

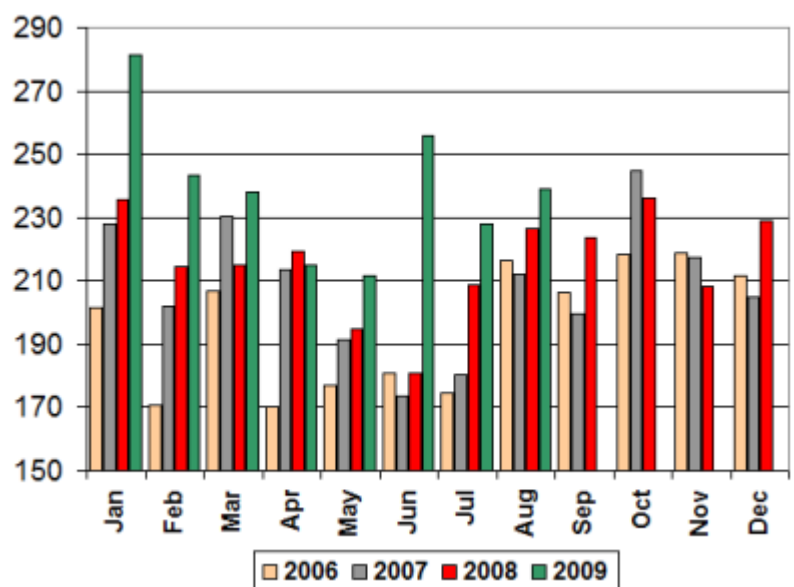
The KDM Dairy Report – Sep 25th, 2009

What's Bullish:

- Cash Market: Blocks punched 8¼¢ higher for the week, closing at \$1.41¼/lb and barrels jumped 8¾¢ to reach \$1.37¾/lb. Sales were infrequent, with just 6 loads of blocks and 3 loads of barrels exchanging hands. Butter shed a penny to close at \$1.26/lb on 16 trades, but nonfat dry milk was bid up again with no trades this week, settling up 2½¢ to \$1.06½/lb.
- Livestock Slaughter Report: 12,600 more dairy cows were removed from the herd in August than a year ago, according to USDA. 238,900 head were culled during the month, compared to 226,300 a year ago (see graph below). For the months Jan-Aug, the dairy cow cull is up by 217,400 head, an increase of 12.8%.
- CWT completed its eighth round in the herd retirement program, removing 74,113 cows from the milking herd. Despite being short of removing 87,000 cows accepted during the bid process, 55,664 head, or 75%, came from the West and Southwest, which will further tighten supplies there.
- NASS butter and powder prices continue to tick higher. Butter increased 0.7¢ to average \$1.18/lb, nonfat dry milk jumped 1.3¢ to 99¢/lb and dry whey increased 0.6¢ to 30.2¢/lb.
- Weekly cold storage stats are reporting a 10% drop in butter stocks at USDA selected storage centers over the period 09/01 through 09/21. Cheese stocks fell slightly over the same period.
- Milk receipts in the Eastern region of the country are about steady, according to Fluid Milk & Cream Review. That is keeping manufacturing levels at lighter seasonal schedules due to good fluid interest. 119 loads of Grade A milk were imported this week, compared to 90 last week.
- Fluid Milk & Cream Review reports milk supplies in Texas are tight. Local cheese production and shipments to bottlers in the Southeast were referenced as causes. Some cheese customers who were sitting on the fence are now ordering to beat the next price increase.
- Some milk handlers in California are scrambling to fill contracts, according to Fluid Milk & Cream Review. Plant intakes are often lighter than desired, especially as finished product prices improve and producers try to build inventories. Processors in Arizona are running on limited schedules. Little, if any milk is available from neighboring states and cream supplies are tightening. Milk production in Utah and Idaho is below year ago levels, but processing capacity has increased in the region, raising demand for fluid milk supplies.
- Central dry whey prices inched higher this week on a firmer market, according to Dairy Market News. Buyer interest is improving from both food and export accounts. Export interest has increased with the decline in the value of the U.S. dollar. Stocks range from light to moderate.
- Dairy Market News reports contracted supplies of Western dry whey are adequate, but spot offerings are harder to find. The market has firmed and some producers are trying to build inventory rather than sell product. Some producers are selling product as fast as they can produce it.
- Western nonfat dry milk supplies are light, according to Dairy Market News. The market tone is firm even as asking prices have been increased. Demand is good for the current production, which is light.

