

The KDM Dairy Report – January 2nd, 2009

What's Bullish:

- Ag Prices Report: After three months of increases, the milk-feed ratio fell in December to 1.97. In light of current milk prices, it's likely the Jan report will fall even further. Traditionally, a ratio below 3.0 discourages expansion in the milk supply.
- Milk production in California is holding steady, at levels at or below a year ago, according to Fluid Milk & Cream Review. CWT herd reduction cows are being seen at slaughter auctions, which is limiting production in the state.

What's Bearish:

- Cash Market: Cheese completely unraveled in this holiday shortened week. Blocks fell 13¾¢ to settle at \$1.13¼/lb, just above the government support price of \$1.1314/lb. Barrels plummeted 17¾¢ to close at \$1.13; its support price is \$1.1014/lb. Buyers picked up 8 loads of blocks and 2 barrels, but were overwhelmed by sellers. Butter dropped a penny to settle at \$1.13/lb on 5 trades.
- Livestock Slaughter Report: November dairy cow slaughter was lower than last year, according to USDA. 208,200 cows left the milking herd, compared to 217,400 in 2007, a drop of 4.2%. In a Catch-22, farmers may be hanging on to more cows to keep milk production higher in light of lower milk prices.
- Commercial Disappearance: Use of milk in all products in October fell 0.4% compared to 2007, according to USDA. Individually, use of butter was down 4.1%, use of nonfat dry milk was off 14.2% and use of other-than-American cheese fell 2%. The lone bright spot was American cheese use, which was up 4.2%.
- The latest NASS survey reflected more price drops in cheese and butter, although they almost seem laughable compared to where the cash market is right now. Cheddar blocks averaged \$1.76/lb for the week ending 12/20, down 2.1¢ from the prior week, while barrels averaged \$1.71/lb, down 7.1¢. Butter fell 6.1¢ to average \$1.17/lb, but nonfat dry milk managed to gain 0.2¢ to 84¢/lb and dry whey was 0.6¢ higher to 17.6¢/lb.
- Weekly cheese inventories continue to build. For the period 12/01 through 12/29, cheese stocks at USDA selected storage centers increased 11.9 million lbs, or a big 13%. Butter stocks, however, continued to decline, falling 4% over the same period.
- Butter stocks at CME-approved warehouses has now started to increase seasonally, after the fall drawdown. Stocks increased 2 million lbs for the week ending 12/27.
- Lower Class I demand and seasonally higher intakes left Eastern balancing plants literally flooded with milk volumes to handle, according to Fluid Milk & Cream Review. There is some anticipated relief as schools will begin to reopen soon, however the challenge now is to try and stay ahead of the volumes coming in. Drying and churning is very heavy, as milk production in the region continues to increase seasonally. In the Mid-Atlantic region, some tankers were forced to sit up to 20 hours before they were able to unload milk, due to plant capacity factors. 350 loads of milk were shipped out of the Southeast, and it would have been more, except for a shortage of tankers to move the milk out.
- Supplies of milk, cream and condensed skim remain burdensome in the Central region, according to Fluid Milk & Cream Review. Class I use remains slow, at "closed schools" levels, so most milk silos are full. Contacts report this year has been generally considered one of the worst yearend holidays in a number of years to move surplus product.
- Fluid Milk & Cream Review reports in the Southwest, more milk is heading into Class III and IV operations, due to limited fluid milk demand. Plants in Arizona and New Mexico continue to take out-of-state milk to help balance the milk supply.
- Dairy Market News reports butter churning is active across the country, as abundant milk intakes and lower fluid demand send more milk into manufacturing uses. Cream is readily available due to higher milk production and the closure of many ice cream manufacturers until January.
- The market tone of dry whey is weak, according to Dairy Market News. Prices had stabilized as of late, but drying schedules are heavy as surplus milk is moving into cheese plants, while at the same time, domestic interest is limited and export buyers are inactive, as lower priced alternatives are available from other countries.

