

The KDM Dairy Report – Sep 11th, 2009

What's Bullish:

- Cheddar cheese prices in this week's NASS survey continued to move higher. 40-lb blocks averaged \$1.37/lb, up 4¢ from last week, while 500-lb barrels increased 2.2¢ to \$1.38/lb. Butter decreased 0.3¢ to average \$1.16/lb and dry whey fell 0.1¢ to 29.1¢/lb, but nonfat dry milk gained 1.7¢ to 95¢/lb.
- Cheese stocks at USDA selected storage centers fell 940,000 lbs during the first seven days of September.
- Dairy cow slaughter for the week ending 08/29 shot substantially higher. 64,400 head were removed from the herd, compared to 55,900 during the same period last year. This week's cull was the highest since February.
- Butter stocks at CME-approved warehouses fell 3.9 million lbs for the week ending 09/05. That's a stronger net out movement than a year ago, when 2.5 million lbs were pulled.
- The milk supplies are still tight in the Eastern region of the country, according to Fluid Milk & Cream Review. Despite the holiday respite, not all milk supply contracts are being met. New England balancing plants continue to receive less milk than needed to fill all manufacturing plant orders.
- Fluid Milk & Cream Review reports Western processors continue to lack all the milk they desire on supply contracts, and other supplies are limited. In Arizona, local supplies are in tight balance, with less milk handled over the holiday weekend than expected. New Mexico balancing plants continue to run on reduced schedules due to milk supplies being several percentage points below a year ago. Milk shipments to other areas are lighter this year, and not able to fill all needs due to the lack of local supply.
- Western nonfat dry milk prices continue to firm, and despite some opinions that prices will head back down, the reality is buyers have few options but to pay or stay on the sidelines. Dairy Market News reports buyer interest has increased as they try to secure supplies, while the undertone to the market remains firm.
- Milk shortages were common for cheese manufacturers in the Northeast, according to Dairy Market News. Extremely tight milk supplies led to some reduced cheese production schedules, which are continuing into this week, as Class III users are still left with less milk than ordered.
- Dairy Market News predicts the heavier cheese volumes sold on the CME Group should lighten, as eligible cheese for the cash market declines. Bottler needs continue to increase, and the return of some warmer weather plus poor dairy economics has caused milk volumes to decline in the Upper Midwest. Components are also lower, so less cheese is being produced. Finding spot manufacturing milk has become much more difficult in recent weeks. Sales of mozzarella, pepper jack and Colby jack are stronger, and Swiss is tight to short.

Futures Month	Class III 09/11 Close	Class III 09/04 Close	Change	Dry Whey 09/11 Close	Dry Whey 09/04 Close	Change
Sep-09	\$12.04	\$12.13	(\$0.09)	30.00¢	29.75¢	0.25¢
Oct-09	\$12.17	\$12.13	\$0.04	30.00¢	29.10¢	0.90¢
Nov-09	\$13.13	\$12.84	\$0.29	30.53¢	29.55¢	0.97¢
Dec-09	\$13.45	\$13.15	\$0.30	30.78¢	30.03¢	0.75¢
Jan-10	\$13.72	\$13.43	\$0.29	31.23¢	30.00¢	1.23¢
Feb-10	\$13.84	\$13.52	\$0.32	29.55¢	28.53¢	1.03¢
Mar-10	\$13.84	\$13.54	\$0.30	29.00¢	27.85¢	1.15¢
Apr-10	\$14.13	\$13.90	\$0.23	29.05¢	27.55¢	1.50¢
May-10	\$14.26	\$14.09	\$0.17	30.50¢	28.75¢	1.75¢
Jun-10	\$14.75	\$14.57	\$0.18	30.00¢	28.13¢	1.88¢
Jul-10	\$14.90	\$14.78	\$0.12	29.00¢	29.00¢	0.00¢
Aug-10	\$15.20	\$15.00	\$0.20	30.53¢	30.53¢	0.00¢
Sep-10	\$15.50	\$15.34	\$0.16	30.08¢	30.03¢	0.05¢
Oct-10	\$15.55	\$15.40	\$0.15	30.03¢	30.03¢	0.00¢
Nov-10	\$15.55	\$15.37	\$0.18	28.05¢	28.03¢	0.03¢
Dec-10	\$15.65	\$15.52	\$0.13	28.03¢	27.75¢	0.27¢
Sep-Dec 2010	\$12.70	\$12.56	\$0.14	30.33¢	29.61¢	0.72¢
	\$14.74	\$14.54	\$0.20	29.59¢	28.85¢	0.74¢

What's Bearish:

