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The KDM Dairy Report – October 17th, 2008

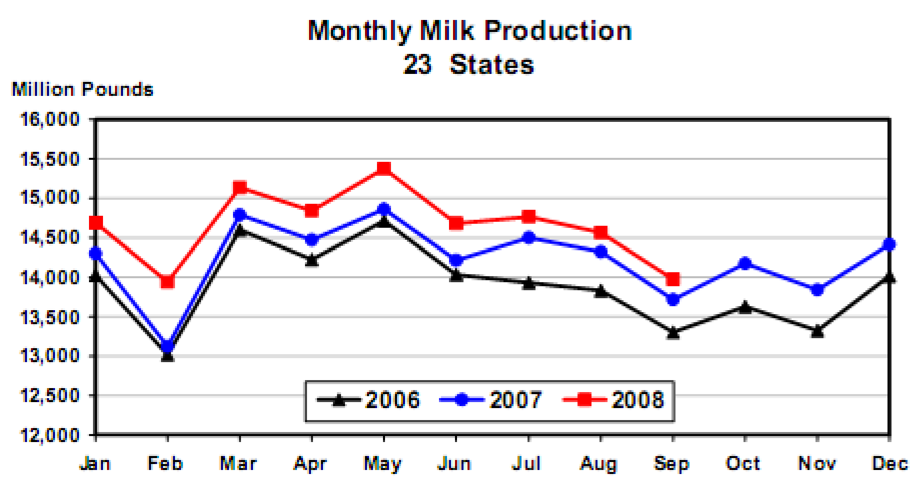
What's Bullish:

Futures Month	Friday 10/17 Close	Friday 10/10 Close	Change
Oct-08	$16.95	$16.88	$0.07
Nov-08	$15.69	$15.69	$0.00
Dec-08	$15.12	$15.50	($0.38)
Jan-09	$14.78	$15.26	($0.48)
Feb-09	$14.76	$15.31	($0.55)
Mar-09	$14.78	$15.45	($0.67)
Apr-09	$15.01	$15.59	($0.58)
May-09	$15.12	$15.75	($0.63)
Jun-09	$15.45	$16.05	($0.60)
Jul-09	$15.50	$16.14	($0.64)
Aug-09	$15.68	$16.25	($0.57)
Sep-09	$15.76	$16.43	($0.67)
Oct-09	$15.75	$16.40	($0.65)
Nov-09	$15.62	$16.35	($0.73)
Dec-09	$15.72	$16.40	($0.68)
Jan-10	$15.71	$16.46	($0.75)
Feb-10	$15.70	$16.44	($0.74)
Mar-10	$15.62	$16.25	($0.63)
Apr-10	$15.80	$16.71	($0.91)
May-10	$15.75	$16.86	($1.11)
Jun-10	$15.80	$16.95	($1.15)
2009 Avg	**$15.33**	**$15.95**	**($0.62)**
Q1Q2 2010	**$15.68**	**$16.38**	**($0.71)**

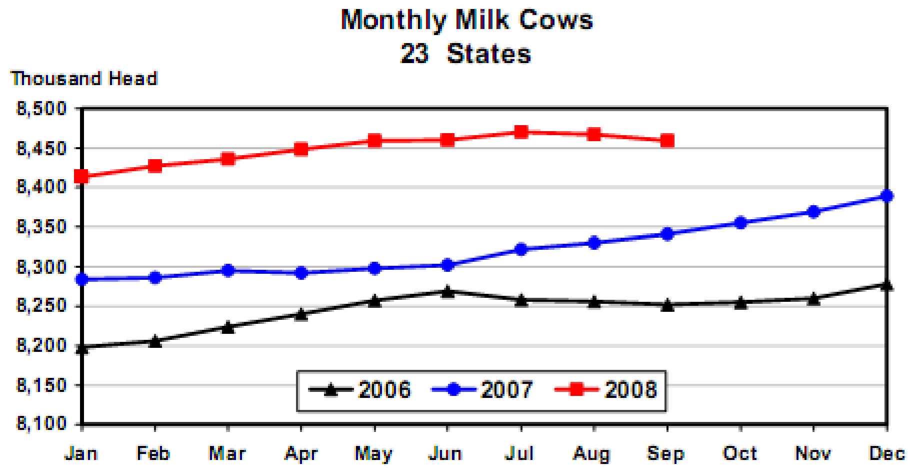
- Midwest cheese supplies are tight to mostly adequate, according to Dairy Market News. Colby/jack, provolone and mozzarella supplies remain snug, natural chunk movement is good and sliced solid and shreds are steady to improved.
- Potential new orders for cheese are currently not able to be filled in the Northeast, because plants are already operating at full capacity, according to Dairy Market News.
- Western cheese demand is often good, with buyers actively seeking cheese for nearby needs, according to Dairy Market News. Interest is best for cheddar blocks and barrels, mozzarella and Swiss cheese.
- Fluid Milk & Cream Review reports milk supplies remain tight in the upper Midwest due to steadily lower milk receipts and solid Class I sales. Extra cream is being generated and churning is heavier, although tempered loads are still needed to supplement fresh supplies. Manufacturing milk demand is good, with cheese makers looking for supplemental supplies. Plant schedules are generally steady to lighter seasonally.
- There were expectations that more milk would flow in California in October, but that has not materialized, according to Fluid Milk & Cream Review. Changes in feed rations, declines in milk per cow, slower growth plans, quota programs and uncertainty from the lending sector in securing credit are all playing a role. In Arizona, milk production is steady, leaving processing room at plants since surplus milk from other regions is not available.
- Weekly cold storage numbers show some encouraging numbers. For the period 10/01 through 10/13, butter stocks fell 14%, or 2.9 million lbs, and cheese stocks dropped 2%, or 2.3 million lbs.
- The Central dry whey market appears steadier this week, according to Dairy Market News. Some producers have seen a boost in near term orders, and with that added buyer interest, are more firm on price offerings. Inventories range from steady to light, with allocation of loads necessary to help keep end user production schedules on track.
- International: Jan-Aug exports of butter totaled 142.3 million lbs, a 467% increase from the same period in 2007, according to the Foreign Ag Service. The Russian Federation was the biggest buyer, at 31.4 million lbs, or 22% of the total.
- International: Jan-Aug exports of cheese and curds totaled 206.2 million lbs, up 49% vs. the same period in 2007, according to the Foreign Ag Service, which was 3.2% of total cheese production. The leading buyer was Mexico at 53.2 million lbs.

