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The KDM Dairy Report – June 19th, 2009

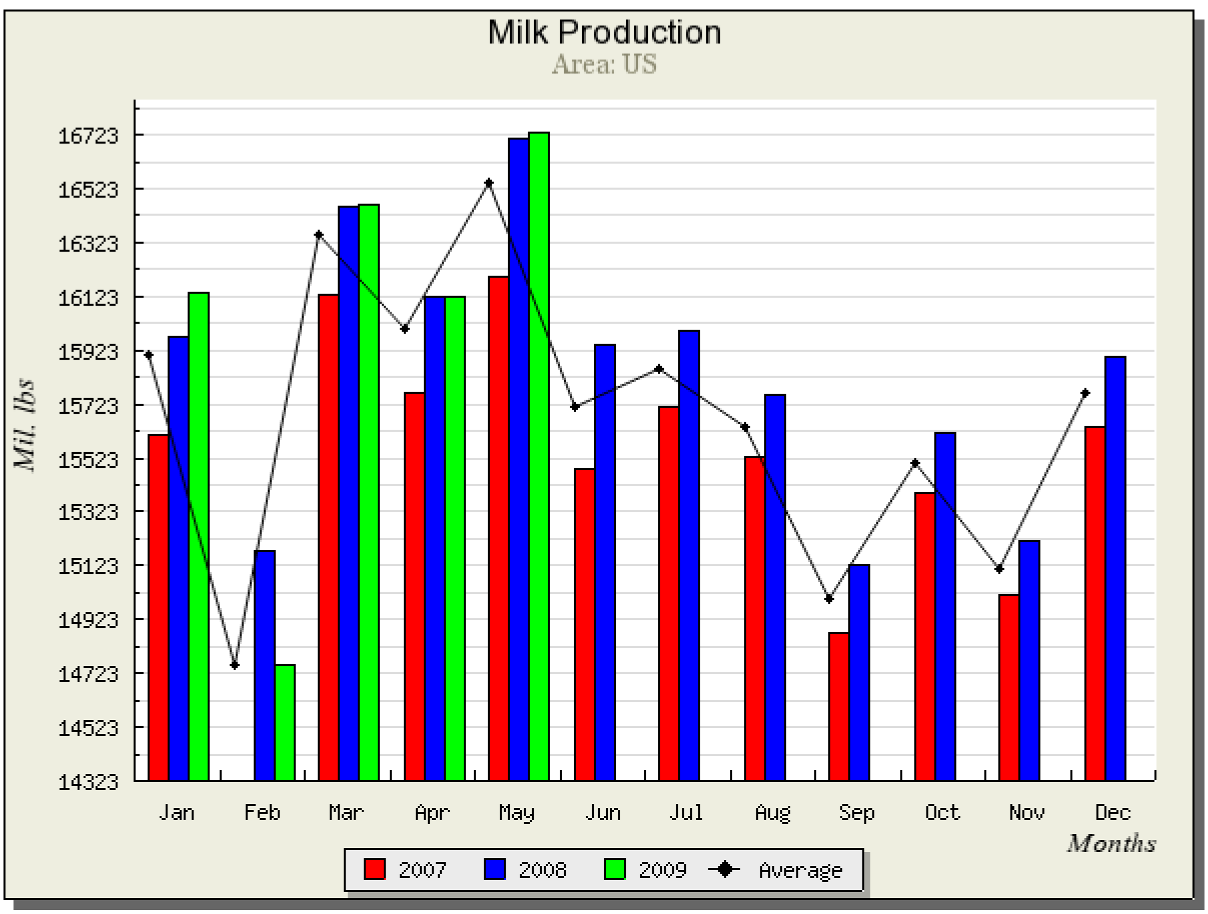
What's Bullish:

Futures Month	Friday 06/19 Close	Friday 06/12 Close	Change
Jun-09	$9.93	$9.91	$0.02
Jul-09	$10.01	$10.45	($0.44)
Aug-09	$10.55	$11.30	($0.75)
Sep-09	$11.50	$12.43	($0.93)
Oct-09	$12.45	$13.31	($0.86)
Nov-09	$13.20	$13.84	($0.64)
Dec-09	$13.52	$14.11	($0.59)
Jan-10	$13.60	$14.25	($0.65)
Feb-10	$13.62	$14.20	($0.58)
Mar-10	$14.11	$14.76	($0.65)
Apr-10	$14.48	$14.87	($0.39)
May-10	$14.70	$15.04	($0.34)
Jun-10	$15.20	$15.43	($0.23)
Jul-10	$15.32	$15.70	($0.38)
Aug-10	$15.35	$15.73	($0.38)
Sep-10	$15.45	$15.79	($0.34)
Oct-10	$15.20	$15.62	($0.42)
Nov-10	$15.35	$15.80	($0.45)
Dec-10	$15.53	$15.77	($0.24)
Jun-Dec	**$11.59**	**$12.19**	**($0.60)**
2010	**$14.83**	**$15.25**	**($0.42)**

