

**The KDM Dairy Report – November 7<sup>th</sup>, 2008**

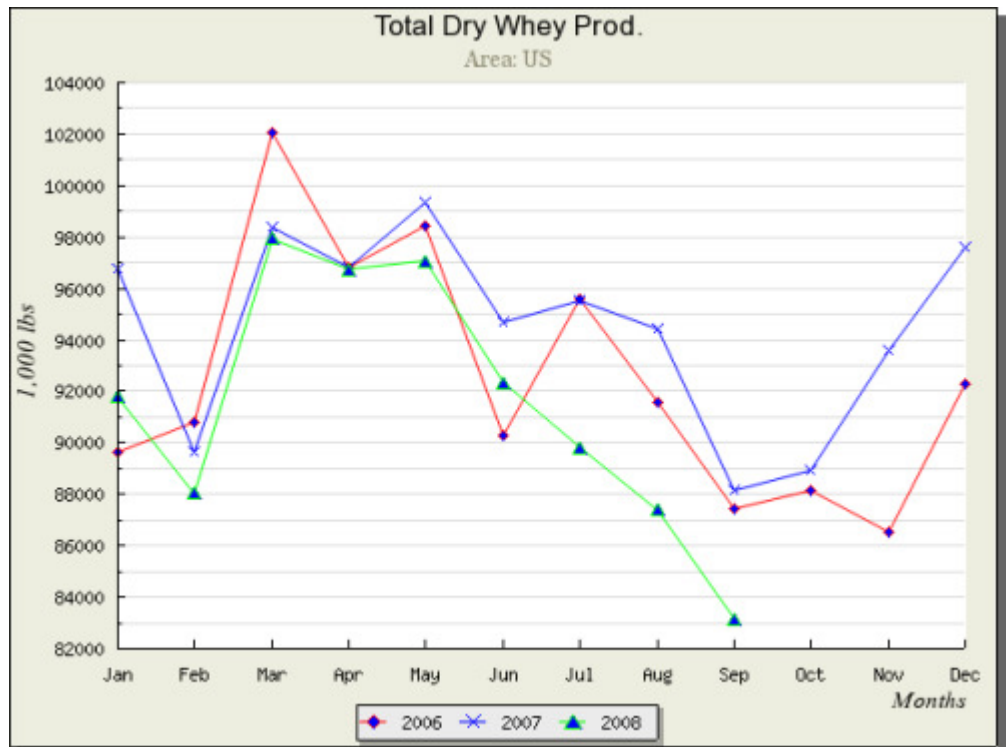
**What's Bullish:**

- Cash Market: Blocks finished the week up 4¼¢ to settle at \$1.65/lb, while barrels fell 4¾¢ to \$1.63¾/lb, fixing the inverted spread. Buyers were more aggressive than sellers, with 33 loads of blocks and 11 loads of barrels exchanging hands. Butter dropped 5¢, settling at \$1.63½/lb on just 2 trades for the week.
- Weekly cold storage numbers are showing a seasonal drop for the very first part of Nov. From 11/01 through 11/03, butter stocks fell 1.1 million lbs, or 9%, and cheese stocks decreased 2 million lbs, or 2%.
- Butter stocks at CME-approved warehouses fell by 3.2 million lbs for the week ending 11/01. That leaves 51.5 million lbs on hand. A year ago, 93.4 million lbs were sitting in storage.
- California is facing a water shortage. The state's Department of Water Resources announced that just 15% of normal water supplies are expected to be available in 2009, especially if the upcoming winter is dry.
- Dairy Products Report: While bearish for cheese, dry whey production in September was down 4.7% vs. a year ago and manufacturer's stocks declined 7.9%, according to USDA (see graph below).
- International: In a report titled, "The Global Dairy Industry – Reshaping in a new Market Era" released this week, ag business lender Rabobank said that despite slumping dairy prices, the medium to long-term outlook is robust. They expect world demand for dairy to start recovering in late 2009, with New Zealand able to provide additional world supply. However, New Zealand supply growth is expected to be constrained by land availability and new growth in dairy demand will need to be sourced by other suppliers.

Futures Month	Friday 11/07 Close	Friday 10/31 Close	Change
Nov-08	\$15.34	\$15.46	(\$0.12)
Dec-08	\$14.30	\$14.47	(\$0.17)
Jan-09	\$14.25	\$14.50	(\$0.25)
Feb-09	\$14.17	\$14.56	(\$0.39)
Mar-09	\$14.26	\$14.58	(\$0.32)
Apr-09	\$14.51	\$14.83	(\$0.32)
May-09	\$14.75	\$14.98	(\$0.23)
Jun-09	\$15.17	\$15.33	(\$0.16)
Jul-09	\$15.36	\$15.58	(\$0.22)
Aug-09	\$15.53	\$15.75	(\$0.22)
Sep-09	\$15.56	\$15.76	(\$0.20)
Oct-09	\$15.50	\$15.79	(\$0.29)
Nov-09	\$15.40	\$15.65	(\$0.25)
Dec-09	\$15.39	\$15.65	(\$0.26)
Jan-10	\$15.44	\$15.69	(\$0.25)
Feb-10	\$15.49	\$15.73	(\$0.24)
Mar-10	\$15.20	\$15.66	(\$0.46)
Apr-10	\$15.20	\$15.62	(\$0.42)
May-10	\$15.25	\$15.50	(\$0.25)
Jun-10	\$15.59	\$15.80	(\$0.21)
<b>2009 Avg</b>	<b>\$14.99</b>	<b>\$15.25</b>	<b>(\$0.26)</b>
<b>q1q2 2010</b>	<b>\$15.38</b>	<b>\$15.69</b>	<b>(\$0.32)</b>

