

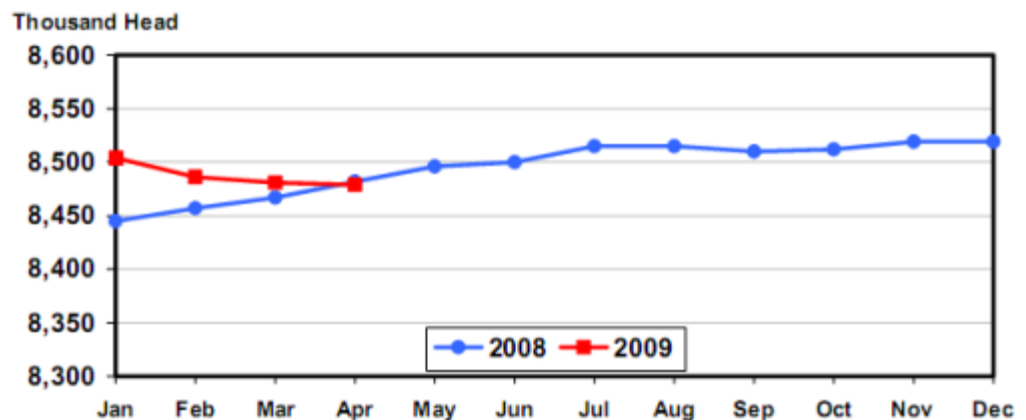
**The KDM Dairy Report – May 22<sup>nd</sup>, 2009**

**What's Bullish:**

- Livestock, Dairy & Poultry Outlook Report: USDA forecasts high feed prices and low milk prices will force the dairy herd size to contract 1.5% in 2009 and 2.5% in 2010, leaving 8.95 million cows in the milking herd. Production per cow is expected to remain weak due to high feed costs and financial stress. While milk prices are expected to stay low for most of 2009, a substantial recovery is expected in 2010.
- NASS butter and powder prices were higher again this week. Butter increased 1.7¢ from last week to average \$1.22/lb, nonfat dry milk gained 0.7¢ to 83¢/lb and dry whey was up 0.5¢ to 23½¢/lb.
- The weekly dairy cow slaughter hit its highest level in 6 weeks. 50,500 head were culled during the week ending 05/09, up from 46,300 head during the same period a year ago.
- Fluid Milk & Cream Review reports milk output in California is steady to lower, and below year ago levels. The upcoming holiday weekend is not expected to create as many problems as in years past. In Arizona, heat is impacting production, and processing plants have been able to scale back on production schedules as milk intakes decline. Same is true in the Pacific Northwest. Dairy plants in the region are not expecting any problems in handling milk supplies over the weekend.
- Western dry whey prices continued to slowly increase this week, according to Dairy Market News. Demand from both domestic and export accounts are strong enough that any offerings are easily cleared. A number of buyers are facing delivery delays, despite powder production nearing the seasonal peak. Inventories are tight to nonexistent.
- Crude oil and grains were both up this week. A sustained rally will affect milk futures, just like it did when prices in these two groups fell from record highs. Also, the U.S. dollar fell to a new annual low against the Euro, which could help the export market.
- Economy: Mass layoff actions by U.S. employers fell sharply in April, according to the Labor Department. Job cuts involving at least 50 employees fell by 221 from the prior month. In addition, 539,000 jobs were lost in April. While not good, it was the smallest number since October.

Futures Month	Friday 05/22 Close	Friday 05/15 Close	Change
May-09	\$9.82	\$9.83	(\$0.01)
Jun-09	\$10.12	\$10.32	(\$0.20)
Jul-09	\$11.02	\$11.85	(\$0.83)
Aug-09	\$12.39	\$13.29	(\$0.90)
Sep-09	\$13.62	\$14.15	(\$0.53)
Oct-09	\$14.25	\$14.72	(\$0.47)
Nov-09	\$14.61	\$14.91	(\$0.30)
Dec-09	\$14.76	\$14.99	(\$0.23)
Jan-10	\$14.85	\$15.11	(\$0.26)
Feb-10	\$14.69	\$15.05	(\$0.36)
Mar-10	\$15.10	\$15.36	(\$0.26)
Apr-10	\$15.45	\$15.57	(\$0.12)
May-10	\$15.50	\$15.67	(\$0.17)
Jun-10	\$15.75	\$15.86	(\$0.11)
Jun-Dec	\$12.97	\$13.46	(\$0.49)
Q1Q2 2010	\$14.88	\$15.17	(\$0.29)

**Monthly Milk Cows  
23 States**



**What's Bearish:**

- Cash Market: Blocks managed another small gain this week, but it took buyers 26 loads to move the price up ¾¢. Blocks settled at \$1.14/lb. Barrels remain unchanged from a week ago at \$1.08/lb on 16 trades. The upward move in butter was also halted, as butter settled unchanged for the week at \$1.26½/lb with fairly active trading of 23 cars.
- Milk Production Report: April milk production in the 23 major states was up an unexpected 0.1% compared to a year ago. Most analysts had expected a decline. For all 50 states, production did decline, but only by 0.1%. In addition, March production was revised 47 million lbs higher, bringing output up 0.3% instead of down 0.3% as originally reported last month. Milk per cow increased 3 lbs, but the number of cows did drop 23,000 head.
- Cold Storage Report: American cheese stocks in April were 8% higher than a year ago and 4% higher than in March. Total cheese stocks were 7% and 2% higher over the same time periods. Butter stocks were down 3% vs. 2008, but up 14% from March.
- Livestock Slaughter Report: Monthly dairy cow slaughter fell behind year ago levels for the first time this year. Just 215,100 dairy cows exited the herd in April, compared to 219,100 during the same month in 2008. Farmers were likely holding off during the CWT bidding process.

