

The KDM Dairy Report – January 9th, 2009

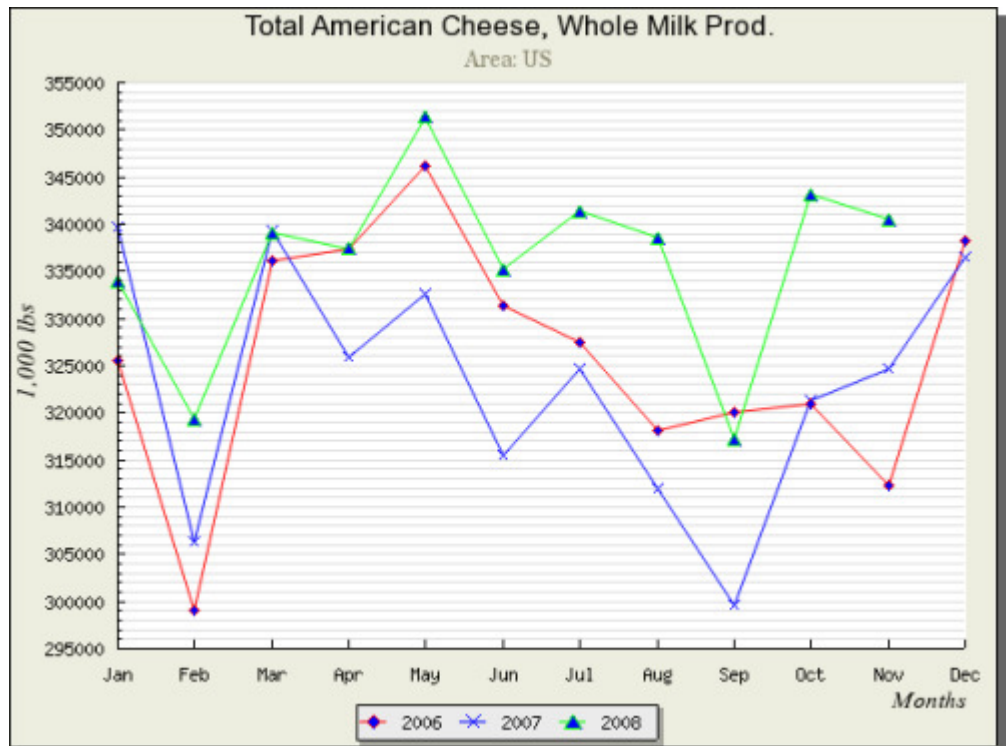
What's Bullish:

- As schools have resumed, balancing plants in the Northeast are returning to more manageable conditions, according to Fluid Milk & Cream Review. Heavy ice cream production is supporting demand for available cream, while other plants have reopened which were closed during the holidays, helping to absorb regional milk. In the Southeast, tankers that were backed up at plants have now cleared. 350 loads were exported out of the region last week, but only 214 this week, all from Florida.
- Several herd retirements in California occurred this week, and intake changes were noticed by processors, according to Fluid Milk & Cream Review. Declining milk prices are expected to put extreme financial stress on producers in the state.
- Grain prices have rallied in the past few weeks, going into Monday's crop report. Beans are above \$10 again and meal over \$300/ton. Combined with falling milk prices, rations are likely to suffer.

What's Bearish:

- Cash Market: While coming off its mid-week lows, spot cheese prices were still lower this week, and fell below the government support price for the first time since 2003. Both blocks and barrels lost 6¢ to settle at \$1.07¼/lb and \$1.07/lb, respectively. Buyers were very active, however, picking up 38 loads of blocks and 11 barrels. Butter fell 2¢ to \$1.11/lb, with 4 cars traded.
- November Dairy Products Report: American cheese output in November was up a strong 4.9% vs. 2007, likely contributing to the current excess supply (see graph). Total cheese was up 1.3% over the same period, while butter output was up 2.2%.
- NASS cheese prices took a big drop as they attempt to keep up with the cash market. 40-lb blocks fell 17.4¢ in this week's survey to average \$1.48/lb, while 500-lb barrels sank 19.6¢ to \$1.44/lb. Butter shed 4.7¢ to average \$1.10/lb and nonfat dry milk gave up 0.4¢ to 83¢/lb, but dry whey was up 0.1¢ to 17.4¢/lb.
- Dairy Market News reports butter was offered to the CCC this week for the first time since May 2003. Additional loads are being readied for government clearance. Churning activity is strong as butter producers continue to work down holiday cream purchases, and uncommitted butter stocks are building as buyer interest remains slow and unaggressive.
- Milk supplies are still heavy in the Midwest, according to Fluid Milk & Cream Review. Plants were still clearing silos holding surplus milk from the holidays, and spot loads of milk are still being discounted, although not as much as last week.

