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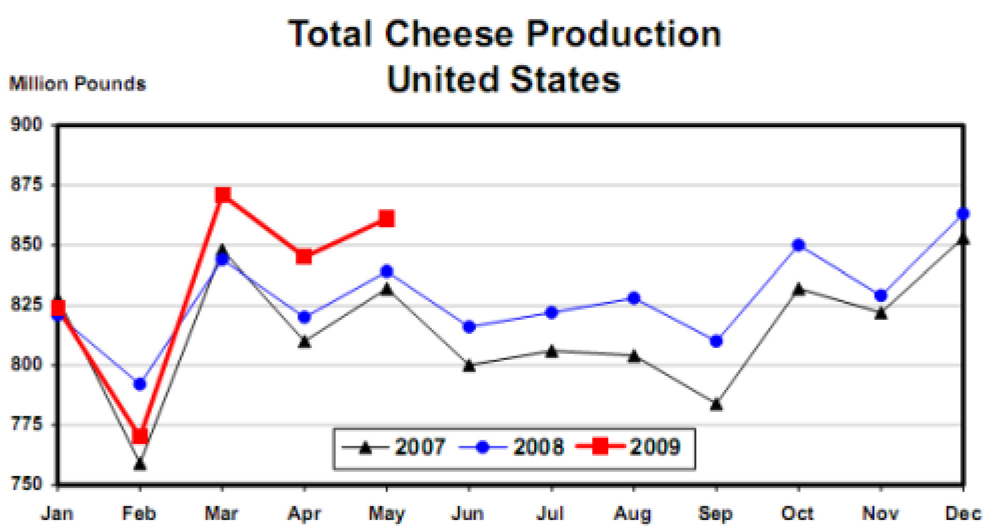
The KDM Dairy Report – July 2nd, 2009

What's Bullish:

Futures Month	Class III 07/02 Close	Class III 06/26 Close	Change	Dry Whey 07/02 Close	Dry Whey 06/19 Close	Change
Jul-09	$10.05	$10.13	($0.08)	29.00¢	29.00¢	0.00¢
Aug-09	$10.52	$10.99	($0.47)	30.50¢	30.50¢	0.00¢
Sep-09	$11.26	$11.94	($0.68)	31.50¢	31.50¢	0.00¢
Oct-09	$12.17	$12.76	($0.59)	30.00¢	30.00¢	0.00¢
Nov-09	$13.15	$13.72	($0.57)	31.00¢	30.00¢	1.00¢
Dec-09	$13.57	$14.01	($0.44)	30.00¢	30.00¢	0.00¢
Jan-10	$13.82	$14.12	($0.30)	29.00¢	28.00¢	1.00¢
Feb-10	$13.88	$14.10	($0.22)	28.50¢	27.75¢	0.75¢
Mar-10	$14.45	$14.63	($0.18)	28.25¢	28.25¢	0.00¢
Apr-10	$14.68	$14.85	($0.17)	27.60¢	27.60¢	0.00¢
May-10	$14.78	$14.91	($0.13)	28.50¢	27.00¢	1.50¢
Jun-10	$15.26	$15.38	($0.12)	29.00¢	29.00¢	0.00¢
Jul-10	$15.41	$15.45	($0.04)	31.00¢	31.00¢	0.00¢
Aug-10	$15.43	$15.40	$0.03	31.00¢	31.00¢	0.00¢
Sep-10	$15.45	$15.50	($0.05)	30.50¢	30.50¢	0.00¢
Oct-10	$15.34	$15.25	$0.09	31.00¢	31.00¢	0.00¢
Nov-10	$15.30	$15.20	$0.10	28.00¢	28.00¢	0.00¢
Dec-10	$15.27	$15.29	($0.02)	27.75¢	27.75¢	0.00¢
Jly-Dec	**$11.79**	**$12.26**	**($0.47)**	**30.33¢**	**30.17¢**	**0.17¢**
2010	**$14.92**	**$15.01**	**($0.08)**	**29.18¢**	**28.90¢**	**0.27¢**

- Ag Prices Report: For the month of June, USDA reports the milk-feed ratio remains pegged at a record low from last month at 1.47. The ratio represents the number of pounds of 16% mixed dairy feed equal in value to 1 pound of whole milk.
- Dairy cow slaughter for the week ending 06/20 totaled 59,500 head, up 7,200 head from the same week a year ago. YTD the cull is running 186,000 head above last year.
- Fluid Milk & Cream Review reports spot shipments of Grade A milk out of Florida dropped to 111 this week, compared to 120 last week and 187 a year ago. Milk production in the Southeast is declining to the point that exports will be coming to an end and imports from Northern areas will resume.
- A few loads of upper Midwest milk started moving south this week to supplement local fluid needs, according to Fluid Milk & Cream Review.
- Fluid Milk & Cream Review reports that cow stress in increasing in California and Arizona as daytime heat is in the 100's and nights are not cooling off nearly as well as they were. Milk production is decreasing and California output is down 5.9% YTD from 2008.
- Dairy Market News reports churning schedules are expected to decline in the near future as most cream offerings will be readily absorbed into Class II operations. Cream supplies are tightening in the Eastern region of the country as milk production edges lower.
- Western dry whey buyers continue to look for additional loads, moving prices higher and leaving a firm tone on the market, according to Dairy Market News. Interest is coming both domestically and from international sources, while inventories remain light to nonexistent. Production is steady, but just on the edge of heading seasonally lower.
- Dairy Market News reports the Eastern dry whey market remains tight, with few manufacturer offerings finding their way to the spot market. This has given resellers the opportunity to clear some inventories, with some moving into export channels destined for Southeast Asia.

