

The KDM Dairy Report – November 21st, 2008

What's Bullish:

- Cash Market: Blocks and barrels were up again this week, but this time, bidders had no resistance from sellers as there were no trades in either. Blocks were up an uncontested 5¼¢ to settle at \$1.77, while barrels gained 4½¢ to close at \$1.74/lb. Butter, however, showed signs of weakness, losing 4½¢ to close at \$1.59/lb with just 3 trades taking place.
- Weekly cold storage numbers continue to be supportive for both cheese and butter. For the period 11/01 through 11/17, butter stocks at USDA selected storage centers were down 15%, or 2.4 million lbs, while cheese stocks declined 3%, or 3.3 million lbs.
- Butter stocks at CME-approved warehouses fell 3.9 million lbs for the week ending 11/15. While less than the 4.6 million pulled out at this time last year, total stocks on hand are down to 42 million lbs, nearly half of the 82 million lbs we had at this time a year ago.
- Dairy cow slaughter for the week ending 11/08 totaled 52,200 head, the sixth straight week over 50k, which is a decent number.
- Cheese packagers out East continue to fill orders mostly for post-Thanksgiving but still pre-yearend holiday delivery, according to Dairy Market News. Food service accounts have stocked up for anticipated needs for the upcoming holiday, but about all their supplies of aged cheddar, put into storage at lower market prices, have moved out.
- The Midwest cheese market is firm, at least for the short term, according to Dairy Market News. Packagers of private label cheese are running extended overtime to fill orders, and tightness is noted for Colby/jack and pepper jack varieties, as well as current cheddar. Process movement is steady, while aged cheddar and parmesan movement have been good in recent weeks. Current cheese production is steady, but good Class I and II production is limiting milk supplies in some areas.
- Holiday interest is definitely having an impact on Western cheese demand, according to Dairy Market News. Buyers continue to order cheese on a regular basis, mainly for immediate needs. Contacts have noted increased interest in store brand cheese versus private label varieties.
- Fluid Milk & Cream Review reports that with the exception of Florida, which exported 50 loads of Grade A milk this week (20 more than last week), the rest of the Eastern region is in a tighter milk supply situation. 74 loads of milk were imported into the Southeast, up from 27 last week, and in the Mid-Atlantic and Eastern regions, milk volumes are flat, leaving little available to balancing plants. Class I demand has been strong and milk suppliers have been scrambling to meet all needs. This has greatly reduced manufacturing milk volumes, although the upcoming holiday weekend should reverse that.
- Milk production in California is mostly flat, with manufacturing plants easily able to handle available supplies, according to Fluid Milk & Cream Review. Hay prices are declining but inventories remain tight. In Arizona, milk production is increasing, but bottlers are taking good volumes. Cream is being readily handled as soft product production for the ongoing holiday season is very good. In the Pacific Northwest, plants are running on normal schedules.
- Class I interest is good while milk and cream supplies were tighter this week in the Central region, according to Fluid Milk & Cream Review. Extra Class II products including dips, sour cream and whipped cream are drawing on available milk, while some loads were shipped from the Midwest to the Southeast.
- Another Rabobank ag report this week suggests that there will be a turnaround in dairy demand late next year, as long as the economy improves by then. They believe the industry is just experiencing short term volatility, and that we still have a world shortage of dairy products. Demand in SE Asia and the Middle East is still growing, while the supply isn't.
- International: Lack of moisture in Australia is once again limiting growth in milk production, according to Dairy Market News. September output was down 1.7% compared to last year as rainfall during the winter was lighter than necessary and spring rainfall has not been as positive as anticipated.

Futures Month	Friday 11/21 Close	Friday 11/14 Close	Change
Nov-08	\$15.50	\$15.55	(\$0.05)
Dec-08	\$14.95	\$14.81	\$0.14
Jan-09	\$14.15	\$14.31	(\$0.16)
Feb-09	\$14.10	\$14.30	(\$0.20)
Mar-09	\$14.10	\$14.27	(\$0.17)
Apr-09	\$14.17	\$14.42	(\$0.25)
May-09	\$14.65	\$14.69	(\$0.04)
Jun-09	\$15.00	\$15.12	(\$0.12)
Jul-09	\$15.32	\$15.50	(\$0.18)
Aug-09	\$15.65	\$15.81	(\$0.16)
Sep-09	\$15.84	\$15.98	(\$0.14)
Oct-09	\$15.85	\$15.90	(\$0.05)
Nov-09	\$15.60	\$15.60	\$0.00
Dec-09	\$15.50	\$15.55	(\$0.05)
Jan-10	\$15.50	\$15.47	\$0.03
Feb-10	\$15.50	\$15.50	\$0.00
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	\$15.40	\$0.00
2009 Avg	\$14.99	\$15.12	(\$0.13)
q1q2 2010	\$15.40	\$15.39	\$0.01

What's Bearish:

- Milk Production Report: Milk output in October was up 1.2% across the country and cow numbers were 88,000 head higher than a year ago, according to USDA. On a positive note, milk per cow was up only 5 lbs and cow numbers were unchanged from last month. Texas again led the way in gains, up 14.1%, followed by KS up 10.7%, ID up 6.2% and

CO up 5.6%. Interestingly, despite an increase of 13,000 cows, CA output fell 0.9% due to 30 fewer lbs per cow, a likely result of expensive feed and the quota programs. WI was up 1.9%.