- NASS surveyed cheese prices continued to fall this week, in order to catch up to the cash market. 40-lb blocks lost 1.4¢ from last week to average \$1.17/lb, and 500-lb barrels fell 0.6¢ to \$1.11/lb.
- Weekly cold storage numbers from USDA indicate cheese stocks are building in May. For the period 05/01 through 05/18, cheese holdings at USDA selected storage centers increased 5.2 million lbs, or 5%.
- Drying plants in the Northeast are running at or very near capacity, with surplus milk from the upcoming holiday weekend likely to bring challenges, according to Fluid Milk & Cream Review. Milk is at or near peak levels in the region, with some milk tankers being backed up for a number of hours at some plants. Compounding issues, most schools in the Southeast have ended classes, further reducing outlets for fluid milk. Cheese production is heavy in the region to accommodate the excess milk. Florida exported 215 loads of Grade A milk this week, up from 213 last week and just 81 a year ago. Retail sales of milk are called "poor".
- Milk production in the Midwest is also trending towards the seasonal peak, with most milk handlers stating there is a lot of milk out there. Fluid Milk & Cream Review reports the overall milk supply exceeds needs, and surplus volumes will be looking for a home over the holiday weekend. Spot loads of milk were running 50¢/cwt above class, but by the weekend had dropped to \$4-5/cwt under class. Manufacturing facilities are running near capacity levels and will not be able to absorb any more.
- Heavy milk production and low milk prices are causing many cheese plants in the Northeast to maintain heavy production schedules, according to Dairy Market News. In fact, some auxiliary cheese plants, normally idle, have been pressed into service to help move milk intakes.
- Dairy Market News reports Midwest cheese buyers have been taking advantage of the current low cheese prices to build working inventory. Contacts report large supplies are already in storage. Bulk buyers are able to acquire needed volumes with little difficulty, while more milk is available for manufacturing now that schools are closing for the summer. Most cheese plants are running on heavy schedules to handle extra milk offering available over the holiday weekend, and most traders feel that the recent CWT cow slaughter result is insufficient to make a sizeable impact in production.
- Western cheese traders continue to wonder whether any cheese will end up in the government price support program, according to Dairy Market News. Sales activity has been good, but there is plenty of cheese available for current interest.
- International: Cheddar cheese output in Australia was up 2.4% in March vs. a year ago, and is up 9.1% YTD, according to Dairy Australia figures. Butter production was up 11.6% and 15.6% over the same periods.

### **Recommendation:**

This week we got a bearish Milk Production Report, bearish Cold Storage Report, bearish Livestock Slaughter Report and a lackluster cash cheese market. It appears one affect of the long CWT bid process which ended May 1<sup>st</sup> was that producers hung on to their animals during the month of April, waiting to see if their bids were accepted. This resulted in a lot of milk being produced in April, fewer cows being culled and lots of cheese being made. The net affect is that it looks like our price recovery has been pushed back several months; it will take months for CWT to complete the current round's slaughter. We have growing concern as well, that the sheer volume of cheese being stashed away in cold storage at these low cheese prices (re: the uptick in cold storage), may end up limiting future gains in the cheese price this fall. Traders are appearing to recognize this too as July and August futures were hit the hardest this week due to their juicy premium to the cash market, which is sitting at an equivalent Class III price of about \$9.68/cwt. There are a few positives. Those dairies that did not make it into the CWT program and that are hemorrhaging cash, may be shut down over the next couple months by banks. However, banks have been surprisingly patient so far. We're also seeing some signs of life in the economy. Finally, while potentially harmful longer term, the weak dollar could help the dairy export market begin to recover, as well as fuel commodity inflation. Like it or not, there is a strong correlation with crude oil and milk. When we had \$140/barrel crude, we also had very high grain and milk prices. After crude crashed, so did grain and milk. So, we need to watch crude closely. If it heads towards \$80/barrel or higher, it's likely milk will eventually follow. Near term, it doesn't look like cheese has much upside, so July-Sep remain particularly vulnerable due to their premium to the cash market. If the front months keep grinding lower, we'd also expect Oct-Dec to head lower as producers will look to sell anything with a \$14 or \$15 in front of it. As we stated in the last few weeks, aggressive hedgers should consider selling these months, with the intention of buying them back early, or quickly closing these positions if the market starts heading higher. Much longer term, prices will have to move higher as the current low prices are unsustainable. We would not sell milk into 2010, tempting as \$15 may be.

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