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The KDM Dairy Report – November 14th, 2008

What's Bullish:

Futures Month	Friday 11/14 Close	Friday 11/07 Close	Change
Nov-08	$15.55	$15.34	$0.21
Dec-08	$14.81	$14.30	$0.51
Jan-09	$14.31	$14.25	$0.06
Feb-09	$14.30	$14.17	$0.13
Mar-09	$14.27	$14.26	$0.01
Apr-09	$14.42	$14.51	($0.09)
May-09	$14.69	$14.75	($0.06)
Jun-09	$15.12	$15.17	($0.05)
Jul-09	$15.50	$15.36	$0.14
Aug-09	$15.81	$15.53	$0.28
Sep-09	$15.98	$15.56	$0.42
Oct-09	$15.90	$15.50	$0.40
Nov-09	$15.60	$15.40	$0.20
Dec-09	$15.55	$15.39	$0.16
Jan-10	$15.47	$15.44	$0.03
Feb-10	$15.50	$15.49	$0.01
Mar-10	$15.20	$15.20	$0.00
Apr-10	$15.20	$15.20	$0.00
May-10	$15.25	$15.25	$0.00
Jun-10	$15.40	$15.59	($0.19)
2009 Avg	**$15.12**	**$14.99**	**$0.13**
Q1Q2 2010	**$15.39**	**$15.38**	**$0.01**

- Cash Market: Buyers overpowered sellers this week as they soaked up 35 loads of blocks and asked for more. Blocks gained 6¾¢ for the week, settling at $1.71¾/lb. Barrels, which are reportedly tighter, gained 5¾¢ on only one trade, settling at $1.69½/lb. Butter was unchanged at $1.63½/lb, with 6 trades for the week.
- Butter and cheese are being pulled out of inventory so far in November. For the period 11/01 through 11/11, butter stocks have fallen 10% and cheese stocks are down 3% at USDA selected storage centers.
- Butter stocks at CME-approved warehouses dropped by 5.4 million lbs, leaving just 46 million lbs on hand. A year ago at this time 86.4 million lbs sat in storage.
- Although shipments to the South have nearly stopped completely, Class I interest is strong in the Central region, according to Fluid Milk & Cream Review. In addition, production of Class II holiday specialties like dips, sour cream and whipped cream has picked up as food service orders have increased.
- Fluid Milk & Cream Review reports California milk output is mostly steady, as growth is being limited by rations, feedstuffs, hay usage, base plans and financial considerations. Less milk is heading out of state as supplies are better balanced. In Arizona, plants have room to handle more milk, yet bottlers are pulling more milk out of manufacturing as numerous feature activity in high population areas stimulates demand.
- In the Pacific Northwest, milk production is facing potential disruption from a powerful Pacific rainstorm bringing near record flooding. Up to 10 inches of rain is expected, making many roads impassable. Financial stress is noted in the region as credit lines have been reduced, some to short-term only. Those producers that locked in grain prices a number of weeks ago, and did not lock in milk prices, are facing major losses.
- Central dry whey prices were unchanged to higher this week, according to Dairy Market News. Production is steady and some spot sales this week were occurring at or above the market, instead of being discounted. Several manufacturers were happy to build some inventory this week in hopes of maintaining price levels.
- Dairy Market News reports recent price strength in the cash cheese market has some industry participants in the Eastern region expecting the trend to continue in the coming weeks as holiday ordering and retail purchasing develop. The current cheddar price is still 13-17% below a year ago, giving incentive for buyers to acquire more product before prices move any higher.
- Western cheese orders for the upcoming holiday season have improved with the recent lower prices, according to Dairy Market News. Indications are that supply and demand for cheese are in close balance in the region.
- While the short to medium term outlook for the dairy industry appears bearish, analysts at ag lending giant Rabbobank think the dairy industry is poised for more growth. Despite the recent fall in dairy commodity prices, global demand for milk at any price has shifted upwards, based on income growth in many parts of the world. More people want to consume dairy products and can afford it. Rabbobank sees an eventual return to increased world demand and a shortfall in supply, which should cause prices to recover and trade in a higher price range.
- International: Despite slowing economic conditions, cheese and curd exports in September were up 34% compared to last September, according to the Foreign Ag Service. During the month, 23.6 million lbs left the country. Nonfat dry milk exports were up 26.4%, but dry whey exports fell 19.8% and butter and milkfat exports were down 5.6% over the same period,

What's Bearish:

- Feed Outlook Report: All feed grain prices were lowered this month as stiff competition from other sources has curtailed U.S. exports.
- World Ag Supply & Demand Report: USDA increased their 2009 milk production estimate slightly, citing lower feed prices aiding higher growth in milk per cow. In addition, weaker international markets will boost domestic supplies, causing USDA to also lower their Class III price estimate dramatically from last month's report. They now expect Class III to average $15.20/cwt in 2009, which is down $1.10/cwt from just a month ago. Expected higher supplies of

cheese have also resulted in a revision of USDA's cheese price forecast. They lowered the average 10½¢ from last month's report to $1.72/lb.