- Cold Storage Report: American cheese stocks in cold storage were up 3% in October vs. a year ago, according to USDA figures released today. And total cheese stocks in cold storage were up 2%. The lone bright spot was butter, whose stocks were down 24% over the same period.
- Livestock, Dairy & Poultry Outlook Report: USDA's look at the domestic dairy situation was mostly negative. While cow numbers are expected to begin declining, 2009 milk output is forecast to increase 1% due to much lower feed costs and better rations. Dairy prices are expected to weaken further as an increased supply from major competitors and a weakening global economy curb exports. Class III milk in 2009 is now expected to average \$15.20/cwt, down \$1.10/cwt from last month's forecast, while cheddar cheese is predicted to average \$1.72/lb, down 10½¢ from the Oct report.
- Dairy Market News reports butter producers across the country are cautious about churning activity at this time, especially with additional cream offerings likely to arrive over the holiday weekend. Prices have fallen in the cash market, so most are concerned about a potential sharp decline while holding inventory of uncommitted stock at higher price levels. Butter demand has slowed as Thanksgiving orders have been placed and shipped. Buyers are now waiting to see how Thanksgiving holiday sales have been before placing additional year-end orders. There is also concern about food service demand, as buyers are stating that the economic down turn is having an impact on traffic flow through their operations.
- Nonfat dry milk prices continue to move lower at a rapid pace, according to Dairy Market News. Buyer interest is improving as prices approach the 80¢ support price, but foreign producers are watching the U.S. market and may reduce prices to whatever level it takes to keep powder moving.
- NASS cheese prices took another big drop this week. 40-lb blocks averaged \$1.68/lb, down 8.7¢ from last week, while 500-lb barrels fell 7.7¢ to \$1.69/lb. Butter was also lower, falling 3.2¢ to average \$1.64/lb, but powder prices made a surprising rebound. Nonfat dry milk increased 0.9¢ to average 87¢/lb and dry whey was up 0.7¢ to 19.3¢/lb.
- International: Not much change in Western Europe from two weeks ago. Dairy Market News reports milk production is still trending lower, but stocks of manufactured dairy products are readily available. Overall buyer interest is slow and unaggressive as they wait patiently for even lower prices in a declining market situation. The EU governments also decided to increase milk production quotas by 1% per year until their elimination in 2014.
- International: Milk production in New Zealand is holding steady at seasonal highs while output in Australia is still showing signs of slight increases, according to Dairy Market News. Like Europe, dairy end-products are readily available for both current and future needs, while significant buyer interest is still absent. Sales continue to be slow as prices keep falling, although there is some feeling out there that a bottom is developing. Trader and handlers continue to discount prices to clear stocks in the near term.
- International: Butter (82% butterfat) prices in Oceania averaged \$1.25/lb this week, while cheddar cheese averaged \$1.50/lb. Dairy Market News reports that Q1 '09 needs are not as heavy, with Q2 needs back to typical levels.

Recommendation:

The job of the futures market is to predict the future, so even though the cash cheese market looks pretty decent right now, the street is telling us it won't last. The cash cheese market went up unopposed, yet the 2009 average lost 13¢ this week. They're probably right, but we're still hoping for a little more excitement before that happens. No one knows how long buyers will hang in there, but this week's cheese updates were the most supportive in some time. The current cash price works out to about \$15.60 milk, so with one week of the Dec calculation in the books, and a short week next week, we could have half the month priced pretty quickly. Dec futures hit a low today of \$14.69 before rallying after the cheese session to close on hit's high of the day at \$14.95. Short sellers could get caught in a squeeze if cheese holds, or even goes higher next week, as the Dec contract has plenty of upside potential left. Of course, cheese prices could just as easily fall dramatically next week if big sellers return, but word we're hearing from commercial contacts and this week's cheese updates lend more support to short-term support. Make no doubt about it, though, we believe that once holiday purchasing is done, we're headed much lower in Q1. The market didn't rally this week like we wanted it to, so look for an opportunity to get more coverage in Q1 next week, although trading will likely be light on this holiday shortened week.

Note: The markets will close at noon Central time on Wednesday, and will be closed Thursday in observance of Thanksgiving. Markets will reopen on Friday. On behalf of KDM, we wish you a safe and happy Thanksgiving. Despite the current state of the economy, we live in the greatest country in the world and have so much to be thankful for!

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