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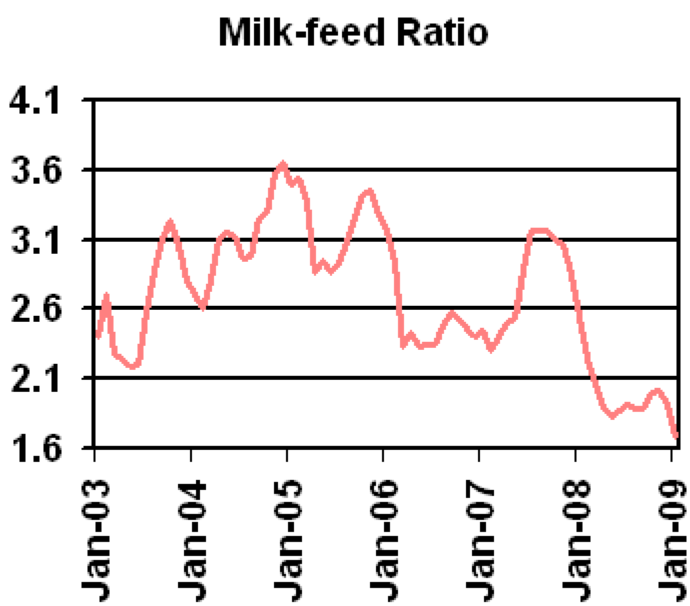
The KDM Dairy Report – January 30th, 2009

What's Bullish:

- Cash Market: Cheese buyers were aggressive again as they picked up 41 loads of blocks and 5 barrels. That bumped the cheddar block price up 7½¢ from last week to $1.15/lb, while barrels gained 1½¢ to $1.11½/lb. Activity in the cash butter market was nearly non-existent, as butter remained unchanged at $1.10¼/lb on just 1 trade.
- Ag Prices Report: The milk-feed ratio in January fell to a new all-time low of 1.69, down from 1.92 in Dec. It's the lowest reading in 24 years (see graph), when measurements began in 1985. The Feb ratio is expected to be even lower.
- Dairy cow slaughter for the week ending 01/17 was strong again. 65,500 exited the herd, compared to 57,600 during the same period a year ago. Already in the first 3 weeks completed in January, dairy cow slaughter is up 31,000 head compared to last year.
- Commercial disappearance of dairy products during the first eleven months of 2008 was up 2.1% compared to 2007, according to USDA. Butter use was up 11.4% and American cheese use was up 2.6%, however, other cheese use fell 1.6% and fluid milk use decreased 0.5%.
- In the Pacific Northwest, many producers are stating that this has been a harder winter than they've seen in many years, according to Fluid Milk & Cream Review. Feed and hay consumption are much higher than most had planned for because of the cold conditions, and many have prices locked in at higher levels.
- Butter demand has been surprisingly strong for this time of year, according to Dairy Market News. Retail orders are strong at a time when they are usually slow. Some retail feature activity is occurring, but most associate the better sales figures to lower shelf prices.
- The supply of pre-January produced cheese eligible for sale at the CME cash market is shrinking as more reaches the 30 day maximum age limit, according to Dairy Market News. This is giving a firmer undertone to prices. Current low prices have stimulated extra sales of consumer products, and private label promotions are moving extra current cheese. Process interest is solid for this time of year, with processors salting away both barrels and other processing solids for current and later year use. Mozzarella demand is strong from both food service and frozen pizza accounts.

Futures Month	Friday 01/30 Close	Friday 01/23 Close	Change
Feb-09	$9.45	$9.38	$0.07
Mar-09	$10.33	$10.03	$0.30
Apr-09	$11.05	$10.57	$0.48
May-09	$11.56	$11.00	$0.56
Jun-09	$12.44	$11.98	$0.46
Jul-09	$13.29	$12.90	$0.39
Aug-09	$14.14	$13.77	$0.37
Sep-09	$14.55	$14.25	$0.30
Oct-09	$14.58	$14.28	$0.30
Nov-09	$14.77	$14.38	$0.39
Dec-09	$14.81	$14.40	$0.41
Jan-10	$14.80	$14.35	$0.45
Feb-10	$14.75	$14.40	$0.35
Mar-10	$14.83	$14.42	$0.41
Apr-10	$14.85	$14.20	$0.65
May-10	$14.95	$14.73	$0.22
Jun-10	$15.05	$14.56	$0.49
Feb-Dec	**$12.82**	**$12.45**	**$0.37**
Q1Q2 2010	**$14.79**	**$14.39**	**$0.40**



