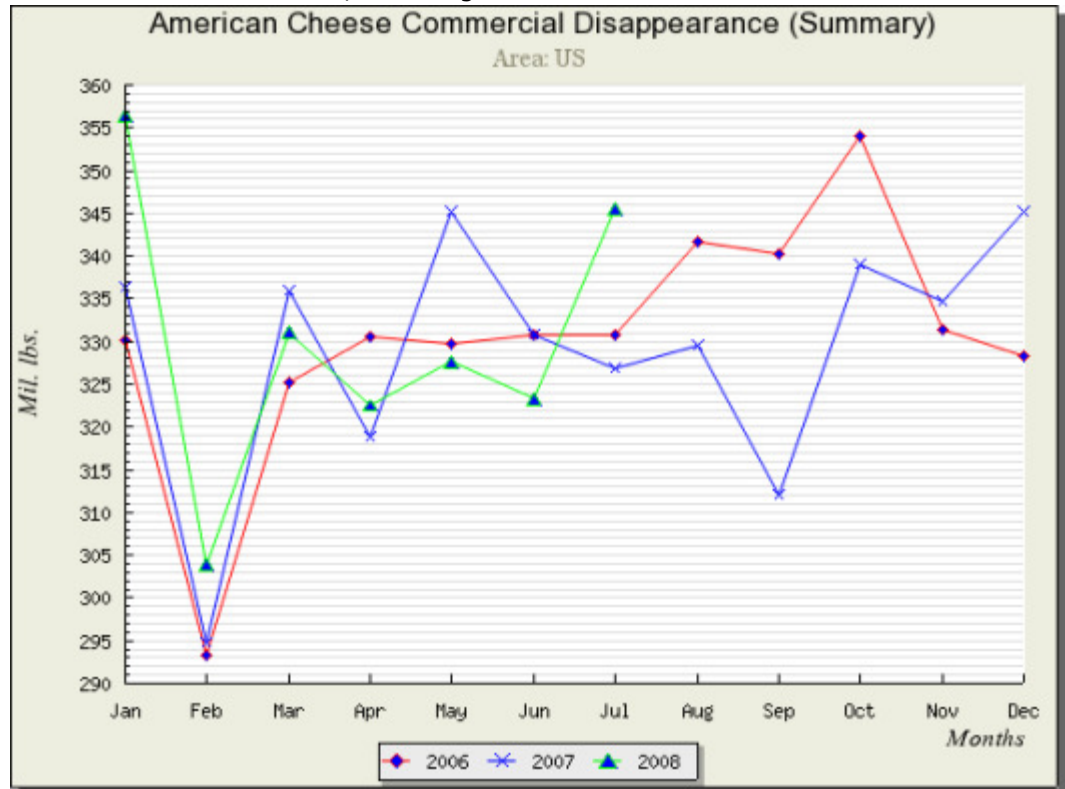


The KDM Dairy Report – October 3rd, 2008

What's Bullish:

- Commercial Disappearance: USDA released July usage numbers this week, with commercial use of milk in all products up 1.8% in July vs. a year ago, and up 2.8% for the period Jan-July. Use of butter in July was up 8.9% and American cheese use was up 5% (see graph), but use of other types of cheese was down 4.2%.
- NASS cheese prices jumped this week. 40-lb blocks averaged \$1.84/lb, up 7.6¢, while 500-lb barrels shot 11.2¢ higher to \$1.88/lb. Butter gained 4.4¢ to average \$1.68/lb in their survey, while nonfat dry milk improved 1.1¢ to \$1.17/lb. Dry whey, however, lost 0.5¢ to 21¢/lb.
- Improved Class I interest in the Central region and continued shipments south, are keeping fluid supplies tight and reducing manufacturing plant operating schedules, according to Fluid Milk & Cream Review. Manufacturing milk interest is strong and volumes available for sale remain limited.
- Milk production in the Northeast is steady, but not expected to increase until another month or so, while in the Mid-Atlantic, milk supplies remain tight. Fluid Milk & Cream Review reports cheese plants continue to pull milk heavily and fluid orders have only eased a bit.
- Heavy cheese sales during the last week in September have helped Midwest cheese producers to reduce inventories, according to Dairy Market News.
- A major fire closed a cheese plant in the Northeast this week, according to Dairy Market News. The plant processed 30 million lbs of milk per month, and produced mozzarella, specialty cheeses and shredded cheese. Balancing plants report strong interest from Class III manufacturers as the fourth quarter is lining up to be strong for cheese sales. Weekly cold storage numbers for the period 09/01 through 09/29 show cheese stocks down 1.9 million lbs and butter stocks down 4.9 million lbs at USDA selected storage centers.
- Dairy cow slaughter for the week ending 09/20 totaled 51,900 head, up from 49,800 head during the same period a year ago.
- Central dry whey prices were up slightly this week and the market tone is "stronger", according to Dairy Market News. Some producers are increasing output in order to meet upcoming contract needs, and buyers are requesting written assurances that milk powder ingredients from China have not been incorporated into any products.
- Dairy Market News reports Eastern dry whey production is steady, but there is beginning to be some tightness in the market. In addition, more interest in liquid whey has reduced the amount available for drying.

