

The KDM Dairy Report – Oct 2nd, 2009

What's Bullish:

- Cash Market: Cheese continued to march steadily higher this week, with blocks picking up 2¼¢ to settle at \$1.43½/lb and barrels jumping 4¼¢ to close at \$1.42/lb. 12 loads of blocks and 4 loads of barrels exchanged hands. Butter lost 2½¢ to settle at \$1.23½/lb, but Grade A nonfat dry milk rocketed 10¢ higher to close at \$1.18/lb.
- CWT announced this week their third herd retirement program of 2009. All bids must be postmarked by Oct 15th, with farm audits running from Nov to early Dec.
- Ag Prices Report: The milk to feed ratio continues to remain well below levels of profitability. The Sep ratio was reported at 1.93, which is up from 1.78 in Aug, but well below the 3.0 level which generally encourages expansion.
- Weekly cold storage numbers are showing a 17% drop in butter stocks at USDA selected storage centers over the period 09/01 through 09/28. 3.2 million lbs were pulled out of inventory. Cheese stocks were down slightly, with 563,000 lbs being drawn.
- 54,600 dairy cows were culled from the herd during the week ending 09/19, up from 51,900 during the same period a year ago.
- Manufacturers in the Northeast are looking to the spot market for additional loads of condensed skim, according to Fluid Milk & Cream Review. Class I demand continues to pull available supplies away from manufacturing plants, who were able to cover contracts, but had little excess supplies available. The Southeast imported 10 fewer loads of Grade A milk this week than last, but demand is expected to pick up as seasonal residents begin to migrate back to Florida.
- Fluid Milk & Cream Review reports milk continues to move out of the Central region into the South. Spot manufacturing milk premiums are firm, with demand exceeding supply in the Minnesota/Wisconsin area. There were a few reports of sales at \$3 over class.
- Good weather conditions, lower feed costs and higher milk prices have been welcomed by California producers; however plant receipts are little changed, according to Fluid Milk & Cream Review. Milk is still being moved around the state to supply customers, and occasional loads are reported to be entering the state from the Pacific Northwest for Class I needs. Milk supplies there are said to be short of full demand, but adequate to meet processing needs.
- Western dry whey prices were firmer this week as supplies are tight, according to Dairy Market News. There is little whey available for the spot market as producers concentrate on filling contract orders. Demand is good with improved interest from export accounts.
- Dairy Market News reports Central dry whey prices were higher this week, reacting to recent export sales in the West that decreased manufacturer holdings in that region. Spot market sales are active with premiums being obtained by most manufacturers.
- The Western nonfat dry milk market is strong, with limited spot offerings to test the market, according to Dairy Market News. Buyer interest is good for the limited offerings, with reports of bids at prices above the range. Contract delivery times are beginning to slip and buyers are not happy. Resale prices have moved higher while drying schedules are lower in many areas due to lower milk production. Stocks are light and held with confidence.
- Lower milk production and Class I demand continue to limit milk supplies available for cheese production in the Northeast, according to Dairy Market News. Demand for Swiss, mozzarella, provolone and low fat cheddar is generally good.
- Commercial Disappearance: USDA published usage numbers for July this week. American cheese use was up 0.9% vs. a year ago, with all other cheese use up 1.1%. Butter use was down 8.7%, but nonfat dry milk use increased 31.7%. But use of milk in all products declined 1.3%.
- International: The USA passed Australia to become the #3 dairy exporter in the world in 2008, behind the EU and New Zealand, according to a Rabobank report. It puts them in position to be a leading dairy exporter.
- International: In Rabobank's "Dairy Quarterly Report", analyst Tim Hunt said the beginning of a global economic recovery was having a positive impact on international dairy prices. The market appears to have made a clear turning point, with economic growth exceeding expectations in some areas. This has led to improved demand, in particular for

