

**The KDM Dairy Report – Nov 6<sup>th</sup>, 2009**

**What's Bullish:**

- Cash Market: Cheese, butter and nonfat dry milk each made new annual highs this week, as a combination of international pricing and multiple bidders combined to push prices up. Blocks picked up a nickel for the week to close at \$1.56/lb on active buying of 23 loads. Barrels gained 3¾¢ to settle at \$1.52½/lb on just 7 trades. Butter was the star, jumping up 9¢ to close at \$1.50/lb on 4 trades, while nonfat dry milk gained 3½¢ to reach \$1.37/lb.
- Dairy products prices for Class III components were higher again in this week's NASS survey. 40-lb blocks increased 1.7¢ and 500-lb barrels were up 1.5¢ with both averaging \$1.47/lb. Dry whey jumped 1.4¢ to average 34¢/lb and butter shot up 5¢ to \$1.30/lb, but nonfat dry milk decreased 1.6¢ to \$1.02/lb.
- Dairy Products Report: While cheese production aspects of this report were bearish (see below), butter output in Sep was down a sharp 22% from a year ago, and down 6.2% from August. In addition, manufacturers total dry whey stocks at the end of the month were down 25.4% from a year ago.
- Both cheese and butter stocks at USDA selected storage centers continue to reflect a drawdown. For the period 10/01 through 11/01, cheese holdings fell 2.3 million lbs, or 2%, while butter stocks dropped 1.1 million lbs, or 7%.
- Butter movement at CME-approved warehouses for the week ending 10/31 shows a new drawdown of 7 million lbs, more than double the 3.2 million lbs pulled during the same period a year ago, and the largest weekly drop in almost 2 years.
- Milk supplies in the Central region needed for fluid uses were tighter this week, according to Fluid Milk & Cream Review. Reasons cited for the reduction were declines in direct-shipped loads, demand for some other manufactured dairy products and increased production of holiday items. Comments continue that crops have not field dried down much, while wet field conditions have delayed corn silage from being harvested at their peak condition. Mold in standing crops was frequently noted.
- With California milk production still 6-8% below year ago levels, competition for milk has increased, according to Fluid Milk & Cream Review. Buyers are paying \$1-2 over class to secure extra milk, while manufacturers are short of milk and not willing to give up milk and risk falling further behind on finished product needs. Milk output in Arizona is flat, remaining well below year ago levels. Several more herds are set to depart due to the CWT program in coming weeks. The impact is more severe because of low milk output already in the state, which further compounds the situation. Plants would like more milk to fill contracts, but are finding extra loads almost impossible to locate from nearby states. Processing plants in New Mexico have extra room to handle more milk, so some are taking down time for maintenance. In the Pacific Northwest, processors continue to run on shortened schedules, with limited spot loads of milk being absorbed quickly. Farmers are actively looking to lock in forage needs for the winter, but high quality hay supplies are limited.
- Dairy Market News reports butter orders in the Central region are surpassing current production, causing suppliers to reach further into inventory to fill needs. Cream volumes are lighter than desired by most butter producers. Retail feature activity is very apparent, with "free pound of butter" promotions expected to attract good buyer interest. Domestic butter producers continue to report international buyer interest, with some now looking at possibly filling some of these inquiries.
- Western butter producers are busy filling orders, with one reporting they are booked to capacity until after Thanksgiving, according to Dairy Market News. Domestic sales to retail and club accounts are good, and export interest is turning into some reported sales.
- Demand for Western dry whey remains good while supplies are described as tight, according to Dairy Market News. Production levels are reduced from last year due to lower farm milk intakes, with little being offered to the spot market.
- Western manufacturers have very limited spot loads of nonfat dry milk to offer as they struggle to even meet contract requirements, according to Dairy Market News. Drying levels continue to be below projections as less milk is coming into most Western plants, reflecting lower milk production and placement of milk into cheese production.

Futures Month	Class III 11/06 Close	Class III 10/30 Close	Change	Dry Whey 11/06 Close	Dry Whey 10/30 Close	Change
Nov-09	\$14.00	\$13.93	\$0.07	34.50¢	33.75¢	0.75¢
Dec-09	\$14.69	\$14.87	(\$0.18)	36.39¢	34.75¢	1.64¢
Jan-10	\$14.87	\$14.96	(\$0.09)	39.00¢	37.25¢	1.75¢
Feb-10	\$14.97	\$15.06	(\$0.09)	38.00¢	36.50¢	1.50¢
Mar-10	\$15.15	\$15.14	\$0.01	37.25¢	36.25¢	1.00¢
Apr-10	\$15.39	\$15.24	\$0.15	36.75¢	36.08¢	0.67¢
May-10	\$15.40	\$15.18	\$0.22	36.25¢	36.50¢	(0.25¢)
Jun-10	\$15.45	\$15.20	\$0.25	37.98¢	36.25¢	1.73¢
Jul-10	\$15.51	\$15.33	\$0.18	37.00¢	35.00¢	2.00¢
Aug-10	\$15.58	\$15.50	\$0.08	35.53¢	35.05¢	0.48¢
Sep-10	\$15.70	\$15.66	\$0.04	37.00¢	35.55¢	1.45¢
Oct-10	\$15.64	\$15.54	\$0.10	36.00¢	34.50¢	1.50¢
Nov-10	\$15.69	\$15.62	\$0.07	36.50¢	34.75¢	1.75¢
Dec-10	\$15.69	\$15.68	\$0.01	35.00¢	32.75¢	2.25¢
<b>2010</b>	<b>\$15.42</b>	<b>\$15.34</b>	<b>\$0.08</b>	<b>36.85¢</b>	<b>35.54¢</b>	<b>1.32¢</b>