Futures Month	Friday 10/03 Close	Friday 09/26 Close	Change
Oct-08	\$16.70	\$17.45	(\$0.75)
Nov-08	\$15.62	\$16.60	(\$0.98)
Dec-08	\$15.50	\$16.45	(\$0.95)
Jan-09	\$15.40	\$16.22	(\$0.82)
Feb-09	\$15.52	\$16.35	(\$0.83)
Mar-09	\$15.59	\$16.36	(\$0.77)
Apr-09	\$15.78	\$16.56	(\$0.78)
May-09	\$15.99	\$16.58	(\$0.59)
Jun-09	\$16.16	\$16.73	(\$0.57)
Jul-09	\$16.40	\$16.82	(\$0.42)
Aug-09	\$16.56	\$16.95	(\$0.39)
Sep-09	\$16.73	\$17.05	(\$0.32)
Oct-09	\$16.78	\$17.05	(\$0.27)
Nov-09	\$16.72	\$17.00	(\$0.28)
Dec-09	\$16.67	\$17.02	(\$0.35)
Oct-Dec	\$15.94	\$16.83	(\$0.89)
2009 Avg	\$16.19	\$16.72	(\$0.53)



What's Bearish:

- Cash Market: Spot cheese crashed on Tuesday, made a solid rebound on Thursday, but then gave back a bunch on Friday. Blocks finished the week at \$1.81/lb, down 13¢ from last Friday, while barrels plummeted 16¢ to settle at \$1.79¼/lb. Butter was higher mid week, but finished ¼¢ lower at \$1.74½/lb. Trading was very heavy with 41 loads of blocks and 38 barrels exchanging hands, and 6 cars of butter.
- September Class III price was announced at \$17.28 today, down from \$17.32 in August and \$20.07 a year ago.
- Cooler days and overnight temps are benefiting cow comfort in the Southeast, according to Fluid Milk & Cream Review. Milk production is steady to improving in the region, reducing the number of Grade A shipments into the region from 164 loads last week to 111 this week.
- Dairy Market News reports cheese orders in the Midwest have slowed from buyers who base prices on weekly averages, as they wait for recent declines in the cash market to affect purchase costs.
- Demand for Western cheddar ranges from fair to light, as buyers have stepped back after recent weakness in the cash market, according to Dairy Market News.
- Cream offerings are increasing as ice cream production slows seasonally, according to Dairy Market News. Butter manufacturers are welcoming the additional cream as churning remains active across the country. Butter demand is steady, but some retail and food service buyers are concerned about consumer spending patterns as the economy is still unsettled.
- Butter stocks at CME-approved warehouses dropped only 2.1 million lbs for the week ending 09/27, compared to a stronger drawdown of 7 million lbs a year ago. Ending stocks are still much lower, however, at 65.4 million lbs vs. 121.8 million lbs in '07.
- While getting tighter east of the Rockies, Western dry whey prices are still trending lower, according to Dairy Market News. Discounts are still being offered and holdings are still moderate to heavy.
- Western nonfat dry milk prices are also trending lower as buying interest remains light, according to Dairy Market News. Export interest is subdued and new orders are slow to materialize.
- Economy: The Labor Department announced that 159,000 jobs had been chopped in September, the fastest pace in five years. Meanwhile, factory orders fell 4% in August and durable goods orders dropped 4.5%.

Recommendation:

Much of the country is still tight milk and cheese, but we have to respect this week's cash market. Sellers showed up in a big way, dumping a total 79 loads of cheese. Buyers, for their part, absorbed the product, but were unable to keep prices at their mid week highs. We hate to be non-committal, but the market could go either way from here. On the one hand, cheese demand appears somewhat strong, current supplies are on the tight side and cheese production is less than desired. Fluid demand is strong, milk is especially tight on the East coast and we may be seeing a bottom in the dry whey market, with even some tightness noted this week. On the other, big players are selling large quantities of cheese on the spot market, the bailout bill passed both the house and senate, yet the market reacted lower. The food service industry appears very uncertain about long-term prospects. Cash prices now work out to \$16.20 milk, with Class III futures trading at a discount, predicting further declines in the cheese price. That may ultimately happen, but current tightness should keep us from plunging straight to \$1.50 cheese in the short term. However, with cooler weather and freshening animals, milk production is now picking up in much of the country. Combine that with the state of our economy, a strengthening dollar and weak exports, and we could be looking at quite a rocky time for the next 6-9 months. Be prepared for a possible plunge to new lows in cheese when holiday buying is through. For that reason, we continue to recommend getting covered Nov through Q1 '09. Target to sell Nov and Dec at \$16.50 or higher (down from our \$17 rec last week) and Jan-Mar at \$16.00 or higher. \$16.00 milk is \$1.80 cheese, which is not bad for Q1. You may even want to sell up to 25% of your Apr-May production at these levels. We would still leave the last half of '09 open.

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