

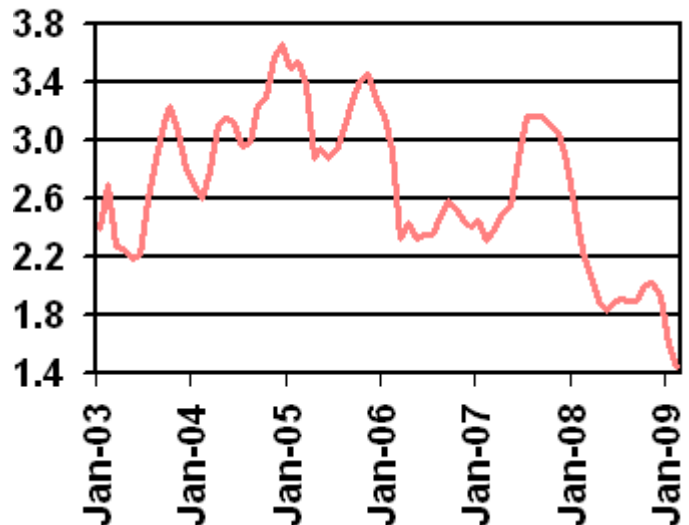
The KDM Dairy Report – March 6th, 2009

What's Bullish:

- Cash Market: Buyers kept their appetite for cheese this week, picking up 55 loads and keeping the pressure on sellers. Blocks gained 2½¢ to settle at \$1.20/lb today, while barrels increased 4¢ to \$1.22/lb. Butter gained a little momentum with it's second higher weekly close, moving up 1¾¢ to \$1.16¾/lb. Buyers grabbed 18 loads on the way up.
- Ag Prices Report: The February milk-feed ratio set another new record low of 1.44, falling from 1.59 the previous month, which had been the record (see graph). The ratio represents the pounds of 16% mixed dairy feed equal in value to 1 pound of whole milk.
- NASS surveyed Class III components were mostly higher this week. 40-lb blocks increased 6¢ to average \$1.23/lb and 500-lb barrels were up 4.4¢ to \$1.24 as they attempt to track the cash market. Butter gained a penny to average \$1.09/lb and nonfat dry milk was up 0.5¢ to 82¢/lb, but dry whey lost 0.2¢ to average 15.7¢/lb.
- Weekly cold storage holdings indicate cheese stocks declined 2% over the period 02/01 through 03/01.
- Dairy cow slaughter for the week ending 02/23 remained brisk. 59,500 head were culled, compared to 51,000 during the same period a year ago.
- Milk production in the Eastern region continues to increase seasonally; however, intakes are being readily handled, according to Fluid Milk & Cream Review. Demand for cream is strong from both ice cream and cream cheese operations. Some plants in the Southeast were scrambling to get milk, due to disruptions from their recent snow storm.
- Manufacturing milk supplies in the Central region continue to be tight, according to Fluid Milk & Cream Review. Class I interest is steady to improved on stronger retail sales, while Class II and III interest is stronger as ice cream and cream cheese production picks up for the upcoming holidays. Cream supplies are tighter. The financial crunch is getting tighter. Some operations received nothing for their Feb milk as assessments were larger than their total receipt from milk sales. Culling of cows is up and dairy sellouts continue. Bankers are being forced to restructure loans.
- Fluid Milk & Cream Review reports January pool receipts of milk in California were 5.5% lower than in 2008. Cows are beginning to flush, but milk volumes are not running up as in other years. Culling is occurring at a higher pace than normal, and feed rations are being changed to limit cost, rather than to maximize output. The financial strain on dairies is immense, and some dairies are only seeing partial February payment due to financial problems with their coop. Processing plants are, however, running full.
- Dairy Market News reports the dry whey market is firming in the Central region. Some contract buyers are requesting additional loads over and above agreed upon numbers, and a few manufacturers report being oversold on expected March dry whey production. Inventories are described as comfortable to somewhat short of demand.
- Western dry whey prices continue to increase as plant inventories are closely balanced to tight, according to Dairy Market News. Buyers now need extra time to get they powder that they need, while export activity continues to absorb additional offerings. Stocks at the end of the month were down 8.7% compared to last year.
- Cheese offerings are about in balance to tight in the upper Midwest, according to Dairy Market News. Many packagers and processors are running on good seasonal schedules, including some overtime. Occasional tightness is noted on specialties such as pepper jack and mozzarella.
- Dairy Market News reports sales of current cheese in the Western region have been excellent at the retail level, and good for food service accounts.

