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The KDM Dairy Report – Aug 14th, 2009

What's Bullish:

Futures Month	Class III 08/14 Close	Class III 08/07 Close	Change
Aug-09	$11.15	$11.09	$0.06
Sep-09	$12.63	$12.69	($0.06)
Oct-09	$13.25	$13.25	$0.00
Nov-09	$13.07	$13.49	($0.42)
Dec-09	$13.52	$13.80	($0.28)
Jan-10	$13.67	$13.90	($0.23)
Feb-10	$13.76	$13.97	($0.21)
Mar-10	$13.60	$14.03	($0.43)
Apr-10	$13.95	$14.32	($0.37)
May-10	$14.30	$14.40	($0.10)
Jun-10	$14.90	$15.15	($0.25)
Jul-10	$15.25	$15.55	($0.30)
Aug-10	$15.43	$15.60	($0.17)
Sep-10	$15.49	$15.64	($0.15)
Oct-10	$15.57	$15.81	($0.24)
Nov-10	$15.69	$15.82	($0.13)
Dec-10	$15.80	$15.89	($0.09)
Aug-Dec	**$12.72**	**$12.86**	**($0.14)**
2010	**$14.78**	**$15.01**	**($0.22)**

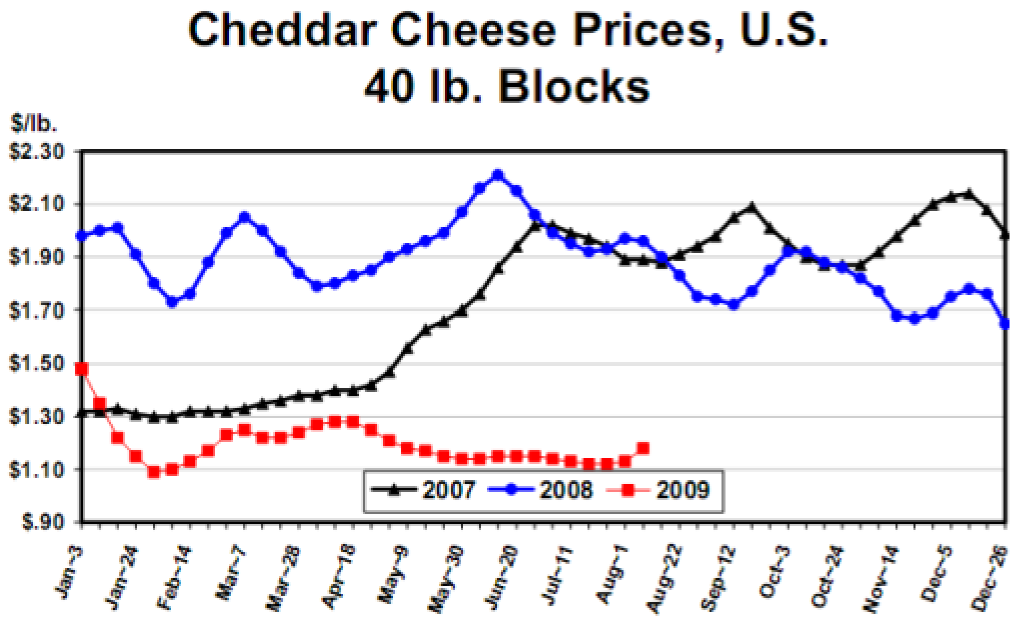
- Cash Market: Blocks jumped 5¼¢ for the week, closing at $1.36¼/lb today. Barrels picked up 5¢ to close at $1.34/lb. Volume was light, with just 7 blocks and 8 barrels exchanging hands. Butter lost a penny to settle at $1.22/lb on 19 trades.
- NASS cheese prices continued to rise in response to recent gains in the cash market. 40-lb blocks averaged $1.18/lb, up 4.9¢ from last week's survey. 500-lb barrels increased 4.7¢ to $1.21/lb. Nonfat dry milk jumped 3¢ to average 87¢/lb, but butter decreased 0.2¢ to $1.22/lb and dry whey lost 0.7¢ to average 28.9¢/lb.
- Fluid Milk & Cream Review reports there is a strong undertone of change in the milk supply, from New England to Florida. Increased heat, lower components, tighter cream supplies and reduced cow numbers are all causing manufacturing concerns over futures supplies. School startups in the Southeast and Florida are diverting more milk to bottling operations, while manufacturing plants are shut down or running at greatly reduced schedules. Florida did not export any milk this week, which is the first time since October, 2008. Last week they exported 68 loads.
- Temperatures have moderated in California, but milk output is stabilizing at levels below a year ago, according to Fluid Milk & Cream Review. Growth in output is being limited as cow numbers are down, and more will clear under the latest cow kill program. In Arizona, milk production continues to trend lower, and processing plants are not getting the milk to keep plants running as long as desired. Milk intakes in New Mexico are running 5% or more below a year ago due to fewer cows and financial stress. Manufacturers in the state are running at less than capacity on reduced schedules. Bottlers are increasing orders to fill school accounts. Recent record-setting heat in the Pacific Northwest has abated, but did have a significant impact on the milk flow and components.
- Dairy Market News reports cheese and cream production is still active in the Northeast, however, recent heat has decreased milk intakes and components to the extent that cheese plants are making purchases on the spot market to ensure adequate supplies.
- Dairy Market News reports current cheese supplies in the Southwest and West are tighter due to lower cheese production. Elevated temperatures caused declines in milk receipts, while packagers are preparing orders for product needed as schools reopen.
- Fluid milk sales in June were up an adjusted 0.5% compared to a year ago, according to Dairy Market News.

