

The KDM Dairy Report – August 15th, 2008

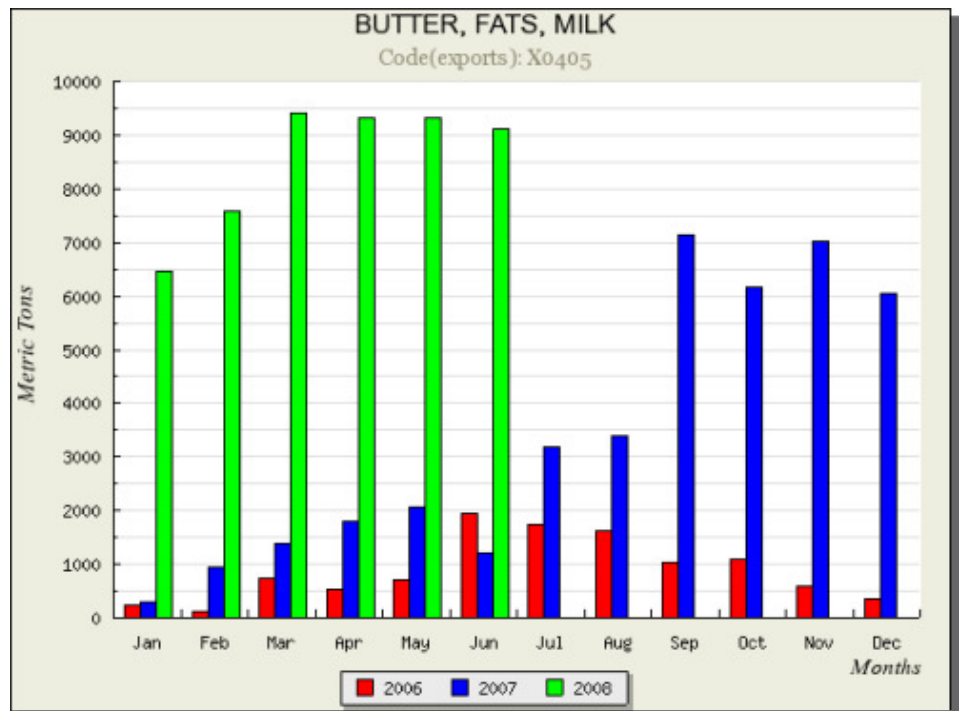
What's Bullish:

- Milk supplies remain tight throughout much of the Eastern region, according to Fluid Milk & Cream Review. Milk is being heavily drawn south to meet demand, which is straining plants' abilities to supply the fluid market. Despite almost fall-like weather in some parts, milk production has not rebounded. A total of 358 loads of milk were shipped into the Southeast and Florida this week, compared to only 28 last week. Widespread retail fluid milk promotions have noticeably increased retail sales, while increased demand for school milk is suggesting milk supplies will remain tight for the next several weeks.
- Cream supplies in the Midwest are tight and prices are firm, according to Fluid Milk & Cream Review. Milk has started to move in to the Southeast, while manufacturing milk interest is very good as supplies decline.
- Butter stocks at USDA selected storage centers were down 6% for the period 08/01 through 08/11, according to the Weekly Cold Storage report. However, cheese stocks were up 1%.
- Dairy cow slaughter for the week ending 08/02 was a solid 49,200 head, up from 44,200 during the same period a year ago.
- Butter stocks at CME-approved warehouses fell 2.4 million lbs for the week ending 08/09, leaving 88.6 million lbs on hand, down 59 million lbs from a year ago.
- Fresh butter production is not keeping pace with demand, according to Dairy Market News. Handlers continue to reach into inventoried stock to satisfy customer orders, as cream supplies remain tight.
- The US Foreign Ag Service reported this week that butter exports for the period Jan-Jun were up 683% compared to 2007 (see chart). 113.1 million lbs left our shores vs. only 16.9 million lbs during the same period a year ago. Nonfat dry milk exports were up 83% over the same period, totaling 283 million lbs. Finally, cheese exports totaled 157 million lbs, a 48% increase from the same period in 2007.
- International: Cheese stocks are low in Oceania as the new production season begins. Prices are holding steady for cheddar at an average of \$2.27/lb.

