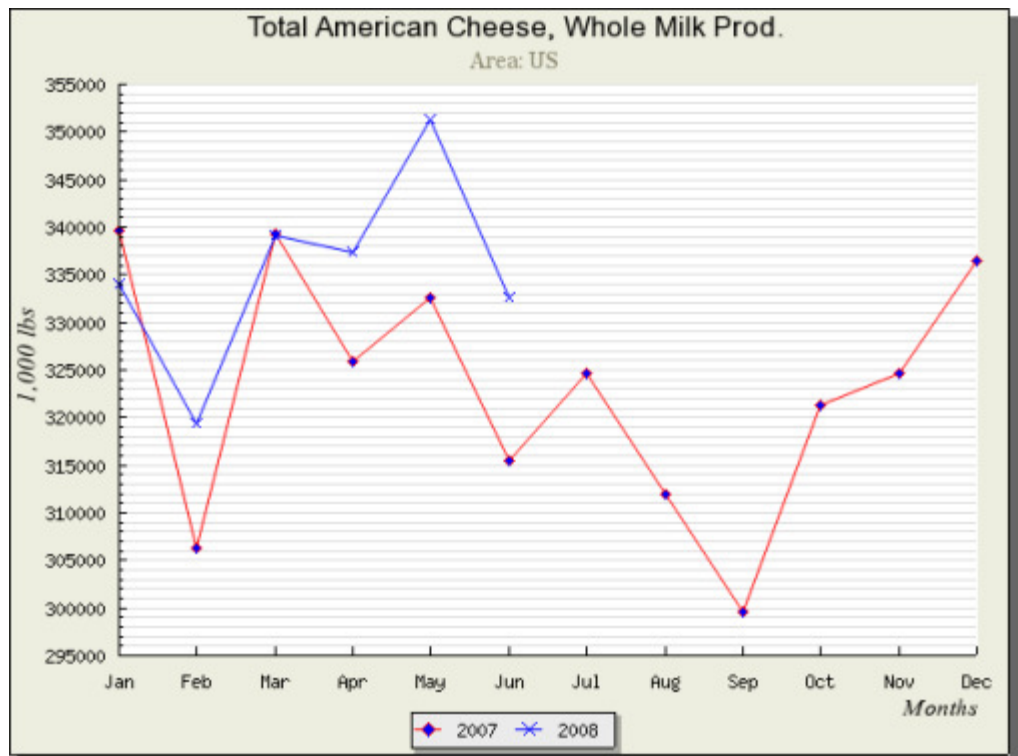


The KDM Dairy Report – August 8th, 2008

What's Bullish:

- NASS cheese prices were up in this week's survey. 40-lb blocks increased 4.1¢ to average \$1.97/lb while barrels averaged \$1.95/lb, up 2.3¢ from the previous week.
- Dairy cow slaughter for the week ending 07/26 totaled 49,700 head, up 7,700 head from 42,000 during the same week a year ago. The higher number could be from the CWT herd retirement program kicking in.
- Butter stocks at CME-approved warehouses continue to plummet. 5.9 million lbs were pulled out during the week ending 08/02, leaving 91 million lbs on hand, down 38% from a year ago and the lowest level in four years. Last year at this time total stocks were 148 million.
- Fluid Milk & Cream Review reports milk supplies are getting tight throughout the Eastern region. Normal seasonal declines in the Northeast have been magnified by the loss of herds to CWT and prolonged rain. In the Mid-Atlantic, milk availability is uncertain, significantly reducing plant operations. Milk may need to be supplied from the Upper Midwest as early as next week. All surplus manufacturing has ceased as school demand has also kicked in. Farm pickup routes are being consolidated in the Southeast to reduce the number of milk trucks in use, while Florida became a milk deficit state, importing 28 loads this week.
- Cheese milk interest in the Midwest is surprisingly good, according to Fluid Milk & Cream Review. Despite the sharp decline in cheese prices, cheese makers were interested in buying extra loads of milk, resulting in demand exceeding current supply. Plants are trying to boost cheese production ahead of the expected surge in cheese orders from sharply lower prices.
- Cream supplies for butter production have tightened dramatically since last week, according to Dairy Market News. Buyers are not able to find all the cream they need, even at prices higher than offered. Ice cream continues to take steady volumes of cream, while butters sales remain strong, as buyers attempt to cover their fall needs.
- Midwest cheese orders were lighter this week as buyers delay purchases in anticipation of lower prices next week, according to Dairy Market News. However, cheese offerings are not really burdensome, and milk shipments into the region have dried up. Operating schedules are now lighter as local milk supplies also decline, while yields are sharply lower as fat and protein levels are low, even for summer.

