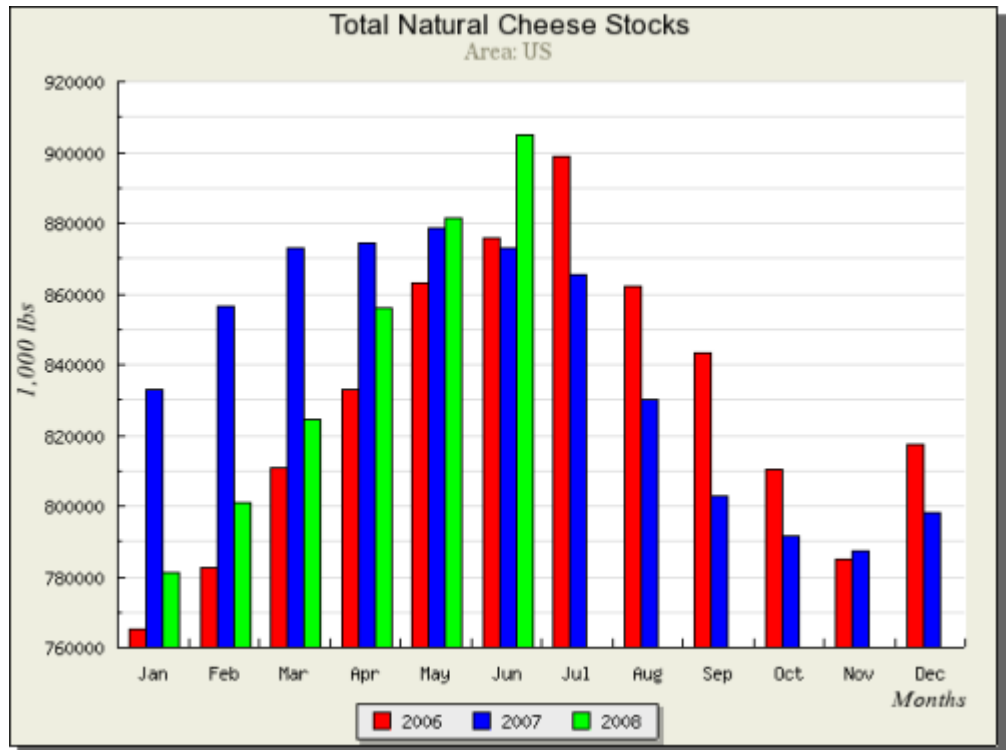


**The KDM Dairy Report – July 25<sup>th</sup>, 2008**

**What's Bullish:**

- Cash Market: Blocks were the star this week, picking up 6¾¢ to settle at \$2.06¾/lb today. Barrels fell to as low as \$1.90½/lb mid-week, but rallied back to finish unchanged from last Friday at \$1.97/lb. Buyers took the lead, placing bids and coming away with 7 loads of blocks and 11 loads of barrels. Butter moved a penny higher to close at \$1.54/lb on 3 trades.
- Dairy Market News calls the block market "firm" in the Midwest, aided by exports of 40-lb blocks, which are close to the 20Kg package used internationally. Both Mozzarella and process interest is improved, while some retailers are preparing orders of the reopening of schools and increased demand for items like string cheese.
- Demand for Western cheese is very good, according to Dairy Market News. Prices are about 40¢/lb lower than the recent record high, and buyers, which have been functioning all year on short supplies, are happy to own product at these levels. Large volumes of current cheese are not available at this time from Western suppliers, and under grade cheese has been cleaned up as buyers try to source more cheese.
- Fluid Milk & Cream Review reports cream supplies in the Central region are in better balance with demand, while ice cream interest remains strong. Manufacturing milk interest is steady as supplies are in close balance with demand. Prices for spot loads of surplus milk are generally increasing as milk volumes in the region decline seasonally. Recent warmer, humid weather has been a factor in the drop in output.
- Milk output in the Eastern region is dropping as well, according to Fluid Milk & Cream Review. Parts of the Mid-Atlantic experienced temperatures above 100 degrees, while Florida exported only 40 loads of milk this week, compared to 180 last week.
- Despite a reprieve from recent hot weather, milk production in California is still lower than before the heat wave began, according to Fluid Milk & Cream Review. Class I sales were higher than expected this week, while several cheese plants were scheduling downtime to help balance inventories. In Arizona, production is lower and processing schedules are declining as less outside milk is moving into the state.
- Butter stocks at CME-approved warehouses fell again in dramatic fashion. For the week ending 07/19, 6.4 million lbs were pulled out of storage, the earliest time on record for a weekly decline of this magnitude, leaving just over 100 million lbs on hand. A year ago at this time, stocks were still building, with an increase of 1.4 million lbs and ending stocks of 150 million lbs.
- Steady domestic and international buyer interest continues to absorb fresh butter stocks, according to Dairy Market News. Producers are reaching into inventoried stocks to fulfill orders.