Futures Month	Friday 08/15 Close	Friday 08/08 Close	Change
Aug-08	\$17.12	\$17.55	(\$0.43)
Sep-08	\$16.48	\$17.19	(\$0.71)
Oct-08	\$17.20	\$17.60	(\$0.40)
Nov-08	\$17.41	\$17.65	(\$0.24)
Dec-08	\$17.55	\$17.63	(\$0.08)
Jan-09	\$17.49	\$17.59	(\$0.10)
Feb-09	\$17.70	\$17.75	(\$0.05)
Mar-09	\$17.71	\$17.76	(\$0.05)
Apr-09	\$17.85	\$17.87	(\$0.02)
May-09	\$17.87	\$17.90	(\$0.03)
Jun-09	\$18.13	\$18.16	(\$0.03)
Jul-09	\$18.33	\$18.35	(\$0.02)
Aug-09	\$18.35	\$18.34	\$0.01
Sep-09	\$18.50	\$18.52	(\$0.02)
Oct-09	\$18.45	\$18.60	(\$0.15)
Nov-09	\$18.55	\$18.57	(\$0.02)
Dec-09	\$18.50	\$18.49	\$0.01
Aug-Dec	\$17.15	\$17.52	(\$0.37)
2009 Avg	\$18.12	\$18.16	(\$0.04)

What's Bearish:

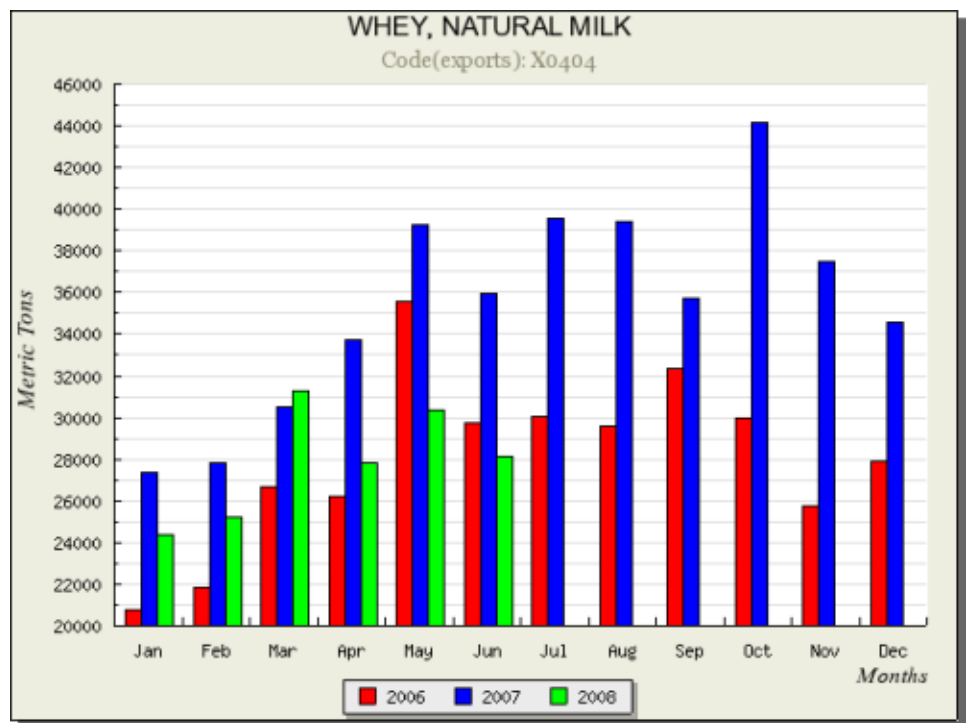
- Cash Market: Cheese sellers stayed in control this week, often offering up to 10 loads at a time. Blocks dropped ¾¢ to \$1.76/lb and barrels gave up 2¢ to \$1.70/lb in during the spot sessions. 27 loads of blocks and 12 barrels exchanged hands in relatively active trading. Butter lost ½¢ to close at \$1.64½/lb in heavy trading, with 37 cars traded.
- Dairy Market News reports cheese offerings are adequate in the Midwest, with normal lead times. Concern over the cheese supply and availability continues to weigh down the market. Current orders are uneven as the market remains unsettled to weak.



