

The KDM Dairy Report – Oct 16th, 2009

What's Bullish:

- Livestock, Dairy & Poultry Outlook Report: Lower milk production and improved exports should combine to strengthen dairy prices in 2010, according to USDA's latest projections. The U.S. dairy herd is expected to average less than 9 million head in 2010, although production per cow is forecast to increase. Nonetheless, milk output in 2010 is forecast to decline 187.2 billion lbs as lower cow numbers trump production increases. In addition, economic recovery has exceeded expectations in several countries in recent months, with the result that demand for dairy products has improved. Increased exports to China and greater sales into North Africa and Middle Eastern countries have boosted world prices. U.S. producers are in position to benefit as the dollar weakens relative to foreign currencies. Class III milk is forecast to average from \$13.85 to \$14.75 per cwt in 2010, while cheddar cheese is expected to average between \$1.52 and \$1.61 per lb.
- All Class III components were higher in this week's NASS survey. 40-lb blocks jumped 5.6¢ from last week to average \$1.37/lb and 500-lb barrels increased 4.7¢ to \$1.39/lb. Butter averaged \$1.23/lb, up 2.5¢, nonfat dry milk increased 0.5¢ to \$1.02/lb and dry whey picked up 1.6¢ to average 31.7¢/lb.
- Class I demand remains strong while the milk supply continues to tighten in the Northeast, according to Fluid Milk & Cream Review. Plants have little, if any, excess fluid supplies once contracts are covered. Mid Atlantic milk supplies are at their lowest levels of the year, and some manufacturing plants have been forced to purchase additional loads to cover contracts.
- With milk production in California continuing to lag last year by 5-7%, plants are looking for additional supplies with little success. Financial stress continues to play a factor. For the same reason, Arizona output is now estimated to be down about 7% from last year, and there is concern that more milk will disappear with the latest CWT action, bankruptcies and selloffs. Cream availability is becoming more problematic as fall approaches. In the Pacific Northwest, lower cow numbers have decreased overall milk intakes, forcing some plants to operate on reduced schedules.
- International: Milk production in Europe is still declining seasonally and stocks of manufactured dairy products are limited, according to Dairy Market News. Prices have risen above EU support levels so product is no longer clearing to intervention programs. Because of the limited availability of commercial dairy product stocks, buyers are paying a firm price for available stock, with even some "panic buying" going on.
- Dairy Market News reports Central dry whey prices are firm, even though inventories are not being characterized as short. The current upward price trend is being influenced by the firm nonfat dry milk market, according to some. Central dry whey continues to move to both Eastern and Western regions of the country due to lack of availability in those areas.
- Western dry whey buyers are seeking additional supplies in anticipation of higher prices, according to Dairy Market News. Spot activity is very light due to most supplies going to contract needs, while production schedules are steady to reduced.
- Prices for Western powder increased sharply this week, according to Dairy Market News. Buyers want more powder and are having great difficulty finding it. Many are going to the resale market where some older powder stocks are still available, but at prices well above the average range. Production is lower with butter/powder plants not getting all the milk that they want. A number of plants report they are down 1-2 days in production per week.
- Dairy Market News reports availability of Central nonfat dry milk is tight, with buyers less concerned about age of material as supplies tighten nationally. In the Eastern region, there is very little drying occurring due to the tight milk supply. Most manufacturers of nonfat dry milk are sold out until Thanksgiving and asking prices are significantly higher. Users are resistant to the high asking prices, but the tight supplies and increased demand may force their hand into trading at these higher levels. Users remain very concerned about availability of future supplies.
- Seasonal declines in milk production and increased Class I demand are limiting manufacturing supplies in the Northeast, according to Dairy Market News. Cheese makers are being forced into reconstituting milk and/or looking to other classes to augment supplies. Most plant managers would like to expand production schedules in preparation for holiday orders, but are finding it difficult to do so.
- A net 3 million lbs of butter were pulled from CME approved warehouses during the week ending 10/10, compared to a 2.5 million lb drawdown during the same period a year ago. This reverses a trend of smaller drawdowns for the past several weeks.
- International: Dairy Market News reports the average price for dry whey in the EU has risen to 46¢/lb for the two weeks ending 10/16. Prices are firm in a tight market.
- International: Milk production in Oceania continues to rebound after a slow start, and Australia is getting badly needed rainfall, but the weaker U.S. dollar and the close balance of dairy product supplies are putting upward pressure on prices. Dairy Market News reports most traders and handlers say they are able to handle established customer needs, but have minimal volumes of stock

Futures Month	Class III 10/16 Close	Class III 10/09 Close	Change	Dry Whey 10/16 Close	Dry Whey 10/09 Close	Change
Oct-09	\$12.73	\$12.75	(\$0.02)	31.50¢	32.00¢	(0.50¢)
Nov-09	\$13.80	\$14.50	(\$0.70)	35.00¢	35.50¢	(0.50¢)
Dec-09	\$14.19	\$14.70	(\$0.51)	36.75¢	37.50¢	(0.75¢)
Jan-10	\$14.29	\$14.75	(\$0.46)	37.00¢	37.75¢	(0.75¢)
Feb-10	\$14.46	\$14.62	(\$0.16)	34.00¢	37.50¢	(3.50¢)
Mar-10	\$14.70	\$14.87	(\$0.17)	36.03¢	36.50¢	(0.48¢)
Apr-10	\$14.73	\$14.77	(\$0.04)	37.25¢	37.50¢	(0.25¢)
May-10	\$14.75	\$14.81	(\$0.06)	36.75¢	37.50¢	(0.75¢)
Jun-10	\$14.90	\$14.90	\$0.00	35.25¢	36.00¢	(0.75¢)
Jul-10	\$15.15	\$15.05	\$0.10	35.00¢	35.00¢	0.00¢
Aug-10	\$15.33	\$15.30	\$0.03	35.50¢	36.00¢	(0.50¢)
Sep-10	\$15.40	\$15.43	(\$0.03)	35.50¢	35.50¢	0.00¢
Oct-10	\$15.50	\$15.48	\$0.02	34.75¢	34.75¢	0.00¢
Nov-10	\$15.64	\$15.52	\$0.12	33.00¢	33.00¢	0.00¢
Dec-10	\$15.64	\$15.66	(\$0.02)	32.50¢	32.75¢	(0.25¢)
Q4	\$13.57	\$13.98	(\$0.41)	34.42¢	35.00¢	(0.58¢)
2010	\$15.04	\$15.10	(\$0.06)	35.21¢	35.81¢	(0.60¢)