- Cash Market: After a few weeks of increases with buyers being more aggressive, both sides backed off, leaving blocks unchanged for the week at \$1.27/lb and barrels up ¼¢ to \$1.25/lb. Trading was lighter on the shortened week, except for one day when 16 of the 18 weekly trades were executed. Butter finished a penny higher at \$1.18/lb on just 5 trades.
- World Ag Supply & Demand Report: USDA left their Class III price forecast for 2010 unchanged at an average \$14.25/cwt, but did raise their production forecast due to more milk per cow. They cite lower feed costs and plentiful supplies of alfalfa to support increased feeding of higher quality rations.
- Crop Report: USDA revised corn production up 2% from last month and 7% higher than in 2008. Yields are expected to average 161.9 bu/acre, up 2.4 bu from August and 8.0 above last year. Soybean production is forecast at a record 3.25 billion bushels, up 1% from the August forecast and up 10% from last year. Yields are expected to average 42.3 bu/acre, up 0.6 bu from last month and up 2.7 bu from 2008.
- Milk and cream supplies were a little more available in the Central region over the weekend, according to Fluid Milk & Cream Review. Fluid needs may be slightly lower than expected going forward due to flu moving through some schools and universities, and manufacturing supplies were more easily procured than in recent weeks.

- Dairy Market News reports Western supplies of cheese appear to be in balance with needs.
- Economy: The federal deficit surged higher into record territory, hitting \$1.38 trillion in August. You can't even comprehend how much that is. It would take a military jet flying at the speed of sound, reeling out a roll of dollar bills behind it, 14 years before it reeled out one trillion dollar bills.

Recommendation:

The market was largely positive this week, with double-digit gains in most months, despite a flat cash market. Perhaps the winds of change are finally coming and the market is realizing that the \$9-10 milk is behind us. While not as bullish as last week, USDA's cheese updates hint that it's likely less cheese will be heading to the cash market in the future as cheese production declines. From a supply perspective, we still appear to be on the in balance to tight side as a nation. We believe that will provide support for the market in the weeks to come to continue to claw its way slowly higher. On the negative front, this week's crop report was bearish, with even lower feed prices likely in the future. This will lower the cost of production and could limit price recovery. The economy as well could prove harmful to full recovery if domestic and international demand do not pick up, or even decline. And, we're still waiting to see what, if any government intervention there will be. With so much uncertainty out there, we think it would be wise to start getting some protection in place for 2010. Here are a couple strategies to think about for the first half of 2010:

- Buy Jan-Mar 12.50 PUTs and sell Jan-Mar 15.00 CALLs for a net cost of 10¢/cwt per contract. Adding commission and some slippage and assume we can eventually get it for 15¢/cwt (\$300). The cost to cover 1 million lbs for Q1 would be \$300 x 5 contracts = \$1,500 per month x 3 months = \$4,500. Milk capped at 15.00 is about \$1.65 cheese.
- Buy Apr-Jun 13.50 PUTs and sell Apr-Jun 16.00 CALLs for a net cost of 24¢/cwt per contract. Adding commission, etc., think we could eventually get it for 30¢/cwt (\$600) per month. The cost to cover 1 million lbs for Q2 would be \$600 x 5 contracts = \$3,000 per month x 3 months = \$9,000. Milk capped at 16.00 is about \$1.75 cheese.

OR, if we're a little more bullish:

- Buy Jan-Mar 15.50 CALLs at an avg price of 20¢/cwt (\$400) each. Cost to buy 1 million lbs would be \$400 x 5 contracts = \$2,000 x 3 months = \$6,000. Then enter good 'til cancel orders with us or your co-op to sell 1 million lbs milk Jan-Mar at, say, \$15.00. If the market continues to recover and your orders are hit, you would have a \$15.00 floor, with upside insurance kicking in at \$15.50.
- For Q2 do the same as above.

For the last half of 2010: Target to buy the 14.00 PUT and sell the 18.00 CALL for a net cost of 30-35¢ per month.

For the balance of 2009, October could be hit since it starts pricing next week and is at nearly a dollar premium to the cash equivalent price of about \$11.40 milk. Sell it, then buy a 12.75 call for up to 15¢ to cover the upside risk. Buy the Nov 14.25 call for 15¢ or better, then sell if Nov futures rally past \$14.00. Buy the Dec 15.00 call for up to 20¢, then sell if Dec futures rally above \$14.50.

We highly recommend getting these resting orders in now, so that they are there, waiting to be hit.

Announcement: For the past four years, KDM Trading, Inc. has traded a very small number of accounts (fewer than ten) on a "for profit" basis. These accounts are traded in such a way as to attempt to profit from milk price movement in both directions. Following are the annual rates of return for the accounts under management: 2005: **-25.31%**, 2006: **+73.04%**, 2007: **+546.57%**, 2008: **+54.76%**, 2009 (YTD): **+25.58%**. We are now opening this program to our customers and newsletter subscribers through a recently established CTA (Commodity Trading Advisor). Minimum investment is \$50,000. Please contact Dan for further information if you are interested in participating in this program.

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.