- NASS cheese prices were up again this week. 40-lb blocks averaged $1.15/lb, up 0.5¢ from last week's survey, while 500-lb barrels jumped 1.5¢ to average $1.12/lb. Butter fell 1.7¢ to average $1.21/lb, but nonfat dry milk increased 1.3¢ to 85¢/lb and dry whey gained 0.4¢ to 26.7¢/lb.
- Dairy cow slaughter for the week ending 06/06 was the highest in 3 months. 60,800 head were culled, a likely result of the start of CWT herd retirement program. A year ago, 45,100 head were removed.
- Class I sales in the Central region are lighter but at very good summer levels, according to Fluid Milk & Cream Review. Lower prices are moving most dairy products at higher levels than in recent years. Demand for whipped cream is strong and movement of ice cream is good.
- Fluid Milk & Cream Review reports California milk output is trending lower as it reacts to low milk prices, high feed costs, seasonal declines and fewer cows. Processing plants are able to keep pace with current milk supplies with no stress. Arizona output is also lower, despite temperatures that have moderated over the past two weeks. In parts of the Pacific Northwest, continued wet weather is impacting the hay harvest. Hay that has been cut is in very poor condition, while hay not cut is maturing and losing quality.
- More cream movement into ice cream accounts is causing churning activity to trend lower in the Western region, according to Dairy Market News. Some butter producers in the Eastern region are indicating that competition from Class II operations for cream is getting more aggressive.
- Export interest for Western dry whey is still occurring, even as prices increase, according to Dairy Market News. There has been some pushback as the market moves past 30¢, but buyers for food accounts are often aggressive and willing to pay premiums to secure additional loads.

What's Bearish:

- Milk Production Report: U.S. milk production in May hit a record high 16.73 billion lbs, up 0.1% vs. a year ago. Expectations were for a decrease from last year. Despite cow numbers falling 11,000 head from April, improvement in production per cow to a record high 58.2 lbs accounted for the additional milk. For all 50 states, cow numbers in May were 43,000 fewer than in 2008.
- Cash Market: Blocks dropped to their lowest price of the year in the spot market, settling at



$1.11¾/lb, a loss of 3¾¢ for the week. Barrels also made new lows, falling to $1.07/lb, down 2¼¢. Trading picked up with 29 loads of blocks and 12 barrels exchanging hands. Butter fell 2¼¢ to settle at $1.20½/lb on 21 trades.

- Milk volumes are still holding at peak levels in the Eastern region of the U.S., according to Fluid Milk & Cream Review. Weather conditions are starting to impact production in the southernmost areas, but in the North, warm days and cool evenings are aiding the milk flow. Balancing plants are active, and some are maxed out. Florida milk output continues to surpass needs, with 240 loads shipped out, compared to 178 a year ago.
- Fluid Milk & Cream Review reports extra manufacturing milk supplies are still available at a discount in the Central region. Milk receipts at most plants have peaked, but intakes have only declined minimally and seem to be holding. Weather has been ideal for milk production, and significant expansions in the southern part of the region, particularly Texas, have held overall plant intakes up surprisingly well, despite financial stress.
- Weekly cold storage numbers are showing cheese stocks at USDA selected storage centers up 3% for the period 06/01 through 06/15. Butter stocks declined 5% over the same period.
- Butter stocks at CME-approved warehouses are still on the increase. 1.5 million lbs were added to storage, compared to a drawdown of 5.7 million lbs during the same period last year.
- Cream supplies are still readily available to Eastern butter makers, and churning activity is still very strong, according to Dairy Market News. Demand is seasonally fair, but orders appear to have been impacted by current economic conditions.
- Nonfat dry milk continues to clear to the support program and buying interest is light, according to Dairy Market News. Both domestic and export sales remain slow.
- Cheese production in the Northeast remains very active, according to Dairy Market News. Current milk intakes near peak levels and a reduction in fluid use due to the closing of schools are keeping plants running on very heavy schedules. Cool, wet weather has hampered cheese demand at many summer vacation destinations, leaving current offerings readily available for sale.
- In the Midwest, current cheese offerings exceed current interest, according to Dairy Market News. Buyers are able to acquire regular cheese varieties with minimal effort. Cheese is available for current use, with some going into storage. Lead times on specialty orders are normal, while process interest is uneven, with some lines operating on less than 40 hour schedules. Plants continue to run on extended schedules to handle available milk, with intakes holding near peak levels.
- Dairy Market News reports active cheese making in the Western region. There are ample milk supplies for all needs, with additional spot offerings of milk and condensed skim being made to cheese producers. Offerings of cheddar blocks are variable, with some in balanced positions, while others are having poor sales and have holdings. Under grade cheddar remains available.

Recommendation:

We tip our hat to dairy producers; the Milk Production Report was a surprise. Despite starting 2009 with $10.78 milk in January, the high for the year, five months later they put out more milk in May than in any prior month in history… ever. Despite cow numbers falling 11,000 head from April to May, and 43,000 fewer cows than a year ago, milk per cow increased, accounting for the record production. The report had a chilling effect on futures, as the realization that we haven't even begun correcting the supply side of the equation hit home. Selling started out slow on Friday, but near the end of the session, futures were hit hard with some 2010 contracts trading at -70 for brief period. Bids came back quickly enough, but futures still finished solidly in the red. All we can say is the lower prices go now, the shorter they'll be here. Financial stress is really hitting hard now all over the country, but the banks hold the keys, and until they start admitting they have non-performing loan portfolios and halt the flow of credit, we may extend low prices longer than thought. That does not mean we think you should sell any 2010 milk, we don't, but we're going to have to be mentally tough and prepared to watch prices go lower before they recover. When this market finally does decide to turn, we predict it will be fast and violent, as there will be no sellers on the other side. Continue to buy call options to protect your sold positions.