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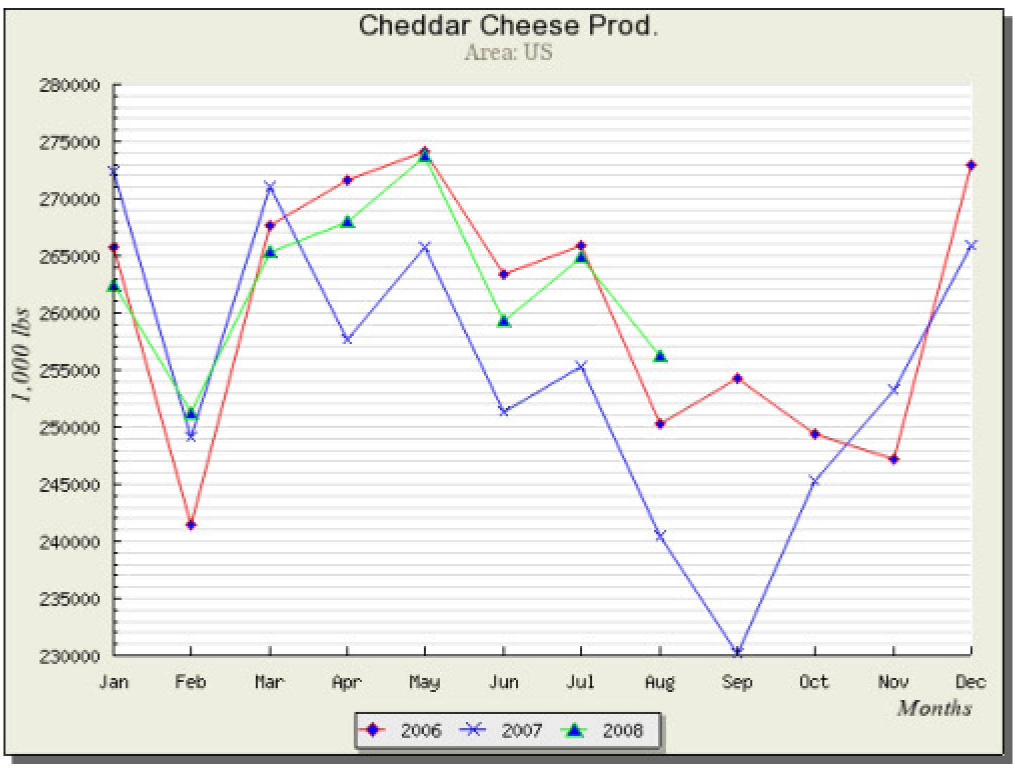
The KDM Dairy Report – October 10th, 2008

What's Bullish:

Futures Month	Friday 10/10 Close	Friday 10/03 Close	Change
Oct-08	$16.88	$16.70	$0.18
Nov-08	$15.69	$15.62	$0.07
Dec-08	$15.50	$15.50	$0.00
Jan-09	$15.26	$15.40	($0.14)
Feb-09	$15.31	$15.52	($0.21)
Mar-09	$15.45	$15.59	($0.14)
Apr-09	$15.59	$15.78	($0.19)
May-09	$15.75	$15.99	($0.24)
Jun-09	$16.05	$16.16	($0.11)
Jul-09	$16.14	$16.40	($0.26)
Aug-09	$16.25	$16.56	($0.31)
Sep-09	$16.43	$16.73	($0.30)
Oct-09	$16.40	$16.78	($0.38)
Nov-09	$16.35	$16.72	($0.37)
Dec-09	$16.40	$16.67	($0.27)
Oct-Dec	**$16.02**	**$15.94**	**$0.08**
2009 Avg	**$15.95**	**$16.19**	**($0.24)**

- Cash Market: Stubborn buyers were able to push block prices up 7¢ and only had to buy 3 loads to do it. Blocks settled at $1.88/lb. Barrels followed, gaining 4¼¢ to $1.83½/lb on no trades. However, butter decreased nearly a dime, before bouncing back a nickel today, limiting the weekly loss to 4¼¢. Butter settled at $1.70¼/lb on 6 trades for the week.
- Cheese prices were up again in this week's NASS survey. 40-lb blocks increased 7.1¢ from the previous week to average $1.92/lb, and barrels were up 4.1¢ to $1.93/lb.
- Cheese buyers in the Midwest were looking for extra loads of various current varieties this week, according to Dairy Market News. However, extra supplies are minimal since plants have little uncommitted product. Good interest is noted for white processing solids as current barrel supplies are limited.
- Supply and demand for cheese in the West is in decent balance, according to Dairy Market News, and under grade cheese is clearing well. Interest in mozzarella is seasonally strong as well.
- Butter continues to be pulled out of storage at a more rapid pace than last year. Movement out of CME-approved warehouses for the week ending 10/04 totaled 4.6 million lbs, leaving 60.8 million lbs on hand. Last year at this time, there was only a 2.5 million lb drawdown and total stocks of 119.3 million lbs.
- Surplus manufacturing milk volumes are limited and difficult to locate in the Central region, according to Fluid Milk & Cream Review. Weather conditions have been nearly ideal and milk output is strong, but demand is also strong and gaining momentum. Milk promos are clearing good volumes at retailers as Class prices have eased.
- Central dry whey prices were mostly unchanged this week, but inquiries from Asian buyers were reportedly increasing, according to Dairy Market News. Dry whey production during the month of August was down 7.2% from last year, and some producers are holding stocks with more confidence.