Futures Month	Class III 10/02 Close	Class III 09/25 Close	Change	Dry Whey 10/02 Close	Dry Whey 09/25 Close	Change
Oct-09	\$12.80	\$12.80	\$0.00	35.00¢	33.00¢	2.00¢
Nov-09	\$13.96	\$13.54	\$0.42	36.00¢	35.00¢	1.00¢
Dec-09	\$14.44	\$14.20	\$0.24	36.03¢	35.25¢	0.77¢
Jan-10	\$14.44	\$14.21	\$0.23	37.00¢	35.00¢	2.00¢
Feb-10	\$14.46	\$14.41	\$0.05	36.00¢	33.00¢	3.00¢
Mar-10	\$14.60	\$14.40	\$0.20	36.00¢	33.00¢	3.00¢
Apr-10	\$14.52	\$14.33	\$0.19	36.00¢	36.00¢	0.00¢
May-10	\$14.68	\$14.45	\$0.23	35.50¢	31.50¢	4.00¢
Jun-10	\$14.74	\$14.75	(\$0.01)	35.50¢	34.00¢	1.50¢
Jul-10	\$14.94	\$15.00	(\$0.06)	37.00¢	32.00¢	5.00¢
Aug-10	\$15.26	\$15.30	(\$0.04)	36.00¢	31.03¢	4.98¢
Sep-10	\$15.44	\$15.53	(\$0.09)	36.00¢	30.08¢	5.93¢
Oct-10	\$15.50	\$15.60	(\$0.10)	32.50¢	30.03¢	2.48¢
Nov-10	\$15.60	\$15.65	(\$0.05)	32.00¢	31.75¢	0.25¢
Dec-10	\$15.63	\$15.75	(\$0.12)	31.00¢	29.03¢	1.98¢
Q4	\$13.73	\$13.51	\$0.22	35.68¢	34.42¢	1.26¢
2010	\$14.98	\$14.95	\$0.04	35.04¢	32.20¢	2.84¢

whole milk powder, from a sharp jump in Chinese imports, with firm buying from key North African and Middle Eastern countries.

- International: Milk receipts in Western Europe are often lower due to milk strikes in various countries. Low milk prices continue to bring financial stress to producers. Whey prices are moderately higher as cheese output is down. The powder markets are firm as the impact of higher pricing in Oceania continues to carry into other world markets. Current offerings are limited for export accounts as demand has improved.
- International: Cream supplies are tight in Oceania and the market tone is firm, according to Dairy Market News. Demand for powder is picking up from international sources and most current production is committed. There has been a shift from mild skepticism of price increases towards acceptance and improved buying activity. Oceania cheese prices have moved higher and now average \$1.44/lb, with buying interest fair to good.

What's Bearish:

- Dairy Products Report: Cheese output was strong in August, according to USDA numbers. Cheddar cheese production was 2.1% higher than a year ago, but 1.6% lower than in July. Total cheese production was 2.6% higher than last August and 1% higher than in July. Butter production took a big hit, down 13.6% from a year ago and down 12.3% from July.
- September Class III was announced at \$12.11/cwt, down from \$16.28 a year ago and still highly unprofitable for most dairies.
- Cream demand is sluggish in the Central Region, according to Fluid Milk & Cream Review. Some handlers are surprised at how weak current demand is, but ice cream production is grinding lower and cream cheese demand is spotty.
- The Midwest cheese market is unsettled, according to Dairy Market News. New orders range from heavier to lighter, some customers have rebuilt inventory, while others are trying to beat additional price increases. Some operations predict fall/holiday sales will be lighter than normal after customers stocked up earlier in the year.
- Economy: The US shed another 263,000 jobs in September, pushing unemployment to a new 26-year high of 9.8%, according to the Labor Department. The President's \$787 billion stimulus package was promised to create 4 million jobs by the end of 2010. The U.S. would have to go through the greatest 16-month average increase in employment in modern American history to do that.
- Economy: Consumer bankruptcies soared 41% in September vs. a year ago, and climbed 4% from August.
- International: New Zealand milk production has caught up to expectations after a slow start, and Australia has been receiving significant rainfall, according to Dairy Market News. Current output is trending 2% higher than year ago levels in New Zealand, and about 2% lower in Australia due to a decline in cow numbers.

Recommendation:

Powder and cheese were the primary movers of milk prices this week. Both dry whey and nonfat dry milk futures were solidly higher, as international demand/prices for these products have quickly increased in the past few weeks. In the cash market, buyers were clearly in control with sellers putting up just a little fight in each session. News that CWT would be removing another round of cows also helped support this week's market. With most of the cows disproportionately coming out of the Southwest in the prior two rounds, it seems likely that processors in those states will continue to be short of all the milk they'd like. As we stated in last week's report, the damage has been done, and we feel we're in the beginning stages of some price recovery. Before we get all bullish, however, we feel the economy, just like when we had \$20 milk a year ago, is the biggest potential bear. 3.7 million jobs have been lost since the first of the year, while we continue to add to that at about a quarter million new jobless per month. Until our economy starts to add jobs, there is great uncertainty about the health of future dairy demand. The front months responded the most to this week's cheese/powder rally, and the fact that the government may purchase \$60 million of excess cheese and hand it out to food shelves. An additional \$290 million is slated to go into either direct farmer payments or additional dairy product purchases. The last half of 2010 actually saw a net drop this week, with the futures apparently predicting \$15.40 avg milk for those months won't hold. They could be right, in light of the economy and the potential for a slow, jobless recovery. We would continue to get a start on your 2010 hedging with GTC orders Jan-Mar to buy 14.00 PUT options for 40¢ each (currently avg 51¢ but were at 80¢ on last week's rec, so coming down towards our target nicely). 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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