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The KDM Dairy Report – Nov 13th, 2009

What's Bullish:

Futures Month	Class III 11/13 Close	Class III 11/06 Close	Change	Dry Whey 11/13 Close	Dry Whey 11/06 Close	Change
Nov-09	$14.05	$14.00	$0.05	34.75¢	34.50¢	0.25¢
Dec-09	$14.41	$14.69	($0.28)	36.00¢	36.39¢	(0.39¢)
Jan-10	$14.55	$14.87	($0.32)	39.00¢	39.00¢	0.00¢
Feb-10	$14.67	$14.97	($0.30)	38.50¢	38.00¢	0.50¢
Mar-10	$14.89	$15.15	($0.26)	38.00¢	37.25¢	0.75¢
Apr-10	$15.20	$15.39	($0.19)	39.00¢	36.75¢	2.25¢
May-10	$15.40	$15.40	$0.00	38.00¢	36.25¢	1.75¢
Jun-10	$15.50	$15.45	$0.05	39.75¢	37.98¢	1.78¢
Jul-10	$15.72	$15.51	$0.21	38.53¢	37.00¢	1.53¢
Aug-10	$15.75	$15.58	$0.17	37.75¢	35.53¢	2.23¢
Sep-10	$15.78	$15.70	$0.08	37.75¢	37.00¢	0.75¢
Oct-10	$15.68	$15.64	$0.04	37.55¢	36.00¢	1.55¢
Nov-10	$15.72	$15.69	$0.03	37.75¢	36.50¢	1.25¢
Dec-10	$15.69	$15.69	$0.00	36.53¢	35.00¢	1.53¢
2010	**$15.38**	**$15.42**	**($0.04)**	**38.18¢**	**36.85¢**	**1.32¢**

- World Ag Supply & Demand Report: USDA cites improved global demand and concerns about world supplies of dairy products in revising their 2010 price forecasts higher. Class III is now expected to average $15.40/cwt, up a solid $1.10/cwt from last month's forecast. Cheese is expected to average $1.65/lb, up 9¢ from last month's prediction of $1.56/lb. Finally, the nonfat dry milk forecast was ramped up 24¢ from last month and is now expected to average $1.23/lb.
- All Class III components were higher in this week's survey. 40-lb blocks averaged $1.48/lb, up 0.7¢, while 500-lb barrels increased 2.9¢ to $1.50/lb. Butter jumped 1.9¢ to average $1.31/lb, nonfat dry milk shot 10.2¢ higher to $1.12/lb and dry whey nudged up 0.4¢ to average 34.4¢/lb.
- For the first 9 days of Nov, weekly cold storage stats are showing a 1% drop in cheese stocks and an 8% decline in butter stocks at USDA selected storage centers.
- Butter continues to fly out of CME-approved warehouses. 7.4 million lbs were pulled off the shelves for the week ending 11/07, compared to a drawdown of 5.4 million lbs during the same period last year. Total stocks on hand are 61.6 million lbs, which is more than the 46 million lbs we had a year ago, but closing in quickly.
- Milk supplies in the Northeast and Mid Atlantic remained tight this week, according to Fluid Milk & Cream Review. Class I demand is strong as bottlers prepare for the busiest time of the year, while Class II and III manufacturers are absorbing most available supplies for holiday product production. Some balancing plants have delayed production until supplies are adequate.
- Increasing milk prices are helping returns, but they remain below the cost of most California producers, according to Fluid Milk & Cream Review. Output in Arizona remains at levels double-digits below a year ago which is impacting processors. Milk is being divided up and some plants are not running, or are on reduced schedules. Cream supplies are tight and prices are higher with a firm market tone. Butter makers are taking all the cream they can get to keep pace with good butter orders. Milk production in the Pacific Northwest remains flat, with some processors working on reduced schedules. High quality alfalfa is hard to find, and many producers are still buying hand to mouth as hay dealers are demanding immediate payment rather than extending credit.
- Churning activity is trending lower across the country as milk volumes decline and cream is absorbed into other class production, according to Dairy Market News. Demand for butter remains strong as Thanksgiving nears and year end orders continue to be placed. Retail feature activity is clearing heavy volumes of butter, with additional features continuing to be reported. International buyer interest is resulting in some domestic producers filling some of these inquiries before year's end and into the new year.
- Dairy Market News reports Central dry whey sellers indicate little push-back against higher prices this week. Whey production is lower at some locations as some plants have switched to butter/powder production over cheese this week.
- Western whey supplies are tight, according to Dairy Market News. Prices are trending higher and spot loads are available in limited supply.
- International: Manufacturing schedules in Europe are declining along with the seasonal drop in milk production, according to Dairy Market News. Stocks of several dairy products are limited to the point that prices continue to rise. Export subsidies have been removed to zero, except for butter and butter oil, which were cut by 61%. Butter prices are firm, averaging $2.22/lb, while whey is averaging 48¢/lb.
- International: Milk production in New Zealand is at seasonal peak levels, but only 0.6% ahead of last year, which is not as much as forecast. Australia milk output is also near its peak, but trails last year's levels. Manufacturing of dairy end products is strong, but little output is uncommitted, and some suppliers are looking to international sources to secure additional stock so that previously made commitments can be fulfilled. Butter prices are firm, averaging $1.64/lb, and cheddar cheese is averaging $1.75/lb.

What's Bearish:

- Cash Market: Blocks picked up 1½¢ to close at $1.57½/lb and butter increased 2½¢ to settle at $1.52½/lb, both new highs for the year, but barrels fell 8¼¢ for the week to $1.44¼/lb. Trading was fairly heavy, with 25 blocks, 12 barrels and 29 cars of butter exchanging hands.
- Fluid Milk & Cream Review reports Florida exported 20 loads of milk this week, the first time they've had excess supplies since becoming a milk deficit state during the summer. Increased production was cited as the reason.
- Current cheddar supplies in the Midwest are not particularly tight, according to Dairy Market News. Barrels are readily available and Natural American supplies are adequate to meet demand.

Recommendation:

Despite cash butter and blocks making new highs for the year, barrels rained on the party. We were rightfully worried last week as the market refused to move higher despite increases in cash cheese prices. We said the market was "waiting for something to happen" and it did. The abundant barrel supply we mentioned spilled over into the cash market with barrels dropping from a high of $1.52½/lb on Monday to a low on Thursday of $1.43½/lb. Dec '09 and Q1 2010 futures sold off in a big hurry though the last half of 2010 finished with a net gain for the week. Dry whey also saw a strong week with several months up close to 2¢ or more. The international picture remains positive as a weak dollar and expensive domestic dairy products are resulting in improved U.S. export interest. $1.75 cheddar in Oceania and $2.22 butter in Europe should limit how far down our cheese and butter prices could go. And with a ray of hope to finish the week, barrels were bid ¾¢ on Friday and blocks made a new annual high of $1.57½ which set futures on fire briefly, before finishing the day still in positive territory. It appears we still need to work through this barrel weakness; expect more volatility next week. But the bid for blocks with multiple buyers present should make the current retracement temporary in nature. The December contract remains vulnerable as it begins pricing Monday. It reached a high of $14.70 today but settled at $14.41. We would sell it at $14.85 or higher. For Q1, consider buying $15.00 to $16.00 calls on any price weakness next week, then place orders to sell your milk within 50¢ of the strike price of the options. This was successfully done for several producers during the last price pullback and may work out again. Q2 and beyond seem well supported, so we wouldn't be sellers there at this point.