KDM Trading, Inc.
877.695.8538 www.kdmtrading.com
Dan Schindler, Mark Potter & Keith Schnese

The KDM Dairy Report – December 19th, 2008

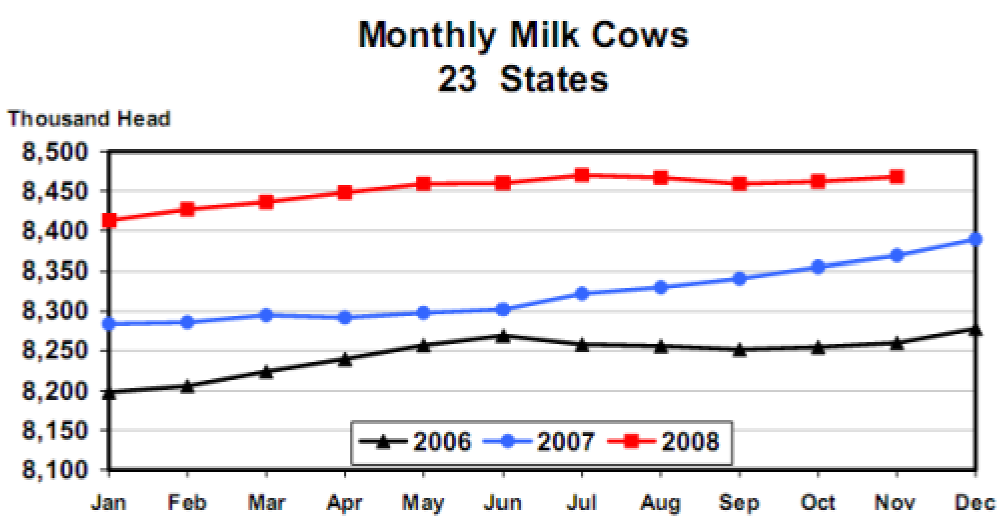
What's Bullish:

- Nov milk production in California was down 0.3% vs. a year ago, according to USDA's Milk Production Report. Despite adding 10,000 cows during the year, production per cow fell 15 lbs.
- Despite the front months getting killed, the back months started moving higher mid-week, with only small losses by Friday.
- Eventually prices will recover….

Futures Month	Friday 12/19 Close	Friday 12/12 Close	Change
Dec-08	$15.02	$15.11	($0.09)
Jan-09	$11.96	$13.20	($1.24)
Feb-09	$12.06	$13.10	($1.04)
Mar-09	$12.23	$13.15	($0.92)
Apr-09	$12.61	$13.15	($0.54)
May-09	$12.86	$13.22	($0.36)
Jun-09	$12.96	$13.29	($0.33)
Jul-09	$13.50	$13.77	($0.27)
Aug-09	$14.08	$14.15	($0.07)
Sep-09	$14.37	$14.41	($0.04)
Oct-09	$14.48	$14.54	($0.06)
Nov-09	$14.50	$14.56	($0.06)
Dec-09	$14.40	$14.56	($0.16)
Jan-10	$14.35	$14.50	($0.15)
Feb-10	$14.40	$14.45	($0.05)
Mar-10	$14.44	$14.65	($0.21)
Apr-10	$14.54	$14.58	($0.04)
May-10	$14.73	$14.80	($0.07)
Jun-10	$14.94	$15.01	($0.07)
2009 Avg	**$13.33**	**$13.76**	**($0.42)**
Q1Q2 2010	**$14.40**	**$14.53**	**($0.14)**

What's Bearish:

- Cash Market: Spot cheese got creamed for the second week in a row. Blocks lost 21¢ for the week to settle at $1.30¼/lb, while barrels shed 16¾¢ to close at $1.35½/lb. 12 loads of blocks and 4 barrels exchanged hands. Butter gained 6¢ this week to close at $1.17/lb, but came off its high of $1.23/lb at midweek. 4 cars of butter traded.
- Milk Production Report: Output in November was up 1.1% in the U.S. compared to a year ago. Cow numbers increased 5,000 head from Oct to Nov, however, milk per cow was up only 4 lbs.
- Livestock, Dairy & Poultry Outlook Report: In what now seems like a common repeat, USDA again lowered their Class III price forecast for 2009 due to weakening global demand. Cow numbers are expected to decline slightly, but milk per cow is forecast higher, resulting in more output. The milk-feed ratio is projected to stay at about 1.9, which should signal contraction in the industry, however, a stronger dollar and global economic weakness will disadvantage US producers as exports fall. This will soften prices across all products and milk class, according to USDA, which expects Class III to average between $14.50 and $15.30 for the year.
- NASS cheddar prices fell after moving higher in previous weeks. 40-lb blocks dropped 2.9¢ to average $1.78/lb and 500-lb barrels gave up 4.7¢, also at $1.78/lb. Butter plummeted 18.3¢ to average $1.23/lb, nonfat dry milk was down 1.4¢ to 84¢/lb and dry whey lost 0.3¢ to average 17¢/lb.
- Cheese stocks at USDA selected storage centers increased 10% during the period 12/01 through 12/15, according to weekly cold storage statistics. Butter stocks fell 9% during the same period.
- Churns are being offered all the cream they can handle, according to Dairy Market News. Some end-users will also close during the final two weeks of the year, making even more cream available. Cream supplies are expected to be ample through next spring, while cream sellers are finding less interest by end users to contract 2009 needs.