Futures Month	Friday 08/08 Close	Friday 08/01 Close	Change
Aug-08	\$17.55	\$18.00	(\$0.45)
Sep-08	\$17.19	\$18.02	(\$0.83)
Oct-08	\$17.60	\$18.30	(\$0.70)
Nov-08	\$17.65	\$18.22	(\$0.57)
Dec-08	\$17.63	\$18.18	(\$0.55)
Jan-09	\$17.59	\$18.10	(\$0.51)
Feb-09	\$17.75	\$18.07	(\$0.32)
Mar-09	\$17.76	\$18.11	(\$0.35)
Apr-09	\$17.87	\$18.28	(\$0.41)
May-09	\$17.90	\$18.30	(\$0.40)
Jun-09	\$18.16	\$18.50	(\$0.34)
Jul-09	\$18.35	\$18.75	(\$0.40)
Aug-09	\$18.34	\$18.92	(\$0.58)
Sep-09	\$18.52	\$19.10	(\$0.58)
Oct-09	\$18.60	\$19.10	(\$0.50)
Nov-09	\$18.57	\$19.05	(\$0.48)
Dec-09	\$18.49	\$19.06	(\$0.57)
Aug-Dec	\$17.52	\$18.14	(\$0.62)
2009 Avg	\$18.16	\$18.61	(\$0.45)



What's Bearish:

- Dairy Products Report: Butter production in June was up 9% vs. a year ago, American cheese output was 5.4% higher (see chart above), cheddar up 2.1% and total cheese up 1.3%, according to USDA figures released this week. YTD through June, American cheese production is up 2.8% and cheddar output is up 0.7%, after being negative for much of the year.

- Cash Market: Blocks fell 6¾¢ to settle at \$1.76¾/lb and barrels shed 8¢ to \$1.71/lb as more records were set in the spot market. Last week it was the biggest drop and spread; this week we set records for single day volume for barrels (22 loads) and most cheese traded in a week (78 loads). Butter trading was also heavy with 35 cars exchanging hands. Butter closed up 7½¢ to close at \$1.65/lb.
- Fluid milk sales in June totaled about 4.2 billion pounds, down 0.2% from a year ago, according to Dairy Market News.
- Dry whey stocks continue to build in many locations, according to Dairy Market News. Whey product interest has faltered, resulting in a slower spot market. Some considering ordering are delaying purchases until they feel a bottom has been formed.
- While cheese prices were up, NASS butter and powder prices fell this week. Butter decreased 0.5¢ to average \$1.51/lb, nonfat dry milk lost 1.6¢ to \$1.40/lb and dry whey decreased 0.5¢ to 25.8¢/lb.
- Dairy Market News reports that with butter prices near their highest levels since September 2005, many handlers and traders anticipate that international demand will slow on all fronts.
- Cheese makers out East are reporting that consumers are migrating to lower cost "store brand" varieties in response to current economic conditions. Higher food and energy prices are keeping customers from buying higher price cheeses than previously, according to Dairy Market News.

Recommendation:

The spot cheese market continued to steal the limelight as the "battle royale" we predicted certainly came to pass. We're seeing some big daily and weekly volumes as neither side wants to give in. Buyers, from what we're hearing, appear largely to be milk producer organizations trying to avoid an all-out collapse in milk futures. Sellers seem to be the cheese makers who are having a hard time finding off-market buyers to take their product. No one knows who has more bullets, but the fight looks set to continue next week. The larger picture doesn't seem so bad, as USDA's weekly cheese updates seem to indicate cheese supplies are not burdensome. At the same time, the milk supply is tightening up significantly as school openings and fall needs start to dominate buying decisions. However, commodities were generally slaughtered today as the U.S. dollar had it's biggest one-day gain against the Euro since 2004. That had crude oil down over \$5/barrel at the time of this writing, which caused the grain markets to plummet. The commodity bull might not be over, but a significant correction has taken place. We could be seeing "smart money" move out of commodities, back into equities, as the Dow was up over 300 points today. Milk futures will not be immune to this! There's also disbelief out there that milk futures could dare to go below \$16.00/cwt. But at today's cash cheese prices, we're staring at \$15.75 milk for the September contract, which is carrying a \$1.50 premium to cash with a week to go before it starts its calculation. September could go much lower. Selling September or buying 17.00 PUT options at 40¢ would be a good idea. Look for cheese to rally this fall to \$1.95 to \$2.00, and if that happens CALL options bought now could be sold into, creating a no lose hedge for October to Dec milk. Target to buy the 19.00 CALL options in those months at 25 to 35 cents. When calls are bought, enter orders to sell futures at 19.50 and wait for the market to come up.

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.