available for new or additional buyer interest. Most feel prices will remain firm into 2010. Oceania cheddar prices have risen to \$1.47/lb and while cheese production is keeping up with needs, supplies are in close balance.

- International: The China Health Promotion Foundation continues to promote milk consumption in the country, setting up advertising billboards in first and second tier Chinese cities, according to an article this week in "China International Business". Despite the recent melamine / tainted milk scare which put thousands in the hospital last year, the Chinese milk industry has been among the more successful sectors in 2009. Sales have recovered to 70% of pre-scandal levels, but some are more bullish, saying sales have fully recovered already. Overall, China's dairy sales rose 12.4% in the first quarter of 2009 compared to the last quarter in 2008.

What's Bearish:

- Cash Market: Blocks lost 7¼¢ in this week's spot market, settling at \$1.43/lb on Friday. Barrels were unchanged at \$1.43/lb, but had been as high as \$1.45¾/lb earlier this week. 24 loads of blocks exchanged hands as sellers returned, but only 2 loads of barrels traded. Butter made a small ½¢ gain to close at \$1.24¼/lb on 6 trades. The other lone bright spot was Grade A nonfat dry milk which picked up another 3½¢ to close at \$1.31½/lb on no trades.
- Fluid Milk & Cream Review reports many retailers in the Central region cut back on features this week, decreasing the need for refilling store coolers. Orders from school districts are also lower, as administrators close schools as a response to student illness. Demand for spot loads of milk is still good, but premiums have tapered back to about \$2.50 over class. Cream availability is ample in the area and demand is lower.
- Butter producers and handlers indicate that the market is firm, but do not anticipate a significant increase in price due to heavy stocks. Dairy Market News reports most butter producers feel they will have sufficient volumes to meet year end needs.
- Midwest cheese inventories are building slightly as a result of slowed purchasing, according to Dairy Market News. Buyers are confused as to what is moving the markets, which has resulted in some decline in anticipated purchasing as buyers step back to evaluate market dynamics.
- Dairy Market News reports supplies of Western cheese are adequate for current contract needs, even though production is slightly behind year ago levels.
- Weekly cold storage numbers indicate cheese stocks at USDA selected storage centers increased 2%, or about 2 million lbs, for the period 10/01 through 10/12. Butter stocks, however, declined 5% over the same period.
- While we wait for the next CWT round to begin, cow slaughter numbers typically decline while producers wait to see if their bids are accepted. Just 49,000 head were culled in this week's dairy cow cull, compared to 52,100 during the same period a year ago.
- International: The Foreign Ag Service reported this week that Jan-Aug butter exports declined 83% compared to the same period last year, while imports of high tier and quota butter from Jan-Sep increased 351% vs. a year ago. Exports of nonfat dry milk Jan-Aug were down 21% from the same period in 2008. Quota cheese imports through September totaled 147.2 million lbs, an increase of 15.7% over last year, while exports of cheese and curd through August were down 27%.

Recommendation:

Cheese is weak, powders are strong. After two straight weeks of nothing but increases, the cash market showed some weakness after blocks breached \$1.50/lb and sellers returned and took control, pushing prices back down. Powders on the other hand continued to make solid gains in light of tightening supplies. The drop in the cheese market could be a recognition that support prices, temporarily boosted, are set to go back to prior levels Nov 1st. We believe, however, that this drop in the cheese price is temporary. While we could see pressure here for awhile, the bottom line is long term milk is tightening up and the latest CWT round will likely take a disproportionate number of animals out of the Southwest, making it near impossible for that region to increase production levels. Processors in those areas are likely to continue to run on reduced schedules, which should support nonfat dry milk prices (since most is dried there) and ultimately bring cheese prices back. The most recent export data clearly shows perhaps the major reason we've had too much milk in the U.S. through August. Exports were down double-digits; but more recent news is telling us the export market could be making a comeback. After the financial beating the dairy industry has taken this year, an improvement in dairy exports going forward would go a long way in taking prices significantly higher. Take advantage of this dip in prices and purchase CALL options in Q1. Enter orders to buy Jan 15.00 CALLs at 35¢, Feb 15.25 CALLs at 35¢ and Mar 15.75 CALLs at 35¢. These are within a few cents of settlement prices. If successful in purchasing these next week, enter GTC sell orders to lock in milk at 14.50 Jan, 14.75 Feb and 15.00 Mar.

Announcement: KDM Trading, Inc. is pleased to introduce Nick Potter as its newest member and broker. Prior to joining KDM, Nick spent the last three years obtaining a law degree from John Marshall Law School in Atlanta, GA. He received his bachelor degree from the University of Wisconsin – La Crosse and is now located in Denver, CO with his wife Tracy, where KDM has established its newest branch office.

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