

The KDM Dairy Report – March 13th, 2009

What's Bullish:

- Cash Market: Buyers slowly but methodically pushed both blocks and barrels higher in the spot market, on much lower volume than previous weeks. Blocks gained 5¢ to settle at \$1.25/lb today, while barrels jumped 9¾¢ to close at \$1.31¾/lb. Just 6 loads of blocks and 9 loads of barrels exchanged hands. Butter increased 1¾¢ to settle at \$1.18½/lb on a heavier volume of 13 trades.
- World Ag Supply & Demand Report: USDA revised their 2009 milk production forecast lower, as milk per cow is expected to be poorer, and herd liquidation rates are higher. Forecasts for butter and cheese prices were raised from last month as demand has been stronger than expected and later year reductions in milk supplies are expected to support product prices. The forecast for Class III milk was raised up 30¢/cwt from last month's report, due to the higher component prices.
- CWT announced this week that they have achieved their membership goal of two-thirds of the U.S. milk supply for two years. 67% of the nation's milk supply has now committed to pay 10¢/cwt for a full two years, which has allowed the program to secure financing aimed at herd retirement activities. No details were released on when and how many cows/milk it intends to remove.
- Most NASS Class III components were higher in this week's survey. 40-lb blocks increased 2.3¢ to average \$1.25/lb and 500-lb barrels bumped up 1.8¢ to \$1.26/lb. Butter gained 2.2¢ to average \$1.12/lb and dry whey was up 0.5¢ to 16.2¢/lb, but nonfat dry milk decreased 0.4¢ to 81¢/lb.
- Cheese stocks at USDA selected storage centers were down 2% during the first nine days of March. 2.2 million lbs were pulled out of inventory during the period.
- Dairy cow slaughter for the week ending 02/28 totaled 58,000 head, up 7,700 head from the same period last year. Since the first of the year, the weekly cull has averaged 11,000 more head per week than last year. To put that in perspective, were that pace to continue, by year's end, 572,000 more cows would have been culled than a year ago.
- Milk production is increasing in the Eastern region of the country, but Class I sales have been surprisingly strong, pre-holiday butter orders are strong and ice cream manufacturing has been strong, according to Fluid Milk & Cream Review. Balancing plants have been very active handling the extra milk, which is expected to increase into May, but demand for cream is very active, moving multiples higher. Cream has moved into the region from the West to meet demand.
- Fluid Milk & Cream Review reports spot interest in Class III milk remains steady, with current spot offerings of extra loads of milk limited in the Central region. Prices are steady, but generally interest exceeds the supply, as manufacturing plants are running on heavier schedules than a year ago.
- Plant receipts in California are heavy, but not at the levels expected earlier in the year, according to Fluid Milk & Cream Review. Normally, milk would be building higher at this time, but the weak dairy economy is limiting the gains via more cows being culled and feed rations being adjusted to minimize cost. The same is true in Arizona, where they are in the middle of their seasonal flush, but at levels steady from a year ago. Output in NM is higher than a year ago, but the fat content of incoming milk is often below expectations, resulting in lower finished product yields. Increased demand for higher classed products is developing for both seasonal and economic reasons.
- Volumes reported at the monthly heifer auction in the Pacific Northwest have been sharply lower than last year for the past three months, according to Fluid Milk & Cream Review. Supreme heifers ranged from \$1,200 to \$1,400, which is lower than during the summer of 2003. The heifer supply is large, yet volumes have been down at sales barns all over the West, leading some to wonder where they are going.
- Dairy Market News reports in the Eastern region, some butter manufacturers are retaining all internal cream and buying additional cream because they believe there is more upside to butter. Other manufacturers are not convinced, but butter sales have been strong lately, in part to its increasingly favorable price compared with margarine. Easter and Passover orders are also driving production, with increased orders drawing cream from as far away as the West to the East.
- Cream availability is tightening in the Central region, according to Dairy Market News. Some butter operations are ceasing churning at midweek due to lack of cream, which is the first lull in production this year. Increased demand from Class II operations producing sour cream, cream cheese and other cream based Easter/Passover items is heavy, further tightening cream availability. Orders for these types of holiday items seem to be heavier this year

Futures Month	Friday 03/13 Close	Friday 03/06 Close	Change
Mar-09	\$10.31	\$10.22	\$0.09
Apr-09	\$10.87	\$10.73	\$0.14
May-09	\$11.07	\$11.08	(\$0.01)
Jun-09	\$11.86	\$11.72	\$0.14
Jul-09	\$12.99	\$12.79	\$0.20
Aug-09	\$13.96	\$13.66	\$0.30
Sep-09	\$14.47	\$14.14	\$0.33
Oct-09	\$14.80	\$14.42	\$0.38
Nov-09	\$14.98	\$14.71	\$0.27
Dec-09	\$15.05	\$14.74	\$0.31
Jan-10	\$15.09	\$14.84	\$0.25
Feb-10	\$15.09	\$14.87	\$0.22
Mar-10	\$15.05	\$14.86	\$0.19
Apr-10	\$15.10	\$14.96	\$0.14
May-10	\$15.10	\$14.95	\$0.15
Jun-10	\$15.15	\$14.90	\$0.25
Mar-Dec	\$13.04	\$12.82	\$0.22
Q1Q2 2010	\$15.08	\$14.86	\$0.22

versus other years. Food service orders are lighter this year than last, but retail butter orders are good, as lower shelf prices and ad features are clearing good volumes.