Futures Month	Wednesday 12/31 Close	Wednesday 12/24 Close	Change
Jan-09	\$10.80	\$11.56	(\$0.76)
Feb-09	\$10.28	\$11.56	(\$1.28)
Mar-09	\$10.77	\$11.93	(\$1.16)
Apr-09	\$11.17	\$12.49	(\$1.32)
May-09	\$11.74	\$12.70	(\$0.96)
Jun-09	\$12.42	\$13.09	(\$0.67)
Jul-09	\$13.01	\$13.68	(\$0.67)
Aug-09	\$13.85	\$14.25	(\$0.40)
Sep-09	\$14.15	\$14.68	(\$0.53)
Oct-09	\$14.17	\$14.75	(\$0.58)
Nov-09	\$14.16	\$14.73	(\$0.57)
Dec-09	\$14.07	\$14.69	(\$0.62)
Jan-10	\$14.15	\$14.40	(\$0.25)
Feb-10	\$14.23	\$14.42	(\$0.19)
Mar-10	\$14.35	\$14.40	(\$0.05)
Apr-10	\$14.50	\$14.54	(\$0.04)
May-10	\$14.73	\$14.73	\$0.00
Jun-10	\$14.94	\$14.94	\$0.00
2009 Avg	\$12.55	\$13.34	(\$0.79)
Q1Q2 2010	\$14.24	\$14.41	(\$0.16)

- Despite lack of buyer interest, cheese production in the Northeast remains heavy, according to Dairy Market News. Most buyers do not expect to make purchases until after the beginning of the year; however, manufacturers are able to buy milk at large discounts, which is allaying apprehension about building inventory.
- Dairy Market News reports much the same in the Midwest. Cheese production is heavy even as buyers are holding off. Most plants are running on extended schedules to handle the surplus milk supply. Cheese inventory is building, but there were some sales this week on product made from sharply discounted surplus milk.
- Western demand for cheese is light, according to Dairy Market News, as buyers are reluctant to make purchases in a declining market. Cheese producers are reluctant to make any extra product unless the price for surplus milk is deeply discounted.
- Economy: The manufacturing index, an indicator of activity, fell to a 28-year low in December, according to the Institute for Supply Management. New orders fell to their lowest levels since 1948. And, consumer confidence fell to a new all-time low, falling to 38.0 in December. The Conference Board, a private research firm, began measuring consumer confidence in 1967.

Recommendation:

Wow! The front months completely fell apart in a short, 3-day trading week as the cheese market finally gave in to fundamentals showing a growing milk supply, combined with weaker demand. There's simply too much milk out there right now, so Feb-May were punished the most, with the reasoning that it will take too long to shrink the milk supply before we hit those months. Hey, we've had a Wall Street bailout and an auto bailout, why not a dairy bailout? Although differing from the previous examples, one has to wonder if the holders of cheese inventory know they can't get rid of it, but also know the government has to buy it at the support price. What better way to get rid of those warehouses of cheese you don't want and then just start over? Even just a month ago, no "expert" would have predicted we'd be sitting at the support price doorstep for cheese, but here we are, and it looks like we may sit here for awhile. There's not much you can do here but gut it out and focus on being a low cost producer. Our recs going several weeks, if not months back, was to get 75% covered in Q1, so hopefully many of you will make it through this train wreck ok. We feel the second half of 2009 may come under some new pressure. While these contracts had been making steady gains over the past few weeks, they were hit hard this week, and producers seeing \$9-10 milk up front may want to sell some \$13-14 milk out of fear. If you can make money at 2nd half prices, we would sell. These prices may come back at some point, but in the near term, there just doesn't appear to be any supportive fundamental out there. Prices in the front months are likely to erode further next week. The current cash price for cheese, butter and whey works to out \$9.30/cwt milk. Incredible. It's unfortunate that our first report for 2009 is so negative, but on the other hand, it would seem we have more risk to the upside now than the downside!

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