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The KDM Dairy Report – September 26th, 2008

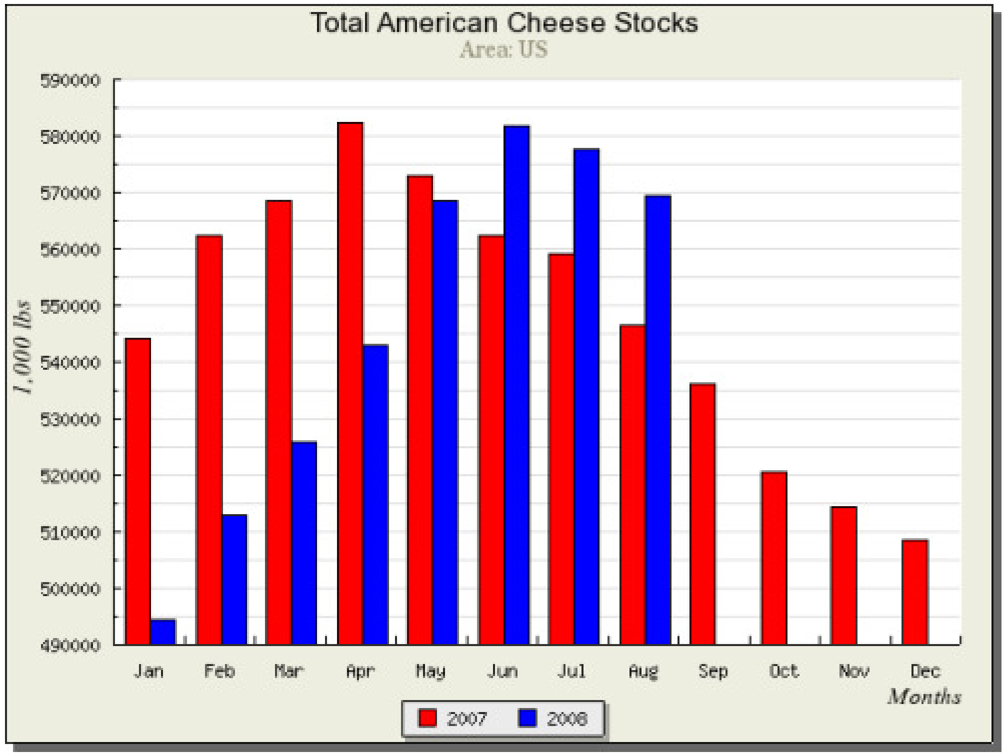
What's Bullish:

Futures Month	Friday 09/26 Close	Friday 09/19 Close	Change
Sep-08	$16.26	$16.29	($0.03)
Oct-08	$17.45	$17.49	($0.04)
Nov-08	$16.60	$16.86	($0.26)
Dec-08	$16.45	$16.75	($0.30)
Jan-09	$16.22	$16.45	($0.23)
Feb-09	$16.35	$16.60	($0.25)
Mar-09	$16.36	$16.65	($0.29)
Apr-09	$16.56	$16.78	($0.22)
May-09	$16.58	$16.79	($0.21)
Jun-09	$16.73	$16.94	($0.21)
Jul-09	$16.82	$16.95	($0.13)
Aug-09	$16.95	$17.01	($0.06)
Sep-09	$17.05	$17.10	($0.05)
Oct-09	$17.05	$16.96	$0.09
Nov-09	$17.00	$17.00	$0.00
Dec-09	$17.02	$17.10	($0.08)
Sep-Dec	**$16.69**	**$16.85**	($0.16)
2009 Avg	**$16.72**	**$16.86**	($0.14)