- NASS cheese prices dropped sharply this week, following recent declines in the cash market. 40-lb blocks averaged $1.77/lb, down 5.2¢ from last week, and 500-lb barrels fell 9.2¢ to also sit at $1.77/lb. Butter declined 4.6¢ to average $1.67/lb, nonfat dry milk lost 5.3¢ to 86¢/lb and dry whey averaged 18.6¢, down 0.4¢.
- With the exception of a little tightness in the Mid-Atlantic region, the Eastern part of the country has ample supplies of milk, according to Fluid Milk & Cream Review. Production is slowly increasing, yet demand is slow. Retail sales in Florida are still considered weak for this time of year; however, there is hope that after the Thanksgiving holiday, more winter residents will return, helping boost fluid milk sales.
- Despite strong Class I & II interest, milk supplies in the Central region remain heavy, according to Fluid Milk & Cream Review. Discounts for spot loads of milk seem to be more common as plant operators are buying extra milk only if they need help to fill an actual order. The manufacturing milk supply is greater than current interest, as cheese producers feel prices may fall further. Milk handlers are running into resistance from plant operators in trying to place milk for the Thanksgiving/deer hunting and yearend holiday periods.
- Milk is backing up in New Mexico, as shipments to the Southeast have slowed, according to Fluid Milk & Cream Review. Plants in the region have been able to handle the extra milk so far, but are being taxed as milk supplies build.
- Butter orders seem to be at normal levels, but contacts are concerned what the economy may do to demand by the end of the year, according to Dairy Market News. Prices are still at historically high levels and cream supplies are sufficient for churns to get all that they want. Many manufacturers expect CME cash butter prices to fall soon, because butter futures for December and beyond are well below current levels.
- Dairy Market News reports Western dry whey prices were under pressure this week as competition from even cheaper dairy products continue to weigh on the market. Powder production is heavier than anticipated and inventories range from in balance to much heavier than desired.
- Western nonfat dry milk continues to clear to the CCC at the support price of 80¢/lb, according to Dairy Market News. Buyers are reluctant to make any added purchases in a declining market, keeping the market tone weak.
- Midwest cheese contacts see the cheese market showing signs of weakness, even though prices could rise temporarily, according to Dairy Market News. Cheese offerings are adequate and orders seem to lack some of the usual seasonal aggressiveness.
- Rabbobank dairy analysts expect the major economies around the world to spend at least the next two years in recession. Farmers with strong balance sheets should survive and even have an opportunity to expand, as those with weaker business models sell out.
- Economy: Jobless claims this week climbed to a 7-hear high, a level not seen since just after the 9/11 attacks, the Labor Department reported. In addition, retail sales in October fell by a record amount. The 2.8% monthly decline surpassed the old mark of a 2.6% drop in November 2001, just after the terrorist attacks. The drop was caused by a sharp cut back in consumer spending, led by a huge drop in auto purchases. With all the negative news, the stock market tallied another week of losses and was down sharply Friday.

Recommendation:

The KDM report suddenly appears more balanced this week as more supportive info comes to light. It appears as though we will have at least one more rally before heading lower into the New Year, which we think will be similar to our historical reference to 2004 in last week's report. The current cash price works out to $15.20 cheese, and with the December futures contract beginning pricing and trading at a discount, further strength in cheese will cause all the front months to move higher. Great! The question is, how long will this rally last and when should we hit it hard and get more coverage. USDA cheese updates this week were more supportive than in many weeks, and with seasonal buying still under way, we could see another 1-4 weeks of decent buying. Hold off selling anything more for now, but be ready to do something soon! Again, we can't stress enough that this rally is a gift and changes none of our expectations for a major break in the next month or two. Economic conditions continue to deteriorate as commodity hedge funds to liquidate positions and the U.S. government wants to plow $25 billion into the automotive industry. Ugh! Crude oil and grains continue to trend lower, and milk will not escape this trend, in our opinion. Give us a call next week if you see the market make a strong move higher. We'll help you put together some targets on getting covered. Don't let this one slip by!