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

The KDM Dairy Report – January 16th, 2009

What's Bullish:

Futures Month	Friday 01/16 Close	Friday 01/09 Close	Change
Jan-09	$10.67	$10.88	($0.21)
Feb-09	$9.35	$9.92	($0.57)
Mar-09	$9.74	$10.18	($0.44)
Apr-09	$10.28	$10.70	($0.42)
May-09	$10.65	$11.08	($0.43)
Jun-09	$11.55	$11.91	($0.36)
Jul-09	$12.22	$12.44	($0.22)
Aug-09	$13.08	$13.21	($0.13)
Sep-09	$13.46	$13.58	($0.12)
Oct-09	$13.50	$13.65	($0.15)
Nov-09	$13.66	$13.70	($0.04)
Dec-09	$13.69	$13.69	$0.00
Jan-10	$13.64	$13.81	($0.17)
Feb-10	$13.67	$13.74	($0.07)
Mar-10	$13.83	$13.89	($0.06)
Apr-10	$13.99	$13.98	$0.01
May-10	$14.25	$14.38	($0.13)
Jun-10	$14.56	$14.63	($0.07)
2009 Avg	**$11.82**	**$12.08**	**($0.26)**
Q1Q2 2010	**$13.71**	**$13.81**	**($0.10)**

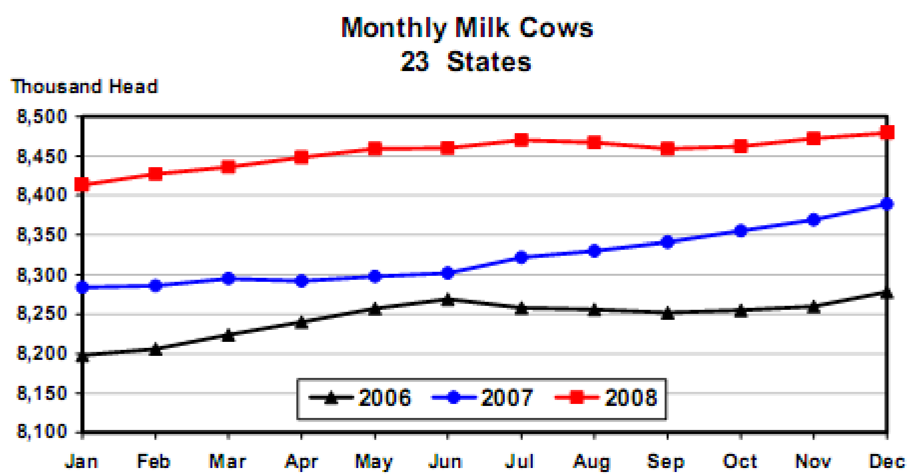
- Cash Market: It didn't go lower! Maybe we have found a short-term bottom here? Blocks ended the week down just ¼¢ to $1.07/lb, but barrels gained 2¢ to settle at $1.09/lb. Trading was fairly active, with buyers more aggressive, picking up 19 loads of blocks and 13 barrels. Butter settled at $1.11¼/lb, up ¼¢ for the week. 5 cars of butter exchanged hands.
- Congress is looking at ways to use the forthcoming stimulus bill to reduce the nation's dairy herd, according to a news article this week. Initial attempts were objected to by Rep. David Obey on the grounds it violated a promise not to include earmarks in the bill.
- Class I demand in the Eastern region was very strong this week, according to Fluid Milk & Cream Review. Some are surprised by the strength, with milk easily being handled despite production creeping higher. The higher level of fluid demand has resulted in a drop in drying activity and a reduction in milk available for manufacturing. Some cheese plant operators were "begging" for more milk. Florida exported 214 loads of Grade A milk last week, but only 133 this week.
- Milk handlers in the Midwest were having difficulty sourcing enough r-BST free milk for buyers this week, according to Fluid Milk & Cream Review.
- 50,100 dairy cows went to slaughter during the first week of 2009, according to USDA. That's up from 43,100 during the same period last year.
- Cheese stocks at USDA selected storage centers were unchanged after several weeks of increases, over the period 01/01 through 01/12.
- Dairy Market News reports buying interest for butter increased this week in the Western region, as end users are willing to own inventory at current price levels.
- Nonfat dry milk prices were mostly steady this week, but buyer interest was high, according to Dairy Market News. Manufacturers reported more requests for fixed-price contracts for the year at current price levels, and while inventories are still high, production this week was significantly reduced out East.
- Retail ordering in the Eastern region for all varieties of cheese is showing increasing strength, according to Dairy Market News. There is a feeling that prices are now near the bottom. Some stores are also ordering in anticipation of Super Bowl promotions.
- Dairy Market News reports that while sluggish yearend sales backed up inventory at Midwest plants, the 30-day age limit on current cheese trading on the cash market may be limiting offerings available in Chicago. Some buyers are placing extra cheese in storage for later year use, while many packagers and processors are reporting improved orders. Reports indicate other customers may be planning additional promotions around current market prices. The pickup in orders has reduced the possibility of short lead time orders and some orders may need a little longer to be delivered.
- Interest in cheese by Western buyers has been spurred by prices under the support price, according to Dairy Market News. Some buyers see no down side price risk and are willing to stock up to normal working inventory levels.
- International: Milk consumption in China has made a strong recovery since the melamine scare last fall, according to a news article this week. Sales of China-made milk were back up to 80% of the pre-scandal level, it was reported.