What's Bearish:

- Dairy Products Report: Cheddar cheese output in August was up a strong 6.5% compared to last year, according to USDA figures, and total cheese output increased by 3%. Butter production was higher too, increasing 4.4% from last August, and the most produced in this month since 1951. The 6.5% increase for cheddar was the biggest year-over-year increase since September, 2006.
- World Ag Supply & Demand Report: USDA reduced their 2009 dairy export forecast, reflecting weaker international demand. A slight increase in 2009 milk production is also forecast due to rising cow numbers. As a result, USDA chopped 95¢/cwt off their 2009 Class III price forecast from last month, now expecting it to average $16.30.

- Milk receipts are up and less milk is being called in to the Southeast, according to Fluid Milk & Cream Review. 167 loads were shipped in to the region, compared to 211 last week. Decreased fluid demand is cited as the biggest reason for the decline, and this is easing pressure on plants further north.
- Milk output in the Southwest is steady and Class I demand is flat, according to Fluid Milk & Cream Review. There are indications that more cows and heifers will be entering the milking strings in October. In the Pacific Northwest, some hay stocks are growing somewhat, with prices being negotiated $10-15 lower in instances. The number of heifers sold at a monthly sale in the region was the highest since May, with prices sharply lower.
- Butter sales to the export market are becoming increasingly difficult to put together without continued CWT assistance, according to Dairy Market News. Prices continue to weaken and demand along with it. Food service orders are holding steady, although some buyers are indicating that traffic flow through some restaurants is easing.
- Nonfat dry milk prices were sharply lower this week, and there were sales to the CCC at the support price of 80¢/lb. Domestic demand is trending lower and new export interest is light.
- While NASS cheese prices were up this week, other Class III components lost ground. Butter averaged $1.68/lb, down slightly from last week, nonfat dry milk dropped 10.7¢ to $1.06/lb and dry whey decreased 0.8¢ to 20.2¢/lb.
- Dairy cow slaughter for the week ending 09/27 dipped below 50k. 49,900 head were culled vs. 52,000 head in '07.
- Crop Production Report: The much anticipated October crop report was bearish grains. Corn production was up 1% from September and bean production up 2%, exceeding analyst's expectations. Analysts also question USDA's usage numbers, thinking they're still too high in light of weaker ethanol and export demand. As a result, corn, beans and meal traded limit down today with more downside likely.
- International: Dairy Market News reports European milk output continuing to trend lower, however, milk supplies continue to be available for processing. In addition, major economic declines in most major international stock markets, fluctuating currencies, and unsettled consumer confidence are all creating uncertainty in world demand. Producers, who had hoped to place EU-sourced dairy products into China due to their tainted milk scandal, are seeing few opportunities to do so. Overall, demand for dairy products is trending lower.
- International: Milk production in Australia was up 1.2% in August and up 3.6% YTD (July-Aug) in their new milking season, according to Dairy Australia figures. Dairy Market News reports that the unsettled economy, along with weakening international dairy product prices, has slowed buyer interest greatly, though lack of moisture continues to be a major concern for dairy-producing parts of Australia. Buyers with long-term fixed contracts at higher prices are not happy about recent price declines and are negotiating for shorter terms and lower prices for future contracts.
- Economy: The Dow and S&P 500 had their worst weeks ever, losing 21.9% and 23% respectively since last Friday. Stalwart stocks like GM were crushed. GM's share price finished at $5.04 today; it hasn't been that low since the 1950's. Ouch. Americans have seen their retirement portfolios drop by as much as $2 trillion in the past 15 months, according to Congress' top budget analyst. Most retirement plans have lost 20% overall since mid-2007.

Recommendation:

You can go back and check (all our previous reports are online), but from Fall of last year through the first half of this year, we did well by advising producers NOT to sell much milk, and they realized the benefit of doing so with very high prices. While we did make a few recommendations this summer to sell up to 25-30% of '08 and'09 milk around $20, in hindsight (which is 20/20, of course), it would have been nice to have 80% sold there about now! Probably the biggest reason we didn't make a stronger rec to sell was grain prices. At the time, they were at record highs, and producers were telling us about needing $18-20 to breakeven in 2009; so why would we be crazy to sell 80% of our production at just over cost? Of course, grain and milk prices have both plummeted since then, and that rationale no longer applies. But it's helpful to look back and try to learn. We now have an entirely new set of dynamics, so where do we go from here? Really, our outlook has changed little from previous weeks; support for the near term, bearish long term. We've mentioned for months that our biggest risk remains the economy, but deep down always hoped things would improve at some point and milk would ride along with it. But in light of the incredible losses on Wall Street, deteriorating economic conditions world wide and grains still looking to hit bottom, we think long-term damage is likely to happen, and we're feeling more urgency in getting some milk covered. Nonfat dry milk plunged to the gov't support price of 80¢ and butter is declining, and we can't but help thinking that it's only a matter of time before the current high cheese prices take a hit, post seasonal buying. We could be in a situation next year where we see milk production reports with negative output numbers (usually very bullish!), but an even larger drop in demand that would still send milk prices lower. It's time to call a spade a spade and admit we're in a bear market that could go much lower. As hard as it is to think about selling milk at these prices, we're now recommending getting up to 50% covered for the first half of the year, and up to 25% covered in the last half. 2009, at $15.95 avg is trading at $1.80 cheese! If you just can't bear to sell milk outright, consider buying 15.00 PUT options Jan-Jun for 60¢ each. This yields an effective floor of $14.40, but if cheese were to go to $1.40/lb, Class III would be a tad over $12.00/cwt. **Get something done next week!**