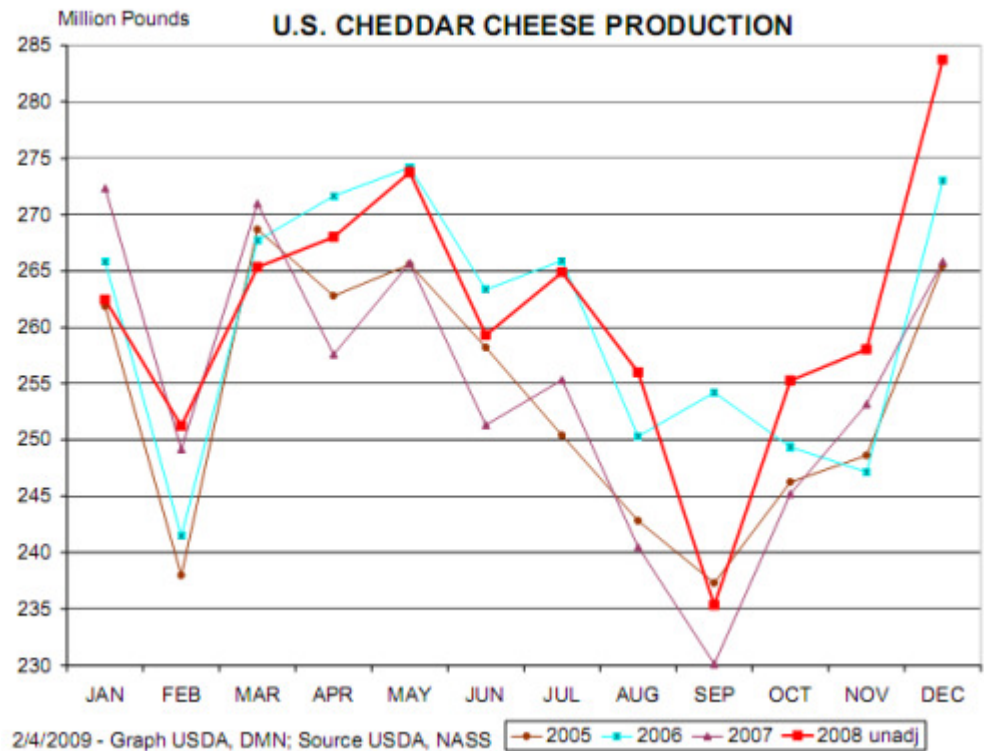


The KDM Dairy Report – February 6th, 2009

What's Bullish:

- Cash Market: Spot cheese continues to trend higher, although on much lighter volume this week. Blocks settled at \$1.15¾/lb, up ¾¢ for the week, while barrels jumped 3¼¢ to close at \$1.14¾/lb. Just 7 loads of blocks and 6 barrels exchanged hands. Butter was unchanged at \$1.10¼/lb on 6 trades.
- Dairy cow slaughter for the week ending 01/24 was strong again. 65,200 head were culled compared to 50,500 during the same period a year ago.
- Fluid milk sales in Florida were strong this week, according to Fluid Milk & Cream Review, driven by an increasing seasonal population. There were also reports of a leveling and possible slight decline in milk production, although the peak is usually not expected until April. Exports out of the state declined by 8 loads compared to last week.
- California milk production remains strong, however there are growing signs of a worsening drought situation this summer as the snowpack is at only 61% of average. This will have the effect of keeping water restrictions in place for dairies. In addition, there are more signs of financial stress as some producers are not able to cover feed costs. In the Pacific Northwest, some producers are trying to renegotiate with suppliers, or face foreclosure.
- Class I demand in the Central region was sharply higher this week, according to Fluid Milk & Cream Review. Many retailers ran promotions for milk with prices at their lowest levels in years. Cheese milk interest is uneven; however, cheese supplies have tightened slightly, so buyers and sellers are in better balance. Many plants are operating on lighter schedules due to the increased Class I use.
- Current cheese interest in the Midwest is steady to occasionally improved, giving a slightly firmer feel to the cheese market, according to Dairy Market News. Supplies are in better balance, and regular customers do not appear to be cutting back on orders. Interest in barrels for the process markets is improved and mozzarella interest remains solid. Strong Class I demand is starting to reduce milk supplies available for manufacturing.
- Dairy Market News reports out West, cheese orders are coming in at a good pace, but many operations are not putting much away for future needs. Plants are seeing a little less milk for processing due to extremely good demand for fluid milk.
- Mozzarella plants in much of the Eastern region are producing heavily, to meet strong demand, according to Dairy Market News.
- International: Despite the reactivation of export subsidies in Europe, sales have not picked up, according to Dairy Market News. Traders indicate even with the subsidies, some products can still not compete internationally. Pay prices to dairy producers are declining in many parts of Europe which is causing many producers to seriously review their milking operations.
- International: Temperatures in Australia hit 113 degrees this week over most of the dairy region, according to Dairy Market News. The impact on the herd is still unknown, but most feel that these conditions will accelerate an earlier season's end. Production forecasts continue to be revised lower, not only because of the weather, but because milk

