

The KDM Dairy Report – July 18th, 2008

What's Bullish:

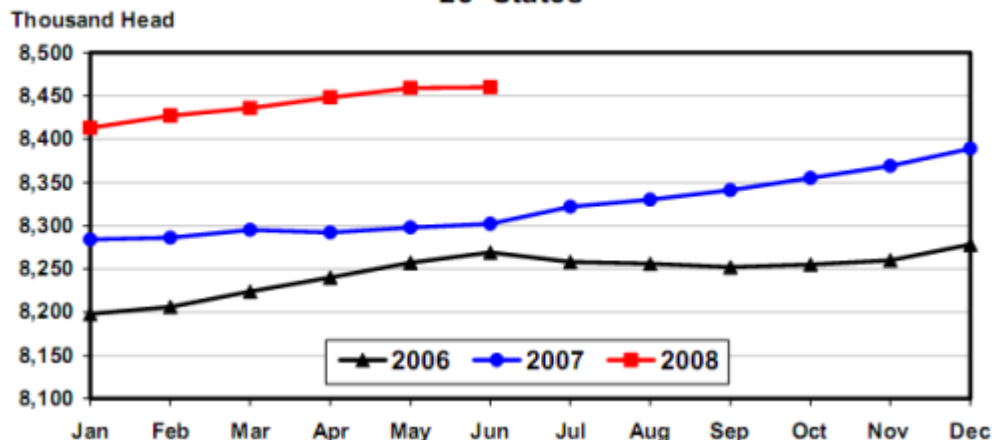
- Cash Market: Both blocks and barrels were bid up 3¢ in today's cash session, capping a week where sellors disappeared after flooding the market in the prior week. Blocks ended at \$2.00/lb, up 6¾¢ for the week, while barrels picked up 5¢ to close at \$1.97/lb. No blocks and only 3 barrels exchanged hands. Spot butter gave up 2¢ to settle at \$1.53/lb on just 4 trades.
- Dairy cow slaughter for the week ending 07/05 totaled 35,800 head, up from 33,600 head during the same week a year ago.
- Butter stocks at CME-approved warehouses fell 1.2 million lbs for the week ending 07/12, leaving 107 million lbs on hand. A year ago at this time, ending stocks were 41 million lbs higher, at 148 million lbs.
- Milk production in California is off 5-8% due to the recent heat, according to Fluid Milk & Cream Review. However, temps have moderated and cows are starting to recover. Output in Arizona and New Mexico are also dropping seasonally as heat abatement becomes less effective in the hot, humid conditions.
- Current cheese orders are steady to slightly improved in the Midwest, as buyers who were delaying orders, had incentive to place orders as cheese prices rebounded in the cash market. Dairy Market News also reports good barrel interest is keeping inventories from accumulating and is snug for some producers.
- According to the Foreign Ag Service, exports of butter through the first five months of 2008 totaled 92.8 million lbs, up dramatically from 14.2 million lbs during the same period in 2007.
- Cheddar cheese exports for Q1 2008 were up 151%, according to the Foreign Ag Service. Leading destinations were Mexico (up 63%), Egypt (up 174%) and the Netherlands (up 219%).
- Dairy Market News reports demand for nonfat dry milk from the export market is better than from domestic accounts. Export interest is still good and clearing current and future production. Prices are steady to slightly higher.
- CWT announced this week that it had accepted 209 bids to retire 25,474 cows representing 440 million lbs of milk. Farmers will be notified starting next week, and will have 12-15 days to send the animals to slaughter.
- International: Neither New Zealand or Australia has received rainfall at desired levels during their winter off-season, according to Dairy Market News. Water levels remain low in catchment basins for upcoming summer needs, causing much concern for dairy producers. Stocks of manufactured dairy products are nearly depleted as current orders are being filled from inventory.

