

The KDM Dairy Report – June 26th, 2009

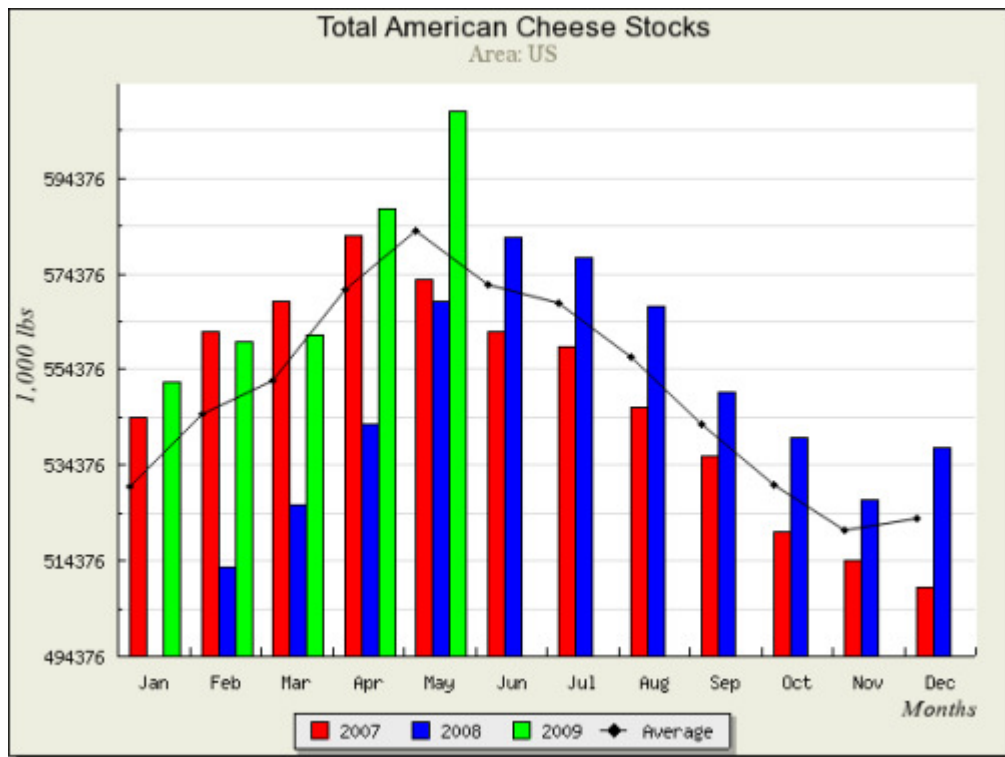
What's Bullish:

- Cash Market: For the week, blocks picked up a ¼¢ on fairly active trading to settle at \$1.12/lb, while barrels gained 2¢ to reach \$1.09/lb. 28 loads of blocks and 9 barrels exchanged hands. It was a stalemate in butter as it closed the week unchanged at \$1.20½/lb on active trading of 29 loads.
- Livestock Slaughter Report: Dairy cow slaughter during the month of May was up 8.7% vs. last May, according to USDA. 211,700 animals were culled, compared to 194,700 in May 2008. Jan-May dairy cow slaughter was up 110,400 head compared to last year, an increase of 10.2%.
- NASS dry whey prices continue their steady move higher. Dry whey averaged 27.6¢ in this week's survey, up 0.9¢ from last week.
- Dairy cow slaughter numbers were strong for the second consecutive week, a likely result of the CWT herd retirement program. 60,500 head were culled during the week ending 06/13, compared to just 43,800 during the same period a year ago. YTD, the cull is up 169,000 head.
- Persistent, extreme heat has noticeably reduced milk production in Florida by 10% to 15% in a week, according to Fluid Milk & Cream Review. Milk shipments out of the state dropped from 233 last week to just 120 this week. Much of the Southeast was hot as well, and some of the plants in the region are reducing manufacturing levels as a result of declining intakes.
- Higher temperatures and humidity reached the Upper Midwest this week, with milk receipts starting to show the affect on milk intakes, according to Fluid Milk & Cream Review. Reductions in milk receipts were welcomed by most plants, although they continue to run on heavy schedules. Ice cream production is running on strong summer levels and orders are strong for Class II products. Supplies of manufacturing milk were noticeably lighter and less was heading north from more southern areas. Spot manufacturing milk prices were also moving higher.
- Fluid Milk & Cream Review reports milk production in the Southwest is beginning to fall at a faster rate as conditions warm up. The first real heat of the season hit California, with more expected in the coming week. Milk flow was down enough that more dryer time is becoming available. In Arizona, temps are now consistently over 100 degrees, and cows are late enough in lactations that output is falling faster.
- Some processors in the Pacific Northwest are noticing lighter milk receipts, related to continued financial stress at the producer level. Fluid Milk & Cream Review also reports hay quality in the region is poor. Some was cut just before wet weather arrived and has been laying on the ground for 2½ weeks, making it useless for dairy feed. Some alfalfa is way past mature and is woody and lodging, which will make it very difficult to harvest. This means more stress on dairy herds looking for good quality, but less expensive feeding options.
- Demand for Western dry whey remains strong, according to Dairy Market News. Any offerings are easily absorbed and inventories are light to nonexistent. Powder is coming in from the Central region to satisfy demand, while increases in European whey prices are giving the market some additional support.
- Churning activity across the country remains active, but cream supplies are tightening, according to Dairy Market News. This is allowing butter operations to better manage their output schedules, with some limiting their production to current and near term needs.
- Economy: Consumer spending in May rose for the first time since February and savings hit a record high, according to the Commerce Department. Consumer sentiment was higher in June, bolstering the view that the economy was close to emerging from recession.
- International: Milk production in Western Europe is now heading lower, along seasonal patterns, according to Dairy Market News. The lighter milk volume is relieving pressure on driers, and milk processors are able to better manage their operations to generate the product of most need. Cream supplies have tightened.