Futures Month	Friday 01/09 Close	Wednesday 12/31 Close	Change
Jan-09	\$10.88	\$10.80	\$0.08
Feb-09	\$9.92	\$10.28	(\$0.36)
Mar-09	\$10.18	\$10.77	(\$0.59)
Apr-09	\$10.70	\$11.17	(\$0.47)
May-09	\$11.08	\$11.74	(\$0.66)
Jun-09	\$11.91	\$12.42	(\$0.51)
Jul-09	\$12.44	\$13.01	(\$0.57)
Aug-09	\$13.21	\$13.85	(\$0.64)
Sep-09	\$13.58	\$14.15	(\$0.57)
Oct-09	\$13.65	\$14.17	(\$0.52)
Nov-09	\$13.70	\$14.16	(\$0.46)
Dec-09	\$13.69	\$14.07	(\$0.38)
Jan-10	\$13.81	\$14.15	(\$0.34)
Feb-10	\$13.74	\$14.23	(\$0.49)
Mar-10	\$13.89	\$14.35	(\$0.46)
Apr-10	\$13.98	\$14.50	(\$0.52)
May-10	\$14.38	\$14.73	(\$0.35)
Jun-10	\$14.63	\$14.94	(\$0.31)
2009 Avg	\$12.08	\$12.55	(\$0.47)
Q1Q2 2010	\$13.81	\$14.24	(\$0.43)



- Fluid Milk & Cream Review reports Arizona is still dealing with a heavy local milk supply, limiting how much outside milk processors can take. Balancing plants remain full. In the Pacific Northwest, despite disruptions caused by heavy snowfall and flooding, plants have access to all the milk they want, and then some.
- Butter stocks at CME-approved warehouses were up sharply this week, increasing 7.6 million lbs. A year ago at this time stocks increased by 6.9 million lbs.
- Western dry whey stocks at some locations are much heavier than desired, according to Dairy Market News. Sellers are lowering the price to try and stimulate buyer interest. Production was heavier than anticipated over the holidays, and competition from other low priced dairy products is a problem.
- Dairy Market News reports nonfat dry milk stocks remain heavy and are in excess of needs. Export interest is limited and competition in the world markets is high, with surplus product in most producing countries trying to battle for reduced world demand. Buying potential has been reduced by economic, credit, exchange rates and other issues.
- International: Dairy Market News reports milk volumes in Western Europe are sufficient for needs, and manufactured stocks are often uncommitted, thus clearing to inventory. Sales activity has been minimal due to the holidays, yet buyers are stating that they may not be returning as quickly as suppliers project. Market uncertainty and depressed economic condition in many countries will impact purchasing patterns for at least the first half of the year, if not beyond.
- International: Milk output in New Zealand has been doing fairly well, and sufficient to maintain strong manufacturing schedules. In Australia, November production was up 1.5% from a year ago and production of finished products is strong. Some manufacturers are looking for warehouse space the product that is not clearing, as more reports of uncommitted stock are occurring. International buyer interest is slow and unaggressive. Traders and handlers feel current economic conditions will probably limit significant sales for at least the first half of the year. Cheddar cheese prices averaged \$1.25/lb in Oceania, making a U.S. equivalent of about \$1.05/lb when accounting for moisture difference and transportation cost.

Recommendation:

Despite cheese coming off its lows and a two-day futures rally, most contracts were significantly lower than last week's close. However, we're seeing some encouraging signs. Cheese buyers were very aggressive this week, taking on a lot of loads. With cheese prices still below support, they must be seeing it as a "value" or they wouldn't be so aggressive. Secondly, commercial interest appears to be picking up. We heard reports this week of cheese buyers looking to lock in prices on an annual basis. When confronted with current futures prices, if you're a buyer of cheese, this really makes sense. There are not many dairies out there, if any, that can turn a profit, given current input costs, with any Class III price out there in 2009 through mid-2010. It just can't be done. And while we've seen prolonged periods of \$9 milk in the past, today's \$9 prices might as well be \$5/cwt. An extended period of these prices would be extreme, and it's our opinion it simply can't last as long as in previous cycles. The front months remain vulnerable to price depreciation. Despite coming off the lows of the week, current cheese prices work out to about \$8.70/cwt. With the February contract beginning its calculation next week, unless bidders in the cash market can keep the momentum upward, the \$1.25 premium Feb is currently carrying to cash could give incentive to sellers of the front months. The second half of 2009, in our opinion, now carries more upside risk than downside. If you have milk sold in these months, you need to get more aggressive getting call options purchased for protection from higher prices. Go after them and get them. Here's another thought. If you are willing to take on more risk, consider actually lifting your hedges now for the second half and just take the profit. Use some of that profit to buy PUT options if you're wary of prices continuing to fall. 2009 is shaping up to be very volatile, so give us a call and we'll help you put together a marketing plan.

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