What's Bearish:

- Semi-Annual Cattle on Feed Report: The number of milk cows on Jan 1 stood at 9.33 million head, up 1% from a year ago. The number of milk replacement heifers totaled 4.41 million head, down slightly from last year, but still at a very high ratio to the size of the milking herd. There are plenty of replacement animals out there.
- All Class III components dropped in this week's NASS survey. 40-lb blocks decreased 7¢ to average $1.15/lb and 500-lb barrels fell 13¢ to $1.13/lb. Butter lost 0.5¢ to average $1.07/lb, nonfat dry milk gave up 0.3¢ to 83¢/lb and dry whey dipped 0.3¢ to average 16.6¢/lb.
- Weekly cold storage numbers continue to reflect a gain in both cheese and butter stocks. Butter holdings at USDA selected storage centers are up 29% and cheese stocks are up 2% over the period 01/01 through 01/26.
- From empty to full. Fluid Milk & Cream Review reports Northeast balancing plants, begging for milk last week, are now full. The recent announcement of a Feb Class I base price of $10.72 has buyers waiting for lower prices starting next week, so milk is backing up. Severe weather in the Mid-Atlantic and Southeast caused major disruptions for haulers and several processors were without power for days. As a result, shipments of Grade A milk out of the region went from 0 last week to 89 this week. Milk production is up in Florida, and despite the increase in winter residents and good fluid demand, exports of Grade A milk increased from 133 loads last week to 174 this week.

- The milk supply in the Central region continues to outpace demand, according to Fluid Milk & Cream Review. Discussion continues on cow numbers and how long it will take to have numbers decline to offset the reduction in exports. Most industry people feel dairy cattle numbers need to be seriously pruned.
- Fluid Milk & Cream Review reports in the Southwest, processors in California continue to struggle with balancing the milk supply, despite more aggressive culling. Milk and components continue to move out of the state. Plants in New Mexico are running full as milk production in the state is running several percentage points higher than last year.
- Bulk butter continues to clear to the CCC under the support program, and cream supplies remain readily available, according to Dairy Market News. Other excess butter is clearing to inventory.
- Dairy Market News report nonfat dry milk prices remain weak, with some producers even offering it 2¢ below the support price of 80¢ in order to entice commercial buyers. Drying schedules are heavy to handle the current milk supply and stocks continue to be burdensome, with surplus clearing to the CCC.
- Economy: Layoffs, layoffs and more layoffs. S&P 500 down 8.8% for January, its worst start in history. 4th quarter GDP shrank at its fastest pace in 27 years.

Recommendation:

Despite giving up some ground on Friday, Class III futures were mostly up double-digits for the week, for the second week in a row. Aggressive cheese buying as end users load up on physical hedges to fill coolers, is giving courage to Class III buyers to continue moving prices higher. The big question is how long this will last. Granted, low cheese prices have encouraged sales and thus demand, but what happens when the coolers for these aging programs are full? The second half of the year is trading at nearly $1.70 cheese, and there is still some healthy skepticism out there that milk production will correct in time to yield that type of cheese price by fall. We respect that. Certainly the Cattle on Feed report is not encouraging. Efforts are under way by CWT to secure private funding for a massive herd retirement, upwards of 300,000 cows. That will help, but with 4.4 million heifers in the pipeline, they could easily be replaced. On the other hand, with a record low milk-feed ratio, something has to give. It simply isn't profitable to milk cows at current prices, so whether CWT does it or not, cow numbers are likely to head dramatically lower. Weekly dairy cull numbers were strong for the second week in a row, and we expect them to stay that way for quite a while. The current cash price works out to $9.28 milk, so the front months still remain vulnerable. As previously mentioned, the last half of the year is carrying a huge premium to the current cheese price of $1.15/lb. If second half prices reach $15.00 to $15.25 next week on continued strength, we would sell between ¼ to ½ of your milk production there. That would be $1.80 cheese, and with economic headlines like we've been seeing, we're not convinced consumer demand will be there to sustain that high a cheese price.

Note: For larger dairies, Mar and Apr are expected to have bigger MILC payouts than Feb, so you may want to consider moving your start month out until then.