Futures Month	Class III 06/26 Close	Class III 06/19 Close	Change	Dry Whey 06/26 Close	Dry Whey 06/19 Close	Change
Jun-09	\$9.95	\$9.93	\$0.02	27.00¢	26.60¢	0.40¢
Jul-09	\$10.13	\$10.01	\$0.12	29.00¢	28.00¢	1.00¢
Aug-09	\$10.99	\$10.55	\$0.44	30.50¢	30.00¢	0.50¢
Sep-09	\$11.94	\$11.50	\$0.44	31.50¢	28.50¢	3.00¢
Oct-09	\$12.76	\$12.45	\$0.31	30.00¢	30.00¢	0.00¢
Nov-09	\$13.72	\$13.20	\$0.52	30.00¢	27.50¢	2.50¢
Dec-09	\$14.01	\$13.52	\$0.49	30.00¢	30.00¢	0.00¢
Jan-10	\$14.12	\$13.60	\$0.52	28.00¢	28.00¢	0.00¢
Feb-10	\$14.10	\$13.62	\$0.48	27.75¢	28.25¢	(0.50¢)
Mar-10	\$14.63	\$14.11	\$0.52	28.25¢	24.80¢	3.45¢
Apr-10	\$14.85	\$14.48	\$0.37	27.60¢	27.53¢	0.07¢
May-10	\$14.91	\$14.70	\$0.21	27.00¢	28.00¢	(1.00¢)
Jun-10	\$15.38	\$15.20	\$0.18	29.00¢	32.00¢	(3.00¢)
Jul-10	\$15.45	\$15.32	\$0.13	31.00¢	31.50¢	(0.50¢)
Aug-10	\$15.40	\$15.35	\$0.05	31.00¢	30.75¢	0.25¢
Sep-10	\$15.50	\$15.45	\$0.05	30.50¢	30.00¢	0.50¢
Oct-10	\$15.25	\$15.20	\$0.05	31.00¢	31.00¢	0.00¢
Nov-10	\$15.20	\$15.35	(\$0.15)	28.00¢	27.75¢	0.25¢
Dec-10	\$15.29	\$15.53	(\$0.24)	27.75¢	27.50¢	0.25¢
Jun-Dec	\$11.93	\$11.59	\$0.33	29.71¢	28.66¢	1.06¢
2010	\$15.01	\$14.83	\$0.18	28.90¢	28.92¢	(0.02¢)

What's Bearish:

- Cold Storage Report: American cheese stocks at the end of May, setting a new all-time record (see graph), were 7% higher than a year ago, according to USDA figures. It appears fitting after record cheese production in April. Total cheese stocks were up an even bigger 9%. On the positive side, butter stocks were down 7% from last year, but up 5% from April.
- Weekly cold storage numbers continue to show a build in cheese stocks this month. Cheese holdings at USDA selected storage centers have increased 2 million lbs over the period 06/01 through 06/22.
- Butter stocks at CME-approved warehouses increased 538,000 lbs for the week ending 06/20. A year ago during the same period, stocks declined 3.6 million lbs.
- Central dry whey prices were higher this week, but demand is reported as uneven on an unsettled market, according to Dairy Market News. Some contract buyers are backing away from taking multiple loads over their monthly commitments.
- Dairy Market News reports cheese manufacturing remains strong in the Eastern region of the country, encouraged by low milk prices and milk output still near peak levels. The longevity of the price weakness in the cheese market, combined with already high inventory levels, is leading to less current buying to supplement inventories.
- Ample offerings of current varieties of cheese are available in the Midwest, according to Dairy Market News. Heavy cheese supplies may be even higher than in the Cold Storage Report, released this week. Buyers are reluctant to purchase more supplies or replace stocks rapidly.
- Low cheese prices are not doing much to stimulate additional sales in the Western region, according to Dairy Market News. Contacts indicate buyers have either reached their goal for cheese stocks and are not interested in additional supplies, or that any more money to purchase more cheese is harder to find.
- International: Dairy Market News reports EU export subsidies for skim milk powder and whole milk powder were increased this week. In Eastern Europe, milk output is still increasing and is ahead of last year, while stocks of dairy products are building.



Recommendation:

The realization that the nation is getting warmer and some aggressive buying in the cash cheese market was all that was needed to cause a short-covering rally in Class III futures this week. While a tightening of the milk supply is welcome news, let's not get ahead of ourselves and call an end to low prices...yet. Sure, there are a lot more bullish points this week related to summer heat, but we had quite a bearish cold storage report, and the weekly USDA cheese updates are still pointing to too much supply and weak buyer interest. Even with a tightening milk supply, the vast amount of product in storage may limit the extent of price increases for cheese in the fall. It was encouraging to see a little life in the cash market as buyers got more aggressive again, but at current cash cheese prices, Class III works out to about \$9.80 milk, meaning Aug-Oct are still vulnerable. If we continue to rally next week, be prepared to buy PUT options in these months to protect your milk price. Remember, Q4 briefly jumped above \$16, only to quickly fall back again. Long term, however, we believe prices will head higher as we hear more and more evidence of financial stress across the country. We continue to recommend NOT selling milk in 2010. Finally, we've added dry whey prices to our weekly price table as they continue to strengthen, and they are worth watching, since every penny move in dry whey, moves Class III milk six cents.

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