- Dry whey prices are firming in the Central region, according to Dairy Market News. Some shortages in availability are occurring, as a few buyers have stepped up the number of monthly loads being taken.
- Western dry whey prices are beginning to increase at a faster rate, according to Dairy Market News. Buyers are more aggressive in searching for powder, thus offerings are lower. Demand from both domestic and international buyers is noted, allowing producers to sell powder out a few weeks into the future.
- Even the nonfat dry milk market is showing signs of life. Dairy Market News reports prices are firming, as sellers have discovered that prices did not need to be at the support level to clear. Export interest is light, but domestic demand is decent. Stocks are getting lighter, and some balancing plants report being somewhat short on low and medium heat nonfat dry milk.
- Retail cheese sales out West are excellent and food service movement is not as bad as was thought, according to Dairy Market News. As cheese prices increased on the cash exchange this week, Western buyers are again aggressively looking for additional loads of cheese. Cheese production is increasing in areas where milk supplies are growing seasonally, but a lot of areas have not seen much increase in milk receipts as heavy culling rates and cheaper rations are limiting cheese production ability.
- January fluid milk sales were up 0.3% compared to a 2008, according to USDA. The long-term trend has been for declining fluid milk consumption, so the increase is a bright spot, and may be the result of families eating out less.
- Economy: Both the S&P and Nasdaq were up more than 10% for the week, as U.S. stocks closed their strongest week in nearly four months. Upbeat forecasts from banks helped power a four-day rally. Consumer sentiment also improved slightly in March, and consumer spending in February was slightly above expectations. Finally, the U.S. trade deficit in January fell to its lowest level six years. While U.S. exports fell sharply, imports fell at an even faster rate as a deepening recession cut demand for goods from abroad.

What's Bearish:

- Butter stocks at CME-approved warehouses increased 5.7 million lbs for the week ending 02/28. A year ago, only 604,000 lbs were added to inventory.
- 200 loads of Grad A milk were exported from Florida this week, according to Fluid Milk & Cream Review. That's down 3 loads from last week, but up 136 loads from a year ago.
- Interest for current cheese in the Midwest appears to be slow in developing, according to Dairy Market News. Bulk buyers are finding supplies to be more available or lead times shorter as new orders have often been lighter. Milk receipts remain above a year ago, keeping plants operating on longer schedules than in 2008.

Recommendation:

On the face of it, this report looks bullish. Sound familiar? But this time, we will call it bullish. Last week we wrote about the growing sense that financial hardship could bring supply and demand into balance more quickly than anticipated. That mindset appeared to drive the market higher this week. Most of the gains came in the second half of the year, but even the front months were mostly higher, with the April contract up 52¢ at one point during trading today. Those that are short the market must have a certain amount of fear, if not panic, at how quickly prices moved higher. And in fact, they may have been the stimulus behind the move higher as they exited positions due to the market moving against them. In the cash market, buyers took control. After several weeks of high volume sessions, sellers appear to have run out of bullets, at least in the short term. Buyers had little trouble moving prices higher. Last week, cheese prices worked out to about \$10.20 milk; this week, \$11.05, an 85¢ increase. If cheese prices keep moving up next week, April will move even higher to catch up to the cash price. It's pretty incredible to read about the powder markets firming, after pushing nonfat dry milk to the gov't support price and dry whey in the low teens. Keep these products on your radar, as dry whey started moving higher a couple weeks ago, and saw significant trade volume this week in its futures contract. March dry whey futures are at 15¾¢, but August has jumped up to 26¼¢. With each penny increase in dry whey increasing the milk price 6¢, August Class III milk currently gets more than a 60¢/cwt boost on that alone. And while we don't think dry whey will be making a run back up to 78¢, it could still head higher from current levels. So what's driving all this? We think milk production is getting hurt more quickly than thought. We've heard tough stories of producers selling off parts of their herd to pay feed bills and pregnant cows going to slaughter. It really is that bad out there. Because milk checks still won't recover within the next month or two, we could see a significant number of dairies out of business in a short period. That could cause milk prices to run significantly higher, especially in the second half of the year and into 2010. So, if you are aggressive, have higher risk tolerance and are well capitalized, we would consider lifting your current profitable hedges if you are able. If you have milk locked in on forward contracts, you MUST try to get call options purchased for the second half of the year. At this time we would not advise selling any milk in any month. By PUT options for unsold milk Apr-Jun.

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