Futures Month	Friday 07/25 Close	Friday 07/18 Close	Change
Jul-08	\$18.22	\$18.20	\$0.02
Aug-08	\$18.94	\$18.99	(\$0.05)
Sep-08	\$19.52	\$19.90	(\$0.38)
Oct-08	\$19.50	\$19.85	(\$0.35)
Nov-08	\$19.49	\$19.83	(\$0.34)
Dec-08	\$19.31	\$19.80	(\$0.49)
Jan-09	\$19.12	\$19.35	(\$0.23)
Feb-09	\$19.07	\$19.24	(\$0.17)
Mar-09	\$19.05	\$19.27	(\$0.22)
Apr-09	\$19.08	\$19.22	(\$0.14)
May-09	\$19.05	\$19.25	(\$0.20)
Jun-09	\$19.15	\$19.37	(\$0.22)
Jul-09	\$19.21	\$19.70	(\$0.49)
Aug-09	\$19.41	\$19.95	(\$0.54)
Sep-09	\$19.54	\$20.10	(\$0.56)
Oct-09	\$19.50	\$20.15	(\$0.65)
Nov-09	\$19.50	\$19.95	(\$0.45)
Dec-09	\$19.45	\$19.93	(\$0.48)
<b>Jul-Dec</b>	<b>\$19.16</b>	<b>\$19.43</b>	<b>(\$0.27)</b>
<b>2009 Avg</b>	<b>\$19.26</b>	<b>\$19.62</b>	<b>(\$0.36)</b>



- Weekly cold storage numbers are indicating the build-up in cheese stocks may be slowing or even halted. For the period 07/01 through 07/21, cheese stocks fell marginally by 312,000 lbs. Butter stocks were up 4%, or 1.3 million lbs.
- Dairy cow slaughter for the week ending 07/12 was a healthy 47,900 head, according to USDA figures. That compares to 43,600 during the same period a year ago.
- Cold Storage Report: While bearish for cheese, butter stocks in cold storage at the end of June were down 6% vs. last year and down 5% from May.

#### **What's Bearish:**

- Livestock Slaughter Report: Dairy cow slaughter for the month of June was 180,900 head, up from 173,800 head last June. YTD, the dairy cow cull stands at 1.26 million head, up from 1.24 million a year ago. However, with the milking herd at 9.277 million compared to 9.144 million last year, there is no percentage gain seen year to year.
- Cattle Report: USDA's twice-annual Cattle survey indicates the number of milk replacement heifers was unchanged from a year ago at 3.9 million head, which is equal to 42.2% of the milking herd. The number of milk cows, at 9.25 million was up 1% vs. last July.
- Cold Storage Report: Cheese stocks at the end of June were up compared to a year ago. American cheese holdings were 3% higher than in June 2007, and 2% higher than in May. Natural cheese stocks exceeded 900 million lbs for the first time since 1986 (see chart above). Total cheese holding were up 2% and 3% over the same periods, respectively.
- NASS cheese prices fell again in this week's survey, despite a rebound in the cash market. 40-lb blocks averaged \$1.92/lb, down 2.9¢ from last week, while barrels fell 0.3¢ to \$1.93/lb. Butter decreased 2.8¢ to average \$1.51/lb and dry whey lost 0.9¢ to 25.8¢/lb, but nonfat dry milk increased 1.3¢ to average \$1.41/lb.
- Dry whey prices continue to be under pressure in the Midwest, according to Dairy Market News. Production is steady to lower, but some industry participants note that less dairy-based protein is moving into livestock operations as raisers are trying alternative sources to cut feed costs.

#### **Recommendation:**

Class III futures finished lower across the board this week, with July-Dec losing 27¢ and the 2009 average falling 36¢. However, mid-week, cheese found a bid, setting up decent rallies on Thursday and Friday, pulling us off our lows and limiting the decline. In our opinion, this is a rally that should be sold. Sure, milk output is falling due to heat, and cheese supplies are starting to tighten. In fact, we think we'll probably continue to move higher in the short-term. And that presents your opportunity. With summer days beginning to shorten and relatively mild temps in the Midwest, milk production is set to move higher this fall. We're hearing reports of large numbers of cows freshening out West, which could put milk processing facilities back to running at max levels. Couple this with lower feed costs (corn is down \$2/bu from highs of a month ago) and plentiful replacement animals, and dairy profitability becomes achievable at lower milk prices. The economy remains a concern, with the Dow seeming to take one step forward and 3 steps backward. For 2008, buy Aug-Dec 18.00 PUT options, or sell milk above \$20.00. Looking into 2009, get started with 16.00 PUT options January to June at an average price of 28¢. There is no guarantee that cheese prices will stay above 1.80 next year. Get the puts done, and then look for an opportunity to sell milk above \$20.00 in 2009.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.