

The KDM Dairy Report – June 12th, 2009

What's Bullish:

- World Ag Supply & Demand Report: USDA reduced their milk production forecasts for both 2009 and 2010 due to higher feed costs and contraction in cow numbers. They also predict exports of skim-solids will be higher as global dairy product supplies tighten and the U.S. dollar weakens. As a result, they increased their 2010 Class III milk price forecast from \$14.30/cwt last month, up to \$14.80/cwt.
- Continued financial strain and the CWT program are resulting in milk processors seeing less milk, according to Fluid Milk & Cream Review. The same is true in Arizona, where loss of milk is noticeable, despite moderate temperatures. In New Mexico, components are lower for fat and protein, which is negatively affecting yields. Demand for ice cream is moving higher as summer gets into full swing.
- For the first time in many weeks, cheese prices in the weekly NASS price survey were higher. 40-lb blocks averaged \$1.14/lb, up slightly from last week, and 500-lb barrels increased 1.1¢ to \$1.11/lb. Butter fell 2.4¢ to average \$1.23/lb and nonfat dry milk slipped 0.5¢ to 84¢/lb, but dry whey was up a solid 1.9¢ to 26.4¢/lb.
- 48,800 dairy cows were culled during the week ending 05/30, up 10,000 head from a year ago, according to weekly slaughter statistics. It appears the first CWT cows are being removed from the milking herd.
- Central dry whey supplies are very tight, according to Dairy Market News. Central loads continue to move West as buyers search for available product. In the Eastern region, some contract deliveries have been delayed due to production issues and tight supplies.
- Dairy Market News reports Western dry whey stocks are very tight as well. Prices continue to firm as available product dwindles. Dry whey exports for Q1 2009 are up 18.7%, according to the Foreign Ag Service.
- Economy: U.S. consumer confidence rose to a 9-month high in June, according to the well-known monthly survey. This marks the third month in a row in increasing confidence. In addition, retail sales rose in May for the first time in 3 months.

Futures Month	Friday 06/12 Close	Friday 06/05 Close	Change
Jun-09	\$9.91	\$9.89	\$0.02
Jul-09	\$10.45	\$10.65	(\$0.20)
Aug-09	\$11.30	\$11.57	(\$0.27)
Sep-09	\$12.43	\$12.85	(\$0.42)
Oct-09	\$13.31	\$13.60	(\$0.29)
Nov-09	\$13.84	\$14.16	(\$0.32)
Dec-09	\$14.11	\$14.39	(\$0.28)
Jan-10	\$14.25	\$14.55	(\$0.30)
Feb-10	\$14.20	\$14.60	(\$0.40)
Mar-10	\$14.76	\$15.05	(\$0.29)
Apr-10	\$14.87	\$15.05	(\$0.18)
May-10	\$15.04	\$15.20	(\$0.16)
Jun-10	\$15.43	\$15.66	(\$0.23)
Jul-10	\$15.70	\$15.80	(\$0.10)
Aug-10	\$15.73	\$15.82	(\$0.09)
Sep-10	\$15.79	\$15.80	(\$0.01)
Oct-10	\$15.62	\$15.68	(\$0.06)
Nov-10	\$15.80	\$15.85	(\$0.05)
Dec-10	\$15.77	\$15.80	(\$0.03)
Jun-Dec	\$12.19	\$12.44	(\$0.25)
2010	\$15.25	\$15.41	(\$0.16)

What's Bearish:

- Cash Market: Blocks managed to gain ¼¢ for the week to settle at \$1.15/lb, but barrels fell ¾¢ to close at \$1.09¼/lb. Trade volume was light with 16 blocks and 9 barrels exchanging hands. Butter lost the most, down 2½¢ to settle at \$1.22¾/lb on fairly active trading of 25 cars.
- Dairy Market News report the cheese market in the Midwest remains weak and under pressure, as heavy milk supplies are keeping cheese plants running hard. Many in the industry don't expect a significant price breakout until after milk supplies decline significantly. Offerings of cheddar are more than adequate for the spotty interest, and mozzarella demand is lighter as schools and colleges have closed for the summer. Overall cheese interest is lighter as some firms have cut back on purchases due to volumes already in storage. Plant operators with additional capacity are easily able to acquire extra milk at significant discounts.
- Western cheese buyers have the coverage that they desire for both the short and medium term, according to Dairy Market News. They have rebuilt aging programs that had gone dormant with the high prices of the past few years, but now have little interest in additional purchases. Cheese production remains heavy and is expected to remain that way through the spring flush.
- The Foreign Ag Service reports that cheese exports for Q1 2009 were down 28.8% vs. last year.
- Fluid Milk & Cream Review reports milk production in the Eastern region of the country has lessened somewhat from last week, but still remains sustained at heavy levels. Despite much warmer weather in the Southeast, a decline in fluid demand resulted in 244 loads of milk being shipped out of Florida, up from 238 last week and 227 a year ago.
- The last remaining schools in the Central region have closed, leaving Class I demand softer, according to Fluid Milk & Cream Review. Milk supplies remain heavy, with cheese plants unwilling to purchase additional milk volumes due to sluggish cheese sales and ample milk supplies of their own. Spot milk prices range from about flat to \$2.50 under class.

- Offerings of bulk butter are heavy and buyer interest is lighter, according to Dairy Market News. Buyers are satisfied with their current level of inventories, so are more likely to add purchases only at lower prices. Food service orders for the summer vacation season have increased, but trail expectations.
- It's still early days in June, but USDA's weekly cold storage holdings report shows butter stocks increased 10% and cheese stocks increased 1% over the first eight days of the month.
- Butter stocks at CME-approved warehouses increased 2.8 million lbs for the week ending June 6th. During the same period last year, stocks decreased 5 million lbs.
- International: Milk production is building in Western Europe as weather has been conducive. The Euro has been stronger, working against export opportunities, but last week the EU Management Committee increased most export subsidies. In Eastern Europe, there are reports that milk output in Poland is 9% higher than a year ago.

Recommendation:

Class III futures took another hit this week as the cash cheese market was lackluster. With plenty of product floating around the country, bids each day were light and usually immediately hit by sellers. There doesn't seem to be an interest in moving the price any lower, but by the same token, bidders are unable to get it higher either. So, we sit at \$9.90 milk for another week, with July beginning its pricing on Monday. It's currently holding a 50¢ premium to the cash price so is vulnerable if cheese prices stay where they are. We wrote about the economic storm for America's dairies moving from West to East. This week we heard more tough stories coming out of the Midwest and East. We've also heard that banks are

starting to be more aggressive and sending letters to operations that they'll need to find alternative financing within 30 days. This could finally be the start of some major liquidating in the business and get us back on the road to recovery. We've written the past couple weeks that the next 60 days will be critical in determining who will survive and who won't. Short term, prices could still be under pressure due to weak fundamentals, but we wouldn't be surprised to see some support show up in the deferred months. Prices just can't stay this unprofitable into 2010 (one should never say "can't" in this biz, but we'll say it anyway). The milk supply is already contracting in the West, and we need to remember that California alone represents about 25% of the nation's milk. Give us some heat in the Midwest and East and milk production could drop rather quickly. At this point, we would hold off selling any more milk Oct '09 on out, and would encourage hedgers who've already sold to aggressively purchase call options to protect their positions against a rally. When all hope is lost and things look the bleakest, is usually when things start to turn around. Our "bold" prediction is that come the last day in August, Class III prices from Oct '09 on out will be higher than they are now. Near term, July-Sep, we would stick with the PUT option strategy to guard against lower prices.

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