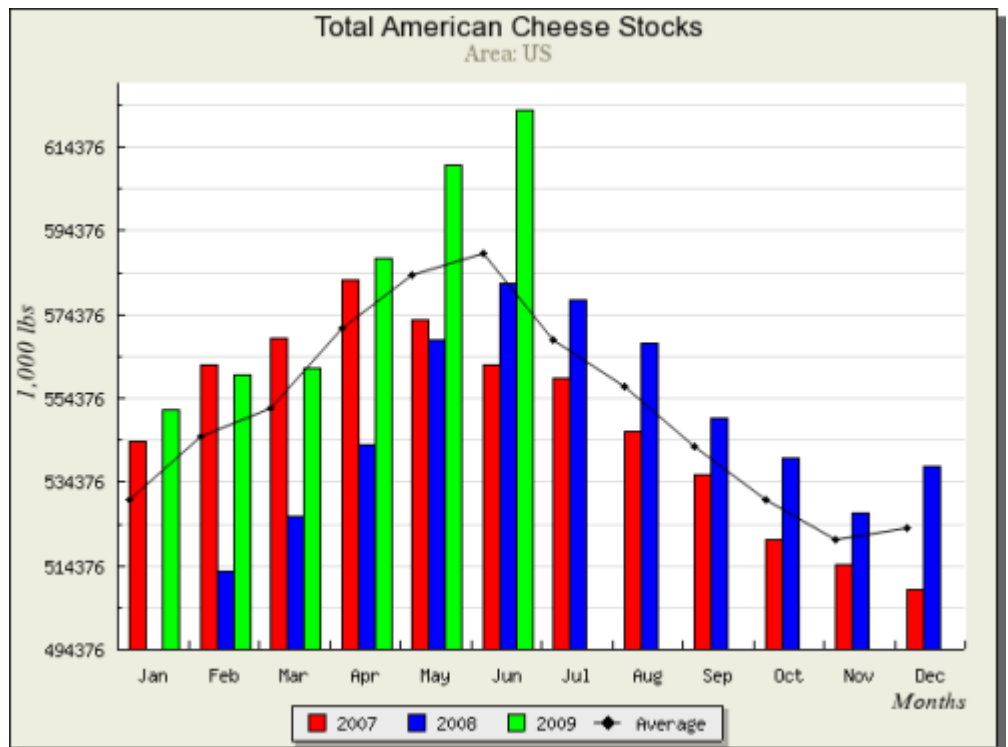


**The KDM Dairy Report – July 24<sup>th</sup>, 2009**

**What's Bullish:**

- Cash Market: Blocks and barrels made new highs for the year in the spot market this week. Blocks settled at \$1.20/lb today, up 5½¢ for the week, and barrels settled at \$1.17/lb, up 3¢. Trading was relatively light with 15 blocks and 8 barrels exchanging hands. Butter gained a penny to settle at \$1.26/lb on active trading of 43 loads.
- Livestock Slaughter Report: USDA's monthly look at cow slaughter in the U.S. shows strong numbers in the dairy sector. 256,000 head were culled from the milking herd in June, up 75,100 head from last year. That represents an increase of 41.5%, in large part likely due to CWT activity. Jan-Jun, the dairy cow cull is up 185,600 head from last year, or 14.7%.
- Dairy cow slaughter for the week ending 07/11 totaled 48,400 head, putting the YTD slaughter up 215,900 head from a year ago.
- Milk production in the Mid-Atlantic region is still above normal, however, the general consensus is that it's about to end. Fluid Milk & Cream Review reports some incoming loads are down as much as 10%. Manufacturing plants are still running heavier than usual for this time of year, but some schools will start up in two weeks, which should increase demand for fluid milk. Florida exported 24 fewer loads out of state than last week, with the trend expected to continue.
- California milk production is trending lower, at a faster pace, according to Fluid Milk & Cream Review. Extended hot conditions are causing stress on the milking herds. Hay buying is said to be very slow, due to financial stress on the farm. Heat and humidity and also hit Arizona, with milk production declining above expected levels. Processing plants are reducing schedules to compensate for the lighter intakes. New Mexico milk output is trending lower, and continues to be below year ago levels. In the Pacific Northwest, parts of Utah and Idaho are seeing daytime temperatures around 100 degrees, which has stressed the cows. Nights are cooler, but production has begun to drop off.