What's Bearish:

- Cash Market: After reaching a high of $1.89/lb this week, blocks gave it all away in one day as we plunged 11¢ to settle at $1.79/lb today. Buyers picked up 9 loads on the way down, which were the only trades for the week. Barrels hung out at $1.90/lb, unchanged for the day and up 6½¢ for the week on no activity. We're told barrels are a little tighter than blocks, but the inverted market never lasts that long. Butter gained 3¾¢ from last week to settle at $1.74, but came off its high of $1.77 on Monday. 5 loads exchanged hands.



- Milk Production Report: Milk output in September was up 1.7%, higher than analyst expectations, and August production was revised higher to 1.5%. Leading the way was TX, up a stunning 15.2%, followed by KS up 9.2%, ID up 5.8% and CO up 5.7%. CA was up only 0.8% (now we know where TX got their cows) with WI up 1.0%. The lone bright spot was that cow numbers fell for the second month in a row, dropping 10,000 head from Aug.



- Livestock, Dairy & Poultry Outlook Report: "Slightly Higher Production, Combined with Softening Exports, Turns Milk Prices Sharply Lower in 2009", reads the headline over the dairy section of this month's report. Despite falling cow numbers, USDA predicts 2009 output will increase slightly over 2008 production due to improvement in milk per cow. But the real story is the predicted drop in exports, due to strengthening of the U.S. dollar, falling European dairy prices and a recovery in milk production in Oceania. Slower global economic growth will also limit demand, the report says.
- Cheese prices fell in this week's NASS survey, even though cash prices moved higher. 40-lb blocks decreased 0.2¢ to average $1.92/lb, while barrels fell 1.3¢ to $1.91/lb. Butter prices increased 1.7¢ to average $1.70/lb, but nonfat dry milk dropped 4.2¢ to $1.02/lb and dry whey slipped 0.9¢ to 19.3¢/lb.
- 186 loads of Grade A milk were imported into the Southeast this week, compared to 167 last week, however, Fluid Milk & Cream Review reports sales of milk are "bad", "down" and "flat". Lower sales for retail milk have been down enough that some shipments have been turned back, so the expectation is that shipments into the area will decline next week.
- Without help from the CWT program, butter export shipments would have slowed substantially, according to Dairy Market News. Higher prices have not impacted domestic sales much, but current world prices are well below current U.S. pricing and butter is available from other world suppliers.
- Western whey prices were steady to lower this week, with some prices negotiated lower in order to remain competitive on the export market. Drying schedules are flat, reflecting cheese production, and stocks vary from light to moderate.
- Western nonfat dry milk continued to clear to the CCC this week at the support price of 80¢/lb. Buying interest is subdued as purchasers look to fill only immediate needs and watch for bargains, while current export demand has slowed.

Recommendation:

We've been warning that cheese prices could not sustain these high levels for long and urged producers to get covered. On Friday, a large commercial cheese seller came back to the cash market after being largely absent for several weeks. Buyers fought valiantly but ultimately were not able to absorb the offers and we finished down 11¢ on the session. These are not usually one day moves so we expect more cheese to show up next week. The 2009 average was hit hard, losing 62¢ from last week, and sellers were even pounding 2010 contracts. However, this week's cheese updates paint a picture that still reflects some tightness in the market and buyers may not be throwing in the towel just yet. Expect a rebound at some point, but consider it another opportunity to sell. We still think Q1 2009 will be a rough period as holiday buying ends and the economy continues to sputter. Look for cheese to make new lows for the year when buyers pull away for good, which will sink 2009 contracts to the low $14's and possibly the $13's. It's still important to get covered because the downside still outweighs the potential upside risk.