Futures Month	Friday 02/06 Close	Friday 01/30 Close	Change
Feb-09	\$9.26	\$9.45	(\$0.19)
Mar-09	\$10.20	\$10.33	(\$0.13)
Apr-09	\$10.90	\$11.05	(\$0.15)
May-09	\$11.37	\$11.56	(\$0.19)
Jun-09	\$12.07	\$12.44	(\$0.37)
Jul-09	\$12.85	\$13.29	(\$0.44)
Aug-09	\$13.52	\$14.14	(\$0.62)
Sep-09	\$14.04	\$14.55	(\$0.51)
Oct-09	\$14.14	\$14.58	(\$0.44)
Nov-09	\$14.35	\$14.77	(\$0.42)
Dec-09	\$14.39	\$14.81	(\$0.42)
Jan-10	\$14.51	\$14.80	(\$0.29)
Feb-10	\$14.44	\$14.75	(\$0.31)
Mar-10	\$14.65	\$14.83	(\$0.18)
Apr-10	\$14.75	\$14.85	(\$0.10)
May-10	\$14.90	\$14.95	(\$0.05)
Jun-10	\$15.05	\$15.05	\$0.00
Feb-Dec	\$12.46	\$12.82	(\$0.35)
Q1Q2 2010	\$14.53	\$14.79	(\$0.26)



payout prices have fallen by as much as 25%. Milk producers may dry off cows earlier than usual to avoid supplemental feed costs.

What's Bearish:

- Dairy Products Report: Cheddar cheese production in December was the strongest in 14 years, according to USDA. Cheddar production was up 6.7% compared to a year ago, and up 9.9% from November (see graph above). Total cheese output was up 1.1% vs. last year and up 4% from Nov. Butter production was even stronger, up 10.1% vs. Dec '07 and up 16.5% vs. Nov. Interestingly, American cheese output in California fell 14.6% from a year earlier, but increased 2.1% in Wisconsin.
- Weekly NASS numbers were down again this week. 40-lb blocks averaged \$1.09/lb, losing 6.2¢, while 500-lb barrels fell 0.4¢ to \$1.14/lb. Butter gave up 0.2¢ to average \$1.07/lb and dry whey decreased 0.7¢ to 15.9¢/lb, but nonfat dry milk was up 0.3¢ to 83¢/lb.
- Weekly cold storage numbers over the period 01/01 through 02/01 indicate cheese stocks increased 5% at USDA selected storage centers. That represents a build up of 5.5 million lbs of cheese, or 125 loads on the CME cash market.
- Dairy Market News reports churning throughout the country remains heavy as cream supplies continue to be burdensome. Cream has moved from Florida to Wisconsin and Texas, to find plants with sufficient capacity. Demand is surprisingly strong, however production is even stronger, pushing excess product into storage or to the government.
- Central dry whey supplies remain heavier than desired, according to Dairy Market News. Production is seasonally strong, and many producers have more inventory than they would like, heading into spring.
- International: Cheddar cheese prices in Oceania remain weak as prices edge lower. Traders indicate sales are occurring, but at discounts to keep stock moving. Cold storage warehousing is limited in the region, thus the impetus to clear product. Cheese is still readily available even as seasonal cheese production declines.
- International: December cheddar cheese output in Australia increased 5% compared to 2007, according to Dairy Australia statistics. Milk output showed a 6.3% increase and was up 2.5% YTD. Meanwhile, exports of manufactured dairy goods fell 3.6%.
- Economy: The jobless rate hit 7.6% in January, the highest level since 1974, according to the Labor Department.

Recommendation:

Class III futures were down for the week, but were sharply higher today, perhaps in response to a strong day on Wall Street. The Dow finished up 217.52 points despite the worst jobless rate since 1974, as hopes hinge on the stimulus plan. We'll see. Overall, however, there are some encouraging things from this week's USDA updates. Class I demand appears to be strong across the country as a gallon of milk dropped by as much as 50¢ at grocery stores. This is leaving less milk available for manufacturing, and it appears the supply of current cheddar is more in balance than it has been in recent weeks, this despite the heaviest cheddar output in December in 14 years. It's our opinion that much of the December output has already been purchased at prices below support and is sitting in aging programs, ready to be sold this fall. Rumors about the big CWT herd buyout amounted to nothing this week, but we did hear there is still activity and negotiations going on for us to assume they will come out with some announcement eventually. Financial stress is hitting hard, so whether there is a CWT herd retirement or not, we will be getting rid of a lot of cows over the next few months. Depending on what kind of weather we get this summer, it could set us up for some explosive price movements for the second half of the year. We're getting more optimistic that prices will have to move higher than they are now in the second half. For that reason, if you have milk sold at higher prices, we would get VERY aggressive NOW at getting call options purchased to protect yourself from upside risk. Either that, OR consider buying your second half hedges back at a profit NOW, if you are able. We suggested this strategy in our Jan. 9th report, and prices since then are substantially higher. The current cash price works out to just \$9.49/cwt, so the front months are still at risk. However, we can't help but feel the pendulum is starting to turn and perhaps cheese buyers start gaining the upper hand in the next few weeks. Time will tell. We're also pulling our recommendation from last week to sell milk at \$15.00 to \$15.25 (which never hit) for the second half. Optimism is growing.

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.