- As schools begin their holiday breaks, there will be a significant decrease in fluid milk demand, according to Fluid Milk & Cream Review. This will challenge balancing plants' capacity to handle the resulting intakes. This reduction in fluid demand is amplified by upward trending production in most of the country, with the exception of the Pacific Northwest. With the increasing volume of milk facing reduced fluid demand, many plants are being careful to pay for the milk based on what they believe they can sell the product for in a weak market.
- The Midwest cheese market is weak, according to Dairy Market News. Buyers are holding off any new large orders until 2009 to assess movement over the holidays, and to take advantage of even lower average prices next week.
- Dairy Market News reports most Western cheese buyers are now covered for end of the year needs, and will not need any additional cheese until well into 2009. Surplus milk available over the holiday weeks will likely go into cheese that

does not have a current home, while pay prices for this surplus milk will be very low, allowing for low-cost cheese production.

- Balancing plants in the East are bracing for a surge of milk as schools begin to close, according to Fluid Milk & Cream Review. In the Southeast, milk production continues to move up, and farm load sizes are increasing. Shipments of Grade A milk out of Florida totaled 81 loads this week, up from 54 last week.
- In the Midwest, manufacturing milk interest is softer after recent large declines in cheese prices at the CME Group cash cheese market, according to Fluid Milk & Cream Review. Discounts on surplus milk over the holiday are sharp, with some loads committed at -$5.00 below class. Milk handlers are finding few operations with uncommitted capacity.
- Out West, milk and components are being shipped longer distances to find processing homes. The hope is that supplies will be handled effectively, but the reality is likely different, according to Fluid Milk & Cream Review. In Arizona, processing plants are getting fuller as more out-of-state offerings come in. However, there is no more room in the state to take more milk. The milk supply in New Mexico is heavy, with handlers attempting to clear volumes to local and out of region accounts. Pricing is a secondary concern to moving loads.
- The nonfat dry milk market continues to be weak, according to Dairy Market News. Buyer interest is often for immediate needs as most buyers see limited upside risk to prices. Current production schedules are heavy and expected to build as surplus milk is balanced over the next two holiday weeks.
- Western dry whey sellers are lowering prices to keep powder moving, according to Dairy Market News. Most do not think storing powder and waiting for higher prices to develop is a good strategy. Inventories range from in balance to larger than desired, and manufacturers are eager to keep powder moving, since they know sales will slow for the various holidays around the world.
- International: Stocks of manufactured dairy end products remain available in Western Europe for both domestic and export needs, according to Dairy Market News. International buyers are largely absent, so most trading taking place is for internal needs.
- International: Despite lack of a significant rainfall, milk volumes in both New Zealand and Australia are sufficient enough to maintain manufacturing schedules at projected levels, according to Dairy Market News. Stocks of manufactured dairy product are readily available for regular and ongoing customer needs with uncommitted volumes also being reported. In many instances, Oceania traders and marketers are looking for buyers to clear current and future production. Buyer interest remains slow and unaggressive.

Recommendation:

More confirmation this week that for the most part, holiday buying of cheese is DONE. Token buyers in the cash market were more than overrun by sellers, resulting in a 21¢ drop in the block price. As unbelievable as it sounds, the January contract at $11.96 is trading a premium to the current cash price! Plugging in today's cash settlement numbers works out to $11.35 milk. With the Jan calculation now under way, further declines in both cheese and Class III are likely next week. We hate to paint such an awful picture, but it is what it is. Cheese will be made on the cheap over the next couple weeks as schools let out for the holidays and the flood of milk looks for a home. With spot loads of milk going for $5 under class, cheese can be made for not much over support prices, which are still 30¢ away. In addition, farmers have not seen a truly bad milk check yet, and won't for another two months when they get paid for Jan milk. All this is pointing to a real train wreck for prices in Q1, and may last longer than most think. Producers don't want to sell milk here, and neither do we, but as bad as it looks, it's likely to get worse before it gets better, so we would continue to look at buying PUT options for the first half of the year. Crude oil hit a 4-year low this week, moving far below anyone's wildest expectations. Milk can do the same; it won't take many more declines in the cash market before $10 milk becomes a serious possibility. It's almost hard to imagine it could happen, but again, look at crude. Until the global economic conditions begin to recover, our export market looks pretty sick, so our milk production needs to come in line with domestic needs. That may take awhile, since producers are still adding cows, according to the latest Milk Production Report. We don't see much possibility for milk price recovery until the second half of 2009. Producers who have already hedged milk at higher prices should start actively protecting those positions with CALL options.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.

©Copyright 2008 - KDM Trading, Inc. All Rights Reserved – www.kdmtrading.com