- In a declining market, Western cheese buyers are being strategic and waiting for a bottom before making purchases beyond immediate needs, according to Dairy Market News. Sales of cheddar and other cheese varieties are down, while availability is moderate for cheddar, long for mozzarella with Swiss in balance.
- Fluid Milk & Cream Review reports milk output in California is moving higher as a combination of moderate weather and a change to no or limited penalties for above base milk has encouraged production. In the Pacific Northwest, milk production is higher than a year ago, which is stressing some processing plants in Utah and Idaho.
- Most NASS survey prices were lower this week. 40-lb blocks averaged \$1.96/lb, down 0.6¢ from last week, while 500-lb barrels lost 6.6¢ to \$1.89/lb. Nonfat dry milk decreased 0.2¢ to average \$1.40/lb and dry whey fell 0.7¢ to 25.1¢/lb. Butter was the only bright spot, up 4.4¢ to average \$1.56/lb.
- Dry whey exports during the first half of the year were down 34% vs. last year, according to the US Foreign Ag Service. A strengthening US dollar is also putting uncertainty into future exports.
- Dry whey prices continue to move lower across the country as inventories are still building, according to Dairy Market News. Manufacturers are discounting in order to move product, while buyers put off new orders in anticipation of lower prices.
- Nonfat dry milk prices continue to slide as additional loads are being offered into the marketplace by several producers. Dairy Market News reports sellers are trying to move extra powder, while production schedules remain active to process the milk supply. Future exports could be impacted by the strengthening US dollar and a good start to the Oceania milk production season.
- International: Milk production in Western Europe is edging lower but still at levels above a year ago. This is allowing manufacturers to run on schedules that are heavier than usual for this time of the season. Stocks of dairy end-products are available for both current and future needs, while buyer interest is slow due to typical holidaying by European citizens.
- International: The new milking season has begun on a positive note in New Zealand and Australia. Rainfall has been widespread in recent weeks, replenishing moisture levels from last season's drought. Early projections are showing that milk production should be steady to slightly higher than last season.

Recommendation:

Cheese sellers were relentless in their desire to offload product this week, many times offering 5 to 10 loads at a time. Buyers were less aggressive, although blocks lost less than a penny for the week and a combined 39 loads exchanged hands. While there appears to be an abundance of cheese, the milk supply is definitely getting tighter, and we have to remember that the Class III market gets its direction from the daily spot cheese session. That cheese session trades only cheddar aged 30 days and under, so it's conceivable that 30-60 days from now, we could be tighter on cheese like we are getting now in milk. Exports are slow now, but part of that could be Europe's tradition of basically vacationing the entire month of August. Exports are likely to pick up some in the fall. Futures prices reflect this as only the front months took significant losses for the week, and Oct and beyond is pricing a hefty premium to the cash market. Sep could still see some decline as it starts calculating on Monday and the current cash price works out to about \$15.65 milk. We would recommend buying Oct – Dec \$19.00 or \$19.25 CALL options in anticipation of a cheese rally in the next several weeks. Use them to protect milk you have already sold, or to sell in to if prices get back near \$18.50 or higher in any of those months. Having the CALL bought ahead of time will give you the freedom to lock in with your plant or sell futures, because further upside will be covered by your option. 2009 contracts were quiet this week and we wouldn't recommend selling at these prices. Wait for the next rally.



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