- Dairy Market News reports cheese demand in the Northeast is good and production is active. Demand for mozzarella and provolone has increased and cheddar cheese makers are expanding inventories to take advantage of the current milk price. Seasonal declines in milk production continue to limit schedules for some cheese makers.
- Western cheese prices continue to firm and are at yearly highs, according to Dairy Market News. Cheese production is matching demand, but some plants are seeking additional milk supplies with little success.
- International: Fonterra's most recent Global Dairy Trading event listed anhydrous milk fat (99%) for the first time, with deliveries for the first half of 2010 averaging \$2.16/lb. Whole milk powder jumped 11% to about \$1.52/lb. Prices all deliverable contracts

### **What's Bearish:**

- Dairy Products Report: Total U.S. cheese output in Sep was up 4.4% in Sep vs. a year ago. Cheddar output was 8% higher with all American types up 6.4% over the same period.
- Cheese plants we spoke to this week in the Midwest indicate sales are slowing down and cheese inventories are starting to build. Customers are switching to less expensive varieties from more costly specialty cheeses. That seems to confirm Dairy Market News' Midwest cheese outlook this week. They report that overall demand lacks the usual holiday season aggressiveness. Plants have more product to move, including current blocks and barrels. The usual fall tightness in pepper jack and Colby jack has not been an issue reported this year.
- Dairy cow slaughter for the week ending 10/24 totaled 51,300 head, which was 500 head fewer than during the same period a year ago. CWT slaughter has yet to kick in.
- Lower Class I demand and milk production increases have partially eased the tight milk situation in the Eastern region, according to Fluid Milk & Cream Review. Most balancing plants were able to cover contract minimums and milk supplies for manufacturing use was improved. Zero loads were imported into the region this week, compared to 78 last week and 173 a year ago.
- Economy: The U.S. jobless rate in October topped 10% for the first time since 1983, according to the Labor Department. The unemployment rate jumped to 10.2%, up from 9.8% in September, and experts believe the rate is likely to go higher as the economy remains weak. And the number of Americans who have been without a job for six months or longer climbed to 5.6 million, a record.
- International: Australia's ability to export finished dairy products is vastly improved this season over last. July-Sep butter exports are up 50.4% over 2008 and cheddar cheese exports have jumped 24.6%, according to Dairy Australia figures released this week. Total dairy exports are up 24.6% over the same period.

### **Recommendation:**

We're nervous and you should be too. Despite a pretty strong showing in this week's cash market, with multiple aggressive buyers taking on 23 loads of cheese, the front months finished lower than a week ago. The current cash prices for cheese, butter and whey work out to about \$14.65 Class III. With Dec set to begin pricing in a week, it is holding very little premium to cash; so are Jan & Feb. Combine that with contacts we talked to this week saying cheese in the Midwest is plentiful and sales are slowing, and one can understand the market's reluctance to push much higher. The market is waiting for something to happen: if cheese makes another strong move higher next week, say above \$1.60, the front months will react and jump higher, but if we see any sign of weakness, we could see the whole first half of 2010 make a sizeable mover lower as producers and specs all try to sell at once. You need to get a much larger percentage of Dec and Q1 2010 covered. Last week we said to cover up to 25% of your milk for Jan and Feb at \$15.10 and \$15.15 respectively. Those prices all would have filled this week. This week we're advising you to get up to 75% covered at these prices or higher, and sell March at \$15.35 or higher as well. Once sold, we'll work on getting call options bought to protect the upside. Something stinks about this lack of a stronger rally in the futures despite what appears on the outside to be a firm cash market. Sometimes the core is rotten on a shiny apple. Big picture, we still see the potential for quite a bit of upside in butter and powder as they respond to international tightness. The first reports of real butter exports this week were encouraging. And there's a chance that cheese buyers will continue to buy the extra cheese we're hearing about in the Midwest due to lighter inventories and a milk production shortage in other parts of the country. But, we don't think it's worth the risk, especially in light of the long-term prospects for the economy. Get some coverage next week. If you don't want to sell outright, then buy PUT options. You can get "disaster" insurance: Dec 14.00 put for 15¢, Jan 14.25 put for 35¢, Feb 14.25 put for 35¢, Mar 14.25 put for 40¢. Don't wait around; get this done.

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