Futures Month	Class III 09/25 Close	Class III 09/18 Close	Change	Dry Whey 09/25 Close	Dry Whey 09/18 Close	Change
Sep-09	\$12.07	\$12.08	(\$0.01)	29.98¢	30.13¢	(0.15¢)
Oct-09	\$12.80	\$12.55	\$0.25	33.00¢	32.50¢	0.50¢
Nov-09	\$13.54	\$13.37	\$0.17	35.00¢	32.75¢	2.25¢
Dec-09	\$14.20	\$13.97	\$0.23	35.25¢	33.00¢	2.25¢
Jan-10	\$14.21	\$14.03	\$0.18	35.00¢	32.05¢	2.95¢
Feb-10	\$14.41	\$14.18	\$0.23	33.00¢	30.58¢	2.43¢
Mar-10	\$14.40	\$14.22	\$0.18	33.00¢	31.00¢	2.00¢
Apr-10	\$14.33	\$14.45	(\$0.12)	36.00¢	31.25¢	4.75¢
May-10	\$14.45	\$14.47	(\$0.02)	31.50¢	31.28¢	0.23¢
Jun-10	\$14.75	\$14.68	\$0.07	34.00¢	30.75¢	3.25¢
Jul-10	\$15.00	\$15.03	(\$0.03)	32.00¢	29.53¢	2.48¢
Aug-10	\$15.30	\$15.38	(\$0.08)	31.03¢	31.00¢	0.02¢
Sep-10	\$15.53	\$15.68	(\$0.15)	30.08¢	30.08¢	0.00¢
Oct-10	\$15.60	\$15.56	\$0.04	30.03¢	30.03¢	0.00¢
Nov-10	\$15.65	\$15.67	(\$0.02)	31.75¢	28.05¢	3.70¢
Dec-10	\$15.75	\$15.80	(\$0.05)	29.03¢	28.03¢	1.00¢
Sep-Dec 2010	\$13.15	\$12.99	\$0.16	33.31¢	32.09¢	1.21¢
2010	\$14.95	\$14.93	\$0.02	32.20¢	30.30¢	1.90¢

Dairy Cow Slaughter (in 1000's)



- Nonfat dry milk production is decreasing in the Central region, according to Dairy Market News. Milk is being moved aggressively into fluid accounts to allow for plant maintenance, and one or two plants in the region do not anticipate restarting drying activities until the end of the year. Building inventories is a high priority for upcoming contract fulfillment, resulting in a general decrease in spot load offerings.
- Wholesale cheese prices are higher in the Eastern region, a reaction to tighter milk supplies, according to Dairy Market News. Fluid sales continue to limit milk volumes available for cheese production, while good demand is noted for mozzarella and Swiss. Aged cheddar demand is sluggish, but expected to pick up soon.
- Dairy Market News reports late August cheese production in the Midwest was reduced as schools pulled milk away from manufacturing. This has limited the volume of cheddar 4-30 days old, eligible for sale at the CME Group. Swiss supplies are short of needs with many cutting blocks as soon as they reach minimum age. Producers are trying to make as much Swiss cheese as milk and plant capacity allows. Fresh mozzarella is also tight to short, with supplemental volumes being pulled from freezers. Current cheddar blocks are adequate, with barrels tight to adequate.
- Western cheese production is steady, with tightness in some areas due to less available farm milk supplies, according to Dairy Market News. Offerings are tight for Swiss due to food service featuring, while seasonal mozzarella demand is tightening supplies as well. Buyers are showing interest in purchasing inventory for fall needs.
- International: A Rabobank dairy report released this week reports the world dairy market has shown a greater than expected improvement, thanks largely to renewed buying from China. Chinese consumers are showing a preference for imported product, after the recent melamine health scare, while powder prices on the world market have been cheap.

What's Bearish:

- Weekly NASS cheese prices fell again according to their most recent survey. 40-lb blocks lost 3.6¢ from last week to average \$1.34/lb and 500-lb barrels fell 4.5¢ to average \$1.29/lb.
- The latest CWT herd retirement round is complete, with the result being the weekly dairy cull substantially lower than the previous two weeks. Just 51,400 head were removed for the week ending 09/12, compared to 55,300 over the same period a year ago. Last week, 64,200 head were culled.
- Large numbers of students out with the flu may impact fluid needs in the Central region, according to Fluid Milk & Cream Review. Cream supplies are available and manufacturing milk interest is uneven, with some buyer resistance noted at the highest prices.
- Butter churning remains heavy in the Midwest, as local milk supplies are higher than they were a year ago. Dairy Market News reports steady supplies of cream are available from bottlers.
- Uncertainty: No markets like the unknown. With both farm lobbying organizations and legislatures in the House and Senate tossing around what to do with \$350 million in aid to the farmer, several outcomes are possible. Politicians like to look like they're doing something for their constituents, regardless of the unintended long-term market consequences. If the funds are used to buy excess cheese and exported or given to food pantries, it might well help milk prices recover quicker, but if they're used to increase support prices, it will likely cause a market sell-off. With these unknowns to deal with, trade volume has decreased as market participants wait it out, and choppy behavior prevails.

Recommendation:

While still dealing with many unknowns in the market, we still think it's safe to say we've put the \$9-10 milk behind us. We're also still optimistic about the long-term future for several reasons: 1.) Though prices have improved, they are still well below cash flow positive for nearly every dairy. In addition, the West and Southwest are still receiving a net pay \$1-2/cwt BELOW monthly CME Class III announced settlements. That means even a \$15 settlement nets only \$13-14 milk. 2.) Though prices have improved, we don't see that anyone in any region is ready to start new, major capital projects to increase milk production at the farm level, and bankers are most likely less than willing to approve it anyway. 3.) We're reading more encouraging stories about the recovery in the international market. If exports pick up on our weaker dollar and we see a call for more milk, all we can say is, "Wow!" 4.) We have done, and are still doing, major damage to the milk supply. So, being that we're most likely still in the early stages of price recovery, what's an appropriate strategy? We would enter GTC orders Jan-Mar to buy 14.00 PUT options for 40¢ each (currently at 80¢). Let the market rally and wait for your price. Enter GTC orders to put on a \$14 floor (\$1.55 cheese), \$18 (\$1.96) cap for up to 25% of your production, April-Dec 2010. Pay up to 30¢ per month.

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