Futures Month	Friday 07/18 Close	Friday 07/11 Close	Change
Jul-08	\$18.20	\$18.15	\$0.05
Aug-08	\$18.99	\$18.82	\$0.17
Sep-08	\$19.90	\$19.75	\$0.15
Oct-08	\$19.85	\$19.81	\$0.04
Nov-08	\$19.83	\$19.80	\$0.03
Dec-08	\$19.80	\$19.76	\$0.04
Jan-09	\$19.35	\$19.30	\$0.05
Feb-09	\$19.24	\$19.32	(\$0.08)
Mar-09	\$19.27	\$19.20	\$0.07
Apr-09	\$19.22	\$19.27	(\$0.05)
May-09	\$19.25	\$19.25	\$0.00
Jun-09	\$19.37	\$19.49	(\$0.12)
Jul-09	\$19.70	\$19.78	(\$0.08)
Aug-09	\$19.95	\$20.11	(\$0.16)
Sep-09	\$20.10	\$20.22	(\$0.12)
Oct-09	\$20.15	\$20.20	(\$0.05)
Nov-09	\$19.95	\$20.08	(\$0.13)
Dec-09	\$19.93	\$20.05	(\$0.12)
Jul-Dec	\$19.43	\$19.35	\$0.08
2009 Avg	\$19.62	\$19.69	(\$0.07)

What's Bearish:

- Milk Production Report: U.S. milk output in June was up 3% compared to a year ago, according to USDA figures released today, and cow numbers were up 133,000 head. Milk per cow increased 26 lbs during the same period. One positive – cow numbers were unchanged from May to June, the first "non-increase" since April, 2007.
- NASS cheese prices continued to fall, despite recent strength in the cash market. U.S. 40-lb blocks decreased 4.3¢ from last week's survey, to average \$1.95/lb, while 500-lb barrels fell 5¢ to \$1.93/lb. Butter was up 3.2¢ to average \$1.54/lb, but nonfat dry milk was down slightly to \$1.40/lb and dry whey gave up 0.6¢ to 26.7¢/lb.

**Monthly Milk Cows
23 States**



- Both butter and cheese stocks are increasing in July, according to USDA weekly cold storage numbers. Cheese inventories increased 2% and butter was up 1% for the period 07/01 through 07/14.
- Northeast plant managers report they are still receiving heavy supplies of milk, according to Fluid Milk & Cream Review. Milk flow is also strong in the Mid-Atlantic region, keeping plant capacity engaged, while a cool and less humid spell in the Southeast has contributed to milk production not declining as much as in prior weeks.
- Fluid Milk & Cream Review reports Class I sales remain sluggish in the Central region of the country. Cheese milk interest is still slow as milk production has held up longer and stronger than usual. Spot loads of milk still demand significant discounts.
- Dairy Market News reports there is additional cream available, beyond expectations, that is entering the churns. Butter export interest is moving previously negotiated contracts, but reorders are often slower.
- International: Europe has experienced a strong milk production season thus far, attributing an early start as a major influence. Milk output remains robust, allowing manufacturers to maintain strong schedules. Stocks of dairy end products are available for both domestic and international demand.

Recommendation:

What a difference a week makes! Last week we had \$147/barrel crude and now we're around \$128/barrel. Sellers disappeared from the spot cheese market and prices continued to head up. But, the 2009 average fell 7¢ for the week and the remaining 2008 contracts did not roar back. Why? The economy remains a concern, cheese is available if wanted, the production report was mostly bearish and feed prices took a tumble, to name a few. Even though blocks are barrels were bid up 3¢ each today, after initially rising, Class III futures were hit with some significant selling and we ended down double digits in the Oct '08 through Aug '09 contracts. The market is confusing and sloppy right now, with short-term predictions nearly impossible. CWT's announcement to get rid of 25,000+ cows is welcome, but only about half of what they've done in previous herd retirement programs. That 25,000 head represents less than one week of the normal cull; pretty insignificant. We believe prices may head lower in the short-term, but eventually recover in late summer or early fall as heat and feed costs start to bite further. Also somewhat encouraging for the long-term outlook was the unchanged number of cows in the milking herd from May to June. If that becomes a trend, or cow numbers even start to decline, the 2009 contracts will be well supported. At this point, we would not chase prices lower for Q4 2008 or any of 2009. Aug and Sept remain vulnerable to weakness in the cheese price going forward and warrant protection. Sell significant rallies or buy PUT options for those months. If you receive a significant premium to Class III, consider this low-cost "disaster insurance" idea. Buy the Oct '08 through Mar '09 16.00 PUT options for 15¢ each, which we filled today. That would yield an effective floor of \$15.75, and assuming about \$1.50 premium, gets you to \$17.25 mailbox. If you can cash flow there, consider it.

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