- Cash Market: A bit mixed this week, but we'll still call it positive. Block cheese got as high as $1.98¼/lb, but then retraced to $1.94/lb by the end of the week, which is down 1½¢ from last Friday. Barrels gained 2¢ to settle at $1.95¼/lb. Though declining slightly, block cheese saw 3 different buyers during the week, trading a total of 8 loads, while in barrels there was no activity. Butter pushed to new highs for the year, up 2¼¢ to reach $1.74¾/lb on just 3 trades.
- NASS cheese prices jumped this week, finally responding to recent strength in the cash market. Both 40-lb blocks and 500-lb barrels averaged $1.77/lb, up 5.1¢ and 6.1¢ respectively from last week. Butter increased 2.5¢ to average $1.64/lb, but nonfat dry milk decreased 5.4¢ to $1.16/lb and dry whey was down 0.6¢ to 21.5¢/lb.
- Milk supplies are "tight" throughout much of the Eastern region of the country, according to Fluid Milk & Cream Review. Demand for fluid milk remains strong and is challenging the ability of some plants to bottle enough milk to meet needs. This has restricted milk availability for manufacturing needs.
- Fluid Milk & Cream Review reports milk supplies are surprisingly tight through most of the Central region, for both fluid and cheese manufacturing. Supplemental milk shipments into the Southeast continue, limiting the fluid supplies available for other purposes. Demand is easily exceeding the offerings of manufacturing milk, with spot loads now going for at least a $2.00 premium over class.
- Milk output is declining at a faster than seasonal rate in the Pacific Northwest, according to Fluid Milk & Cream Review. Feed value from pastures is minimal, necessitating more supplemental feeding, which is adding to the cost of producing milk. Very little corn silage has been cut, and the crop is at least a couple of weeks behind normal. Many dairy operators are not as covered as normal on hay supplies, hoping prices will be lower later.
- Current cheese supplies have tightened in the Midwest, according to Dairy Market News. Buyers are only able to acquire a few extra loads of cheddar and natural American offerings, while competition from bottlers is limiting the extra milk supplies available for cheese production.
- Since early September, when cheese prices hit a low in the $1.60's/lb, cheese demand in the Western region has been excellent, and any available stocks have generally cleared, according to Dairy Market News.
- With milk supplies tight and wholesale cheese prices rising, some manufacturers in the Northeast are turning to the condensed market in an attempt to maintain desired production levels, according to Dairy Market News. Overall, cheese production in the region is steady to lower, while manufacturers expect retail demand to increase in the coming weeks.
- Churning activity in the Central region is active, but demand continues to outstrip fresh supply, according to Dairy Market News. Some plants are bringing in cream from outside locations in order to maintain fuller operating schedules. Even so, some butter handlers are voicing concerns about having sufficient volumes of butter for year end domestic needs. Retailers report butter sales are holding steady, while food service orders are remaining stronger than anticipated.
- Weekly cold storage numbers are still reflecting a drawdown in both cheese and butter stocks. For the period 09/01 through 09/22, butter stocks have declined 15% and cheese stocks are down 1% at USDA selected storage centers.
- Confirming USDA's numbers above, butter stocks at CME warehouses for the week ending September 20th fell 5.9 million lbs, compared to a drop of 3.4 million lbs during the same period a year ago. Total stocks remaining are down to 67.5 million lbs, almost half the 124 million lbs we had last year at this time.
- Livestock Slaughter Report: 226,300 dairy cows were culled during the month of August, an increase of 14,400 head over last year.
- International: Dairy Market News reports European whey prices firmed slightly this week, as declining cheese output reduces availability. Animal feed buyers are returning to the marketplace and making purchases.
- International: Lack of moisture continues to be a concern in Australia, according to Dairy Market News. There has not been enough rainfall to replenish water reserves, which could hurt later in the season. Milk output is up just 1% from last season.

- International: The sad story of contaminated milk powder in China could have a positive effect on U.S. exports. Countries such as Indonesia, the Philippines, Korea and even parts of Europe are cancelling and recalling China-sourced dairy products. They may look to the U.S. as a "safer" and more reliable trading partner. The brand names of several Chinese suppliers have, "been damaged beyond repair", according to Sanlu shareholder Fonterra.

What's Bearish:



- Cold Storage Report: American cheese stocks in August were up 4% vs. last year and total cheese stocks were up 6%. Early summer hoarding could partially explain the increase in storage, but more is still more. On positive side, butter stocks were down 15% from last August and down 10% from July.
- Milk production in the Southwest is mostly steady, with weather conditions ideal for milk cows, according to Fluid Milk & Cream Review. Most contacts expect increases in output as October will see additional fresh cows and heifers come online. Processors are running on expected levels.
- Central dry whey this week ranged from 18-19½¢ per pound, as prices continue to be pressured by other powder markets. Buyers are starting to make more purchases, thinking the bottom is near, however, cheese and whey production is active, with whey inventories building at some locations.
- The nonfat dry milk market appears to be in the worst shape, with future offerings to the government price support program a possibility, according to Dairy Market News. Prices have fallen 45% in the past few weeks, but little product has moved. Buyers remain on the sidelines and stocks are heavy and building.
- International: Milk production in Western Europe is declining seasonally and is lagging last year, but is sufficient to keep manufacturing plants running at favorable levels, according to Dairy Market News. Stocks of manufactured dairy products remain available for both domestic and international buyer interest. Buying interest is slow and unaggressive as prices continue to decline at a steady pace, with the only sales for short-term needs. Handlers anticipate buyers will remain absent until markets stabilize.
- International: Dairy Market News reports milk output in New Zealand is on schedule and projected to be 6-7% higher than last year. More sun is helping dry saturated areas and promoting pasture growth.
- **Economy**: $700 billion bailout, WaMu bank bust (largest ever), jobless claims at 7-year high and a slowdown in foreign economies.

Recommendation:

We sold some $17+ milk this week in Nov and Dec as they briefly eclipsed those levels early in the week. Sources, including cheese plants we work with, have conceded that cheese demand is better than expected. And indeed, it appears we are quite tight on milk in both the Central and Eastern parts of the country. Strong fluid demand is limiting cheese-making capability, and we now think it's possible we could hang on to some decent cheese prices through mid-October instead of our original thoughts of the end of September. The majority of the report again this week is largely supportive, but don't be fooled that happy times are here again. **Use this opportunity!** If Nov and Dec get above $17 again, sell some of your milk. We've been all but assured the new make allowance is a done deal and will begin in October, taking 35¢/cwt off of Class III. So selling $17 milk is selling $1.90 cheese. We remain unconvinced we'll hold that level through the end of the year. Target to sell Q1 at $16.75 of higher and Q2 at $16.90 or higher.