What's Bearish:

- World Ag Supply & Demand Report: USDA increased their milk production forecast for 2010 and lowered their export forecast. They cite the fact that the decline in cow numbers is slower than expected, and an increase in exportable supplies from competitor countries. As a result, they lowered both the cheese and milk price forecasts for 2010. Cheese is now expected to average $1.56 for the year, and Class III is expected to average $14.25/cwt.
- Dairy cow slaughter for the week ending 08/01 was only 48,600 head, below last year's cull during the same week of 49,600 head.
- Butter movement out of CME-approved warehouses totaled just 843,000 lbs for the week ending 08/08. A year ago during the same period, 2.4 million lbs were pulled. Butter on hand is now up to 94.9 million lbs, which is above year ago levels of just 88.6 million lbs.
- Most plants in the upper Midwest continue to run on unseasonably heavy schedules, according to Fluid Milk & Cream Review. Recent increases in temperature and humidity have so far caused just minimal declines in milk receipts. Manufacturing milk interest is spotty and milk handlers are hoping for milk shipments to build to the south in order to reduce the volumes of milk being manufactured.
- Churning activity across the country remains stronger than many butter producers had anticipated, according to Dairy Market News. Cream volumes have been more available than in recent years during this time of the summer. Current churning schedules are providing additional butter stocks, so inventoried stock is not being pulled as much as typical for this time of year.
- Central dry whey prices were slightly lower in a weaker market, according to Dairy Market News. Sales are steady to slower, while cheese and whey production have been uncharacteristically high. Dry whey inventories are steady to building.

- Current blocks and barrels are still readily available in the Midwest, according to Dairy Market News. Cheese production remains unusually heavy as milk volumes and components have held up better than seasonal norms.
- Crop Report: USDA's highly anticipated crop report this week did not lower corn acres, as was widely expected. Instead, both corn and bean production were projected higher, by 5% and 8% respectively. Beans were sharply lower on Friday.

Recommendation:



Price action this week had a lot of traders scratching their heads. Cheese prices would increase, but milk futures were sold lower after each day's cash session. Trade volume was fairly light all week. We're not sure what to make of it. Bidders in the cash market appear to have control and look ready to keep moving prices higher. Milk, and perhaps even cheese, is tight out West, while big drops in output appear to be occurring out East. School is about to begin, pulling milk away from manufacturing, yet despite all this, futures responded lower. Granted, there is still plenty of cheese in warehouses and the Midwest continues to be resilient in regards to both milk production and cheese output, but something doesn't seem to add up. Perhaps it's the calm before the storm and the market is just waiting to make a big move one way or the other. The Milk Production Report will be released next week Tuesday, and it will be one of the more highly anticipated reports. The nation's July output should have been affected by both heat and the most recent CWT cull. While these reports rarely make the markets move in a major way, it might be an early indicator of where milk output is headed longer term. We finished flat to lower in every month but Aug this week, with the first half of 2010 taking the biggest hit. We would not be sellers here, but would continue to look at our rec from last week, putting on a fence strategy for the last half of 2010. Consider buying the 14.00 PUT and selling the 18.00 CALL, July-Dec 2010 for a net cost of 30¢ or less per month. Do this on 20-25% of your monthly production.

Note: Just another reminder for those of you that may have been trying to reach us this week. Our old 715 numbers are **no longer in service**. We can be reached at our same, toll-free, **877 number above**, or directly at **920-787-5700**.