Futures Month	Friday 03/06 Close	Friday 02/27 Close	Change
Mar-09	\$10.22	\$10.23	(\$0.01)
Apr-09	\$10.73	\$10.40	\$0.33
May-09	\$11.08	\$10.75	\$0.33
Jun-09	\$11.72	\$11.30	\$0.42
Jul-09	\$12.79	\$12.44	\$0.35
Aug-09	\$13.66	\$13.24	\$0.42
Sep-09	\$14.14	\$13.71	\$0.43
Oct-09	\$14.42	\$14.02	\$0.40
Nov-09	\$14.71	\$14.33	\$0.38
Dec-09	\$14.74	\$14.41	\$0.33
Jan-10	\$14.84	\$14.50	\$0.34
Feb-10	\$14.87	\$14.50	\$0.37
Mar-10	\$14.86	\$14.60	\$0.26
Apr-10	\$14.96	\$14.70	\$0.26
May-10	\$14.95	\$14.75	\$0.20
Jun-10	\$14.90	\$14.80	\$0.10
Mar-Dec	\$12.82	\$12.48	\$0.34
Q1Q2 2010	\$14.86	\$14.53	\$0.32

Milk-feed Ratio



- International: Customer interest in finished dairy products from the Oceania region is picking up, according to Dairy Market News. Buyers are sensing the need to secure product and understand that current prices are workable. Powder markets are firming.

What's Bearish:

- Dairy Products Report: January was a month of big production for finished dairy products. Cheddar cheese output during the month was up 4.5% vs. Jan 2008, according to USDA. Total cheese output was up 1%, and butter production was up 3.5%.
- Weekly cold storage holdings indicate butter stocks increased 27% over the period 02/01 through 03/01.
- Florida exported 203 loads of milk this week, up from 98 last week, according to Fluid Milk & Cream Review. Production is thought to be near its peak, as cows have responded to cooler weather.
- Western nonfat dry milk prices remain steady at current levels near support. Dairy Market News reports buyers are taking contract and spot loads as needed, with little concern of upward price risk. Production remains active to handle the milk supplies, and stocks remain in excess of trade needs. Surplus inventory is still being offered to the CCC.
- International: Milk production in the European Union is up about 1% from a year ago, according to Dairy Market News. Offerings are heavy and buying interest is slow for both local and export accounts. Farm prices are being lowered to reflect slower sales, while milk production levels are expected to increase as the winter season ends.
- International: Dairy Market News reports New Zealand milk output is up 4-5% compared to a year ago, when drought played a significant role in cutting production.
- Economy: The jobless rate jumped to 8.1% in February, the highest rate since 1983, as 651,000 jobs were cut. The figures were worse than analysts expected, with little hope for a turnaround any time soon. GM shares plunged to a 75-year low, as even its own internal auditors expressed doubts about whether the company could avoid bankruptcy.

Recommendation:

Class III futures were solidly higher this week for no one reason in particular. However, there's a growing sense that the financial hardship being felt on many of the nation's dairy operations is almost unprecedented. Some farms will receive no income in February as assessments consume the little that was made that month. Dairy bankruptcies and sellouts are likely to increase over the coming months as milk prices remain under \$11 in the front contracts. This increased awareness of severe hardship has some thinking that milk supply and demand will come into balance more quickly than anticipated. Culling continues at a good pace, with nearly 100,000 more cows slaughtered this year than last, after only eight weeks. With much of the culling occurring in the Southwest, we've seen California milk production now dip below 2006 levels, and their peak, usually in mid-April, may already be in. It's hard to know exactly who is moving the market higher. It's most likely a combination of short-covering, new spec long positions and commercial hedging. There was a lack of sellers all week; certainly producer selling has dried up at these levels, so buyers were forced to go after bids each day 10 to 20 higher. Domestic cheese sales continue to be strong, and now the dry whey market looks to be firming as export interest increases. We're not trying to argue for a bullish run here, for the front months remain vulnerable. The current cash price works out to \$10.20, making April and beyond trading a premium to cash. In addition, there's no positive news about the economy, and little hope it will improve soon. The Dow went from a high of over 380 just before the Great Depression in 1929, to a low of 40, and then took 25 years, 1954, to get back above 380. The Dow, currently at 6,627, would have to hit about 1,560 to equal that low. Let's hope and pray it does not. But the economy remains the biggest impediment to higher milk prices long term. Should the economy continue to collapse, milk prices will too. If the front months keep rallying next week, we would buy at-the-money PUT options for unprotected milk; there's no reason we can't come right back down in this choppy trade. We would get aggressive about getting CALLs bought for the second half of the year on sold milk. We could rocket higher in those months IF, and that's a BIG if, we kill off too much milk, the economy begins to rebound this summer, and inflationary pressures begin to move all commodities higher. Hang on!

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