What's Bearish:



- Cash cheese: Blocks were unchanged for the week at \$1.11½/lb and barrels gained 2¢ to settle at \$1.10/lb, but sellers were clearly in control as they hit bids all week. 29 loads of blocks and 11 barrels exchanged hands. Butter gave up 1¼¢ to settle at \$1.19¼ on 10 trades.
- Dairy Products Report: May cheddar cheese output was up 3.7% from a year ago, and 6% higher than April, according to USDA numbers. The 285 million lbs produced was a new all-time record for the month of May. Total cheese output was 2.6% higher than last year. 860.7 million lbs of cheese were made during the month, also a new all-time record for May.

- NASS surveyed prices for most Class III components were lower this week. 40-lb blocks averaged $1.15/lb, down a fraction from last week, while 500-lb barrels gave up 0.5¢ to $1.11/lb. Butter decreased 3.9¢ to average $1.17/lb and dry whey dipped 0.3¢ to 27.2¢/lb, but nonfat dry milk managed to increase 0.3¢ to 85¢/lb.
- Weekly cold storage numbers indicate cheese stocks increased 3% at USDA selected storage centers over the period 06/01 through 06/29. Butter stocks increased a more dramatic 10%.
- Milk handlers continue to indicate milk volumes are heavy in the Northeast for this time of season, according to Fluid Milk & Cream Review. Usually higher temps and humidity levels are reported by now, but this year, conditions are more comfortable and seasonal declines more gradual. Milk volumes over the 4th of July are expected to be heavy, while balancing plants running full again to process all the milk.
- Handlers in the Midwest are already looking for places to book surplus cream over the holiday weekend, according to Fluid Milk & Cream Review. A partial rebound in plant receipts has been noted after temperatures, which had been in the upper 80's with high humidity, fell this week with highs in the 60's. Manufacturing plants continue to operate on heavy schedules.
- Central dry whey prices were higher this week, but inventories were building as demand for spot loads has declined, according to Dairy Market News. Customers seem content with their regular monthly contract loads and are less interested in obtaining additional loads above those numbers.
- Current cheese offerings remain seasonally heavy in the Eastern part of the country, according to Dairy Market News. Some improvement in demand is noted as improved summer weather has increased tourism, however, current cheese production remains active due to the volume of milk available.
- Heavy seasonal cheese production and offerings in the Midwest continue to weigh on the market, according to Dairy Market News. Most buyers expect limited upside price movement for the short term so are not interested in building any inventory.
- Western cheese production and stocks are both very heavy, while demand is fair at best, according to Dairy Market News. Many buyers have taken advantage of low cheese prices all spring to stock as much as they want for fall needs. Most indicate they have no real desire to increase their holdings at this time, and banks are not sure they want to tie up even more money.
- Butter stocks at CME-approved warehouses increased 2.5 million lbs for the week ending 06/27. During the same period a year ago, stocks decreased by 4.7 million lbs.
- Economy: Employers cut a larger-than-expected 467,000 jobs in June, and the unemployment rate climbed to a 26-year high of 9.5%, according to the Labor Department.

Recommendation:

While we continue to see signs that the milk supply is beginning to decline, it isn't happening fast enough. And cheese production is happening at record levels (see chart and bullet points above). Two processors in the Midwest we spoke to this week said their milk receipts were up anywhere from 6.5% to 16%! Financial stress has not hit this part of the country as hard as other parts, and with much of Midwest milk output going into cheese production, it looks like we'll be stuck in a bearish rut for a while yet. USDA cheese updates this week hint that buyers' warehouses are as full as they want to be, with some even having most of their fall needs purchased already. That, combined with the amount of current cheese available and floating around the country, does not bode well for Q4 '09 prices, which fell an average 47¢ this week. We're not convinced you should sell here, but we would recommend getting PUT options bought in Q4, in the event this train doesn't turn around and we're headed for 12 months of sub-$11 milk (six down already). With a long holiday weekend with surplus milk available to process, on Monday, go after the Sep 11.00 PUT at 45¢, Oct 11.75 PUT at 51¢, Nov 12.25 PUT at 46¢ and Dec 12.50 PUT at 49¢. Yes, these are expensive, but they will keep you from a disaster. 2010 prices, while slightly lower, are seeing decent support. We continue to maintain our rec not to sell 2010 milk yet.

Note: Our offices will be closed on Friday, July 3rd in observance of Independence Day. We will reopen on Monday. We wish all of you a safe holiday weekend, and be sure and thank a service man or woman for the freedoms we daily enjoy!