heavy inventories of milk into next week, and managers wish there were outlets for more milk to be shipped out.
- Western butter producers noted some push back on demand as prices moved above the \$1.50 mark, according to Dairy Market News. Export interest has not materialized as much as expected, while more cream was available for churning over the holiday weekend.
- Dry whey inventories are building in both the Western and Central regions, according to Dairy Market News. Some producers are indicating that sales activity for both domestic and international accounts is slower. Prices are mostly unchanged, but the market undertone is weak.

Recommendation:

The economy has always been the biggest risk to the bull market in milk, and frankly, we're getting more concerned. The Dow hit a 2-year low today, crude oil set a new record above \$147/barrel, home sales tumbled 4.7% in May, consumer confidence is near a 28-year low, and now we're starting to see the trickle affects in this week's Dairy Market News reports. Cheese sales are slowing, the dry whey market is weak and milk production remains very strong in the Midwest and Northeast. This week's cash market was incredible, as buyers tried to have their way. While they managed to move prices up slightly, we get the feeling that sellers still have product available. This week's cheese updates certainly indicate there is more cheese out there, and cheese producers have an incentive to keep the vats working with milk available at \$5 under class. Then there is the matter of the new make allowance, which will be implemented in September of this year. It shaves another 30¢/cwt off the Class III price, so that \$2.00 cheese now translates into 18.70 Class III milk. Export buyers appear to like to buy between \$1.80 and \$2.00, slowing or stopping their purchases when prices rise above \$2.00. That may change and cheese could get tighter later this summer as heat continues out West and CWT begins its cull in August, but it appears that in the near term, cheese will have a tough time getting much higher. For that reason, we think you should sell rallies, Sep-Dec '08. Sep-Dec 2008 currently averages \$19.78 and 2009 is at \$19.69, which works out to more than \$2.10 cheese under the new make allowance. With the economy sputtering through next year, it may be very difficult to maintain a cheese price above \$2.20, and you have the opportunity to sell these months at a level above where export buyers and domestic demand seem to be willing to buy cheese. If Sep-Dec opens stronger next week, consider selling up to 50% of your production. Sell up to 25% of your 2009 production at \$19.70 or higher. Did we pick the high? No, but it may not be in yet. Although we put out a sell recommendation two weeks ago, in hindsight, we should have sold more earlier. But the growing risk to the economy is increasing the risk for lower milk prices, so we believe it's prudent to start getting some coverage if you can make money at these prices.

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