

**The KDM Dairy Report – March 27<sup>th</sup>, 2009**

**What's Bullish:**

- CWT should be announcing some type of process to use their dollars to kill cows. But from what I know all is quiet.
- Continued higher grain prices should spark recovery in milk prices. Hearing stories of dairies not able to pay for grain.
- European Union intervention program has removed large quantities of butter and nonfat dry milk from the market.
- Some balancing plants are comfortably below capacity, citing continuing heavy diversion of milk for cheese production and varied Class II uses. Other balancing plants report heavy intakes attributed to abrupt but temporary reductions in ice cream production, coupled with weak fluid milk sales. (Fluid Milk and Cream Review – East)
- Recent fluid promotions have reduced milk volumes manufactured at some plants and helped keep inventories from accumulating significantly at the plant level. Cheese yields continue to drift lower seasonally. Wisconsin cheese plant reports milk components are down more than normal requiring more milk to make a lb of cheese.
- Barrels seem to be still in a tighter position than most natural varieties as process orders pick up seasonally for warmer weather. Quick serve food service orders remain generally good. (Midwest cheese report)
- Weekly cold storage holdings at USDA selected storage centers report cheese stocks down 1% from March 1<sup>st</sup> (104,802) to March 23<sup>rd</sup> (104,200).
- Some milk plants in California reporting short milk and taking base requirements off.
- At a time when milk is usually increasing, plant intakes are flat. Additionally, solids levels are at lower levels than normal. Low milk prices and relatively high feed costs are working against producers in the current financial environment. (Fluid Milk and Cream Review – West)
- Cow slaughter numbers for the week ending 3/14 were 54,100 vs. 51,600 last year. Running 5% higher than normal.
- Futures for the week reached new highs in several months on who knows what; CWT, cash cheese, banks non-renewal of loans, high grain prices, all of the above!
- Strong competition among plants in the Midwest to get new producers to ship milk to them; sometimes two or three plants in the running to get the milk.
- Fluid milk prices in the retail stores as low as 99¢ a gallon; a recent Costco visited - 2 gallons for \$3.25.
- Butter producers and handlers state that butter sales have been very good this reason. Butter prices that are about 20 cents lower than last year at this time are a contributing factor to good butter demand.
- Weekly NASS numbers came in at block cheese \$1.22 a slight decrease from the previous week of \$ 0.1 cents per pound. Barrels averaged \$1.28, up 4.6 cents from the previous week. Whey price increased 0.9 cents from the previous week to 17.4 cents. Butter average is \$1.16 an increase of 2.4 cents from the previous week and NFDM averaged \$0.82, an increase of 0.3 cents per pound. Cheese and whey prices reflect a Class III milk price of \$10.62 and a Class IV price of \$10.07.
- The trend is your friend.

Futures Month	Friday 03/27 Close	Friday 03/20 Close	Change	5-yr Average	Top 3rd Price
Mar-09	\$10.46	\$10.51	(\$0.05)	\$14.55	\$15.28
Apr-09	\$11.72	\$11.41	\$0.31	\$15.61	\$16.83
May-09	\$12.74	\$11.96	\$0.78	\$16.19	\$17.54
Jun-09	\$13.77	\$12.68	\$1.09	\$16.65	\$17.74
Jul-09	\$14.85	\$13.78	\$1.07	\$15.95	\$16.86
Aug-09	\$15.75	\$14.91	\$0.84	\$15.17	\$16.11
Sep-09	\$16.20	\$15.47	\$0.73	\$15.53	\$16.42
Oct-09	\$16.45	\$15.94	\$0.51	\$15.32	\$16.11
Nov-09	\$16.40	\$16.10	\$0.30	\$15.16	\$16.14
Dec-09	\$16.37	\$16.05	\$0.32	\$15.77	\$16.86
Jan-10	\$16.15	\$15.90	\$0.25	\$14.24	\$15.08
Feb-10	\$15.99	\$15.50	\$0.49	\$13.48	\$14.17
Mar-10	\$15.75	\$15.55	\$0.20	\$14.55	\$15.28
Apr-10	\$15.75	\$15.57	\$0.18	\$15.61	\$16.83
May-10	\$15.80	\$15.55	\$0.25	\$16.19	\$17.54
Jun-10	\$15.75	\$15.55	\$0.20	\$16.65	\$17.74
<b>Mar-Dec</b>	<b>\$14.47</b>	<b>\$13.88</b>	<b>\$0.59</b>		
<b>Q1Q2 2010</b>	<b>\$15.96</b>	<b>\$15.65</b>	<b>\$0.31</b>		

**What's Bearish?**

- International sales of dairy products: One side-effect of the downturn in milk product sales internationally is that buyers are unable to get credit. "The dairy export prices have overshot the mark. They've gone lower than they needed to", an analyst says. There is some evidence buyers are coming back into the market. "We're hopeful that the market is going to turn around. In a falling market people are going to delay buying, for obvious reasons, but I think we're hearing that part of the problem is that regular buyers can't get credit."
- Midwest dairies continue with expansion plans, construction costs are down and cows are cheap.
- Some producers on interest only payments banks are reluctant to throw in the towel just yet. Dairy men are just starting to meet with their bankers about spring operating loans. Many are looking positively at the end of 2009 Class III milk prices as a reason to keep going forward. (Fluid Milk and Cream Review – West)

- Milk intakes are generally steady to slightly higher seasonally. Some comments from the field have some producers selling the herd while others are expanding to keep cash flow higher despite the current low milk prices. Fat and protein tests are easing lower seasonally. (Fluid Milk and Cream Review – Central)
- USDA's plan for the 200 mil lbs of dry milk powder will be used for the school lunch programs in various swaps for other dairy products. 1 million lbs for use by the Agency for International Development. Their goal is this will help the dairy producers, but I fear it will do the opposite, replacing product we already are selling to schools.
- Potential herd reduction efforts seen as a significant factor that will drive prices during the balance of the year. This one factor may be the reason for buying and storing a variety of dairy products.
- Grain has seen a good bit of selling by the producer into the March market rally. Prices on the farm hit \$4.00 for corn and \$9.00 for beans. Rains in the major wheat growing areas could drive Chicago prices down to \$4.90 this spring.
- When Starbucks announced last year that it was closing 600 U.S. stores, the Inland Empire was home to a quarter of the 88 California outlets on the hit list. And the final count could be even higher than that when Starbucks identifies an additional 200 U.S. cafes slated for closure. (Reuters)
- Cancelation of grain orders taking a toll on Idaho elevator feed mills. People are not paying or cant pay for grain.

### **Recommendation:**

Wild week in the dairy markets closing at new highs in Class III milk. Have we overdone the prices to the upside? They seem not to be influenced by other markets as Friday was a down day for grains and the stock market. Loads of cheese both blocks and barrels traded in significant volume each day. For the week we are up 1 cent in blocks on a volume of 34 loads and up 1.25 cents on a volume of 39 loads for barrels. Multiple buyers and one seller; how much extra cheese does the seller have? And why not buy at these levels? It's a bargain compared to last year. For some in the industry, these are desperate times. Futures seem to be anticipating a dramatic turnaround.

On a conservative hedge, buy September to December 14.50 puts at 40 cents. Sit back and wait. We believe an opportunity to buy higher level puts will be there down the road.

If you have calls that you have bought for the purpose of selling your milk, and they are in the money you should reward the market and sell into those calls.

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