Futures Month	Class III 07/24 Close	Class III 07/17 Close	Change	Dry Whey 07/24 Close	Dry Whey 07/17 Close	Change
Jul-09	\$9.96	\$10.00	(\$0.04)	29.00¢	29.00¢	0.00¢
Aug-09	\$10.83	\$10.52	\$0.31	30.50¢	30.25¢	0.25¢
Sep-09	\$12.13	\$11.65	\$0.48	31.00¢	31.00¢	0.00¢
Oct-09	\$13.12	\$12.46	\$0.66	29.60¢	30.00¢	(0.40¢)
Nov-09	\$13.93	\$13.42	\$0.51	30.25¢	31.00¢	(0.75¢)
Dec-09	\$14.57	\$13.98	\$0.59	30.50¢	30.75¢	(0.25¢)
Jan-10	\$14.65	\$14.25	\$0.40	27.78¢	26.75¢	1.03¢
Feb-10	\$14.80	\$14.49	\$0.31	27.25¢	26.75¢	0.50¢
Mar-10	\$15.19	\$15.05	\$0.14	27.00¢	26.75¢	0.25¢
Apr-10	\$15.55	\$15.30	\$0.25	27.50¢	27.00¢	0.50¢
May-10	\$15.54	\$15.40	\$0.14	28.23¢	28.23¢	0.00¢
Jun-10	\$15.94	\$15.84	\$0.10	29.00¢	29.00¢	0.00¢
Jul-10	\$15.99	\$15.77	\$0.22	31.00¢	31.00¢	0.00¢
Aug-10	\$16.01	\$15.95	\$0.06	31.00¢	30.50¢	0.50¢
Sep-10	\$15.96	\$15.94	\$0.02	30.50¢	30.50¢	0.00¢
Oct-10	\$15.84	\$15.80	\$0.04	31.00¢	31.00¢	0.00¢
Nov-10	\$15.90	\$15.74	\$0.16	28.00¢	28.00¢	0.00¢
Dec-10	\$15.99	\$15.84	\$0.15	27.75¢	27.75¢	0.00¢
Jly-Dec	\$12.42	\$12.01	\$0.42	30.14¢	30.33¢	(0.19¢)
2010	\$15.61	\$15.45	\$0.17	28.83¢	28.60¢	0.23¢



- Butter churning is trending lower in the Midwest, reflecting less cream moving into butter plants, according to Dairy Market News. There is a growing consensus that higher production levels are near an end.
- Western dry whey prices showed some strength this week, according to Dairy Market News. Demand is adequate, while production has slowed as milk intakes drop off due to heat in the West.

- Contract demand for dry whey in the East is higher than product availability, according to Dairy Market News. Inventories are tight to oversold at several manufacturer locations, resulting in some delays on deliveries. Resale offers are 2-3¢ above the top of the range.
- Cheese yields in the West are below expectations, according to Dairy Market News. Hot temperatures have returned and farm milk supplies are trending lower.
- International: European whey prices are higher and the market tone is firmer, according to Dairy Market News. Lower cheese production is resulting in less whey being made, but demand has improved from segments of the animal feed market.

### What's Bearish:

- Cold Storage Report: Stocks of American cheese in June were 7% higher than in 2008, and 2% higher than the previous month (see ugly chart above). Total cheese stocks were up an even stronger 8% over last year. Butter stocks were 3% higher than last June and 5% higher than May.
- The weekly NASS survey of Class III components was mostly lower or just marginally higher this week. 40-lb blocks fell 1.3¢ to \$1.12/lb, but 500-lb barrels managed a slight 0.1¢ gain to \$1.11/lb. Butter was up 1.4¢ to average \$1.19/lb and dry whey increased 0.2¢ to 29.4¢/lb, but nonfat dry milk decreased 0.8¢ to 84¢/lb.
- Cheese stocks have increased 3% over the first 20 days of July, according to USDA weekly cold storage numbers.
- Milk production in the Northeast remains significantly above seasonal norms, according to Fluid Milk & Cream Review. Cool, wet weather persist, keeping cows happy, but giving rise to crop and feed stock concerns.
- Fluid Milk & Cream Review reports many locations in the Midwest are seeing plant intakes above year ago levels despite poor economic conditions and without adding new patrons. Cool summer temps have caused minimal animal stress, and reduced declines in fat and protein levels.
- Dairy Market News reports a weaker undertone in the dry whey market this week. Inventories in the Central region are building incrementally, and buyers are becoming more cautious. Sales appear to be more hand-to-mouth vs. multiple loads.
- Cheese offerings in the Eastern region remain heavy, according to Dairy Market News. Buyers are content with their current inventory levels, limiting new purchases. Current cheese production remains seasonally active as summer heat stress on cows in the region has been minimal. Most cheese plant operators would welcome less milk in order to reduce schedules and allow time for additional maintenance.
- Dairy Market News reports offerings of cheese in the Midwest are more than adequate. Most processors and packagers are seeing limited need to run overtime.
- International: Milk production in Western Europe is trending higher than last year, while sales into international channels remain slow, according to Dairy Market News. Product prices remain weak due to the slow recovery of the world economy.

### Recommendation:

Class III futures turned in another strong week as the fuel this time was a stronger cash cheese market. Cheese sellers were still there, but much less aggressive as buyers bid up prices. Short-term fundamentals are still mostly bearish; we still have plenty of cheese and plenty of milk, with the exception of the Southwest. And we had a bearish Cold Storage Report released this week. Class III futures were down the day after the report was released, but we need to put this report in perspective. The numbers are for JUNE storage, which is nearly month-old data. We also know we produced a lot of milk in April and May, and made a lot of cheese. Cheese was priced very low, so commercial buyers bought and stored a ton of it. So, it makes sense that the report would show such a large number, but what impact does it have on prices in Oct and beyond? What is key to determining market direction is **anticipating** what supply and demand **will be** at that time. We brought up the idea of **anticipation** last week, and it appears follow-through buying from last week is reinforcing the idea that supply and demand are getting closer to being in balance. CWT intends to have most cows in their second round slaughtered by the end of Sep and it's still very hot in CA, AZ and NM. The milk supply could be in better balance in the next 45 days or so, especially with schools starting up in the next 2-4 weeks. That will leave less milk available for manufacturing. The market is anticipating (there's that word again) this, which is pushing prices higher. The front months remain vulnerable to correction, however. We would buy PUT options Sep-Oct to protect unsold milk. We continue to recommend producers not sell any 2010 milk.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.