What's Bearish:

- Milk Production Report: Milk production in December was up 1.4% in the U.S., according to USDA. Cow numbers were 75,000 head higher than a year ago, and increased 8,000 head from November. Milk per cow was up 10 lbs per cow as well. Largest increases were seen in KS up 20%, TX up 13.7%, CO up 6.8% and NM up 6.1%. CA output was down 0.8% despite having 9,000 more cows, while WI output was up 2.3%.
- World Ag Supply & Demand Report: USDA lowered their 2008-2009 Class III price forecast from last month by $3.90/cwt, expecting it now to average just $11.00/cwt. The dramatic change reflects current market sentiments of weak demand and poor exports. USDA also knocked 40¢/lb off their cheese price forecast from last month, expecting it to average just $1.30/lb for the year.
- NASS cheese prices continue to play "catch-up" with the cash market. 40-lb blocks dropped 13.1¢ in this week's survey, to average $1.35/lb. 500-lb barrels fell 15.7¢ to $1.28/lb. Butter increased 1.7¢ to average $1.12/lb and nonfat dry milk was up a slight 0.4¢ to 84¢/lb, but dry whey decreased 0.3¢ to 17.1¢/lb.

- Butter stocks were up 18% at USDA selected storage centers over the first 12 days of January. In addition, butter stocks at CME-approved warehouses increased 11.2 million lbs for the week ending 01/10. A year ago, stocks only increased 5.1 million lbs. Total stocks are still below year ago levels by 61 million lbs, but the gap is closing quickly.
- Fluid Milk & Cream Review reports bottlers in the Central region are expecting Class I needs to be lighter in the near future, due to school closings this week from the extreme cold, and the MLK holiday on Monday. Cream supplies remain heavy and churning remains active. Spot loads of milk are still being discounted, although not as bad as during the yearend holidays. Few plant operators are looking at adding additional producers and some firms are looking at reducing their premium structure.
- Processing capacity in California remains under stress as plants try to handle milk and components, according to Fluid Milk & Cream Review. Some processors are cutting back on supply contracts to help them balance production with finished product needs, but this forces more milk to be balanced at other locations. Class I interest is flat. Plants in Arizona are running full as the cows have responded to favorable weather. Distressed cream is common, with sellers taking low prices in attempts to clear product. Butter churning remains heavy.
- Current butter production in the Central region remains higher than demand, according to Dairy Market News. Surplus stocks are clearing to inventory, with come being cleared to the CCC support program. Food service sales are not that strong, due to current economic conditions; lighter traffic is reported at restaurants.
- Dry whey markets remain weak as manufacturers remain aggressive on pricing to keep stock levels under control, according to Dairy Market News. Demand is soft, so inventories are building and offers are becoming more numerous.
- International: The EU has moved to reintroduce export subsidies for dairy products, after a two-year suspension, according to a news article this week.

Recommendation:



While this week's report appears more balanced, we're clearly not out of the woods yet. Class III futures took it on the chin again, with the 2009 average losing 26¢, falling below $12 for the first time. Our contacts still report a lot of finished dairy product kicking around, so inventory issues remain as well. This week's Milk Production Report was bearish too, with 8,000 cows being added from Nov to Dec (see graph). Clearly that trend needs to be reversed. Ugh! The news from the EU is not welcome either. Subsidizing their finished dairy products, which are already lower than U.S. prices, could result in them showing up on our shores; not something we really need or want at this point. In addition, the milk production recovery in Oceania, and their limited ability to store product long term, might result in "price wars" for some time to come. However, the good news is that it appears our cheese prices have found some support. Buyers see little downside from here and seem happy to purchase at these levels. Milk production in California continues to weaken, with the impending financial stress likely to bring down production in all areas of the country. Grains were up strong today despite weak fundamentals. Regardless, it combines $9 milk with $4 corn, $10 beans and $300 meal. There is no dairy in the country that can turn a profit with these numbers, leading us to conclude that more risk is to the upside at this point. For those producers who have milk at higher levels, get more aggressive in getting CALL options purchased to cover your risk. No one thought $9 milk was possible, and no one thinks $18 milk in Q4 is possible now. Maybe it isn't, but we wouldn't take that chance. Get covered. The front months remain vulnerable to more downside. Even with cheese moving off its lows, we still calculate out to about $8.80 milk at current cheese, butter and whey prices. However, there is a large "short" position hanging on right now, and we wouldn't be surprised to see a short-covering rally at some point, especially if cheese finds its legs next week and keeps creeping higher.

Note: In observance of Martin Luther King Day on Monday, all U.S. markets will be closed. KDM will reopen its offices on Tuesday, Jan 20th.