**What's Bearish:**

- Dairy Products Report: Cheddar cheese output in September was up 2.2% compared to a year ago, according to USDA figures released this week. American cheese output was up a stronger 5.7%, while total cheese output was up 2.3%. Butter production increased 7.4% from a year ago.
- All Class III components fell in this week's NASS survey. 40-lb blocks dropped 3.2¢ to average \$1.82/lb while 500-lb barrels slipped 1.5¢ to \$1.86/lb. Butter lost 0.9¢ to average \$1.71/lb, nonfat dry milk slipped 0.9¢ to 91¢/lb and dry whey decreased 0.2¢ to average 19¢/lb.
- For the week ending 10/25, a modest 51,200 head of dairy cattle were culled, compared to 54,100 during the same period a year ago.
- Dairy Market News reports Western butter retailers are expecting an average holiday season at best because of the general economic problems. Some end users report that they have their fall needs covered due to buying earlier and heavier than usual. Food service accounts are seeing slower interest and cream



supplies are readily available for churns.

- Florida is no longer a milk deficit state as they exported 20 loads of Grade A milk this week. Cows have responded to the cooling temps while retail sales have been flat. In the Northeast, handlers are dealing with up to 24 million lbs of extra milk per week that would have been delivered to 2 cheese plants in the region (1 closed by fire, 1 down for maintenance). This milk is now being absorbed elsewhere, primarily at drying operations.
- More milk is being sent to drying operations in the Central region, as shipments to the Southeast have declined or ceased, according to Dairy Market News. Nonfat dry milk prices continue to be weak in the region as the movement of powder into the CCC support program is a factor in all buying, selling and pricing decisions.
- Milk receipts in the Central region were slightly lower this week, according to Fluid Milk & Cream Review, however, fluid sales were slower, sending more milk into manufacturing facilities. Spot loads of milk are being discounted \$3-5/cwt and are being aggressively turned into sour cream, whipping cream and dips as Thanksgiving approaches.
- The Midwest cheese market is weak, according to Dairy Market News. Buyers are taking advantage of the lower prices to build a heavier working inventory prior to the holidays, but they remain concerned over the affect that the weak economy and tight credit conditions may have, as the food service sector is often weaker.
- Western cheese buyers are cautiously taking additional volumes, but are concerned about owning "expensive cheese" should the market decline rapidly. Most buyers currently have adequate supplies.
- International: Milk production in New Zealand is 8% ahead of last year's limited production, according to Dairy Market News, while Aussie output is up 1.4%. Drought conditions in Australia still persist and water allocations are being cut, but all dairy product markets are under distress as output increases and the demand picture weakens.
- International: Cheddar cheese prices in Oceania reached as low as \$3,400 per metric ton, or \$1.54/lb this week, according to Dairy Market News. When account for moisture differences and the cost to transport, it works out to about \$1.29 cheese for the U.S. to be competitive. Cheese supplies in the region are moderate to heavy and the market undertone remains weak. Handlers are negotiating lower contract prices to be competitive and export sales are expected to move product, but the world economic slowdown will likely limit sales in emerging markets.
- International: Dairy Market News reports dairy product movements into world markets have slowed due to weakening demand. Milk prices in Europe are moving lower while production in the region is up 1% overall. Credit and finance issues are playing a big part in curtailing demand, which is fair for domestic usage, but slow into international markets.
- International: Skim milk powder prices continue to drift lower in both Europe and Oceania, according to Dairy Market News. Buyers are well aware of U.S. support price offerings and sales to the CCC, so are not actively seeking to make purchases.
- International: China's dairy consumption fell by up to 50% in September following the milk contamination scare, it was reported this week.
- Economy: The jobless rate reached a 14-year high of 6.5% in October, according to the Labor Department. GM lost \$2.5 billion in Q3 and says they're running out of cash, while Ford lost \$129 million in Q3 and burned through \$7.7 billion in cash.

### **Recommendation:**

It looks like dairy producers will get another chance to put on some protection for 2009. Despite finishing down for the week, Class III futures came off their mid-week lows with a strong uptick today. Apparently cheese buying for the holiday period is not yet done and buyers were clearly more aggressive in this week's cash cheese sessions. We may have another "December rally" like we've seen in recent years. In 2004, June settled at \$17.68, and then we crashed in July to \$14.85, followed by sub-\$15 prices through Nov, before rallying in Dec to \$16.14. That year the Dec contract finished the day at \$15.05 on 11/15, and just 12 trading days later stood at \$17.20! It's 11/07 today, very close to the time that rally started in '04, but you need to be ready to take advantage of it should it happen again, because it was very short lived. The following month, Jan, settled at \$14.14, and we didn't settle above \$15 until March 2007, more than 2 years later! None of this changes our long-term outlook, which is very bearish. The macro picture is still very negative (see bullets above), with international dairy demand at a standstill and the U.S. economy getting one bad headline after another. Should cheese buyers come out swinging again next week, get something done! At this point there is just one major buyer holding the spot market up. They may hang in there for another 1-4 weeks, but when they're gone, watch out! Reports we received this week indicate there is plenty of cheese out there. Both Jan and Feb traded in the upper \$13 range this week, shocking some that we could even get to that number, and while they've climbed back up above the \$14 level, we would not be surprised to see them eventually trade in the \$12's by year end. Do not be misled that the bottom has been put in. This rally is another gift; don't let it get away. Get 75% sold Jan-Apr, 50% sold May-Dec. If and when we hit the \$12 milk in Q1, buy call options to protect your sold positions in the last half of 2009. Call us for specific price recommendations.

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