

**The KDM Dairy Report – Dec 11<sup>th</sup>, 2009**

**What's Bullish:**

- Thursday's Daily Dairy Report headline, "Exports Stronger in October". U.S. dairy exports in October were the highest of the year as well as topping last October's levels. Several dairy product categories were significantly higher, and cheese exports were just 5.5% lower.
- World Ag Supply & Demand Report: USDA increased their Class III forecast from last month by 48¢/cwt. 2010 is now expected to average \$15.55/cwt. Despite improving milk prices and an increase in their 2010 milk production estimate, improving demand is expected to support prices for most products.
- Cash Market: Strong buying kept block prices relatively high at \$1.70/lb, down 1¾¢ for the week, while barrels were unchanged from last Friday at \$1.46/lb. Butter was unchanged as well, holding at \$1.45/lb. 19 loads of blocks, 2 barrels and 20 cars of butter exchanged hands.
- NASS Class III components were all higher in this week's survey. 40-lb blocks jumped 2.7¢ to average \$1.58/lb and barrels gained 2¢ to \$1.52/lb. Butter bumped up 0.8¢ to average \$1.50/lb, nonfat dry milk shot 5.7¢ higher to \$1.26/lb and dry whey increased 0.9¢ to 36.2¢/lb.
- Milk supplies in the Southeast are very tight, according to Fluid Milk & Cream Review, with strong pulls from bottling plants. There are no manufacturing supplies available and plants are seeking additional supplies without much success. Significant rains are adversely affecting milking conditions and production.
- From the Southwest to Pacific Northwest, plants have plenty of capacity to handle additional milk, according to Fluid Milk & Cream Review. Output in California continues to lag year ago levels, while balancing plants in New Mexico are still running on reduced schedules. Plants in Utah and Idaho are looking for more milk but are having little success.
- Lagging milk production in the Southwest is having a major impact on butter production, according to Dairy Market News, while retail sales have been reported as good. The food service sector also indicates an improving environment.
- Central dry whey producers are holding stocks with confidence in a firm market, according to Dairy Market News. Offerings are on the light side, despite a recent uptick in output. Some buyers are reaching to resellers to find desired volumes of product.
- Western dry whey producers indicate they are comfortable to tight on their current stock levels. Powder production is at or below expectations, while both domestic and export buyers continue to take good volumes.
- Economy: U.S. retail sales in November were unexpectedly strong, climbing 1.3% during the month, which is the largest advance since August. The strong sales data bodes well for the holiday shopping season as consumer outlook on the economy has improved.
- International: Dairy Market News reports milk production in both New Zealand and Australia is below expected levels. New Zealand is running 1-1.5% higher and Australia is 3.9% lower. Many processors anticipate that future output will not be strong enough to make up for these early season declines. Oceania traders and handlers indicate that product availability is often limited, since most current production and stock is committed to regular customers. With tight supplies, some are looking to outside sources for supplemental stock. Butterfat is in strong demand and is averaging \$1.88/lb. Cheese markets are firm as well, with negotiations for contracts in 2010 at or near \$5,000 per metric ton, or about \$2.27/lb. For the two weeks ending 12/11, cheddar cheese sales averaged \$2.00/lb.
- International: July-Oct dairy product exports Down Under increased 12% in 2009 compared to a year ago, according to Dairy Australia. While this might seem bearish, it's impressive in that world dairy prices continue to increase despite this, which indicates stronger demand.
- International: Global dairy market analysts Rabobank, in their most recent report, conclude the most recent boom to bust cycle has drawn to a close. They conclude that the global dairy sector is emerging into a time of solid fundamentals with demand growth supporting price recovery into 2011-13. They state dairy consumption growth came out largely unscathed, and as per-capita income once more begins to increase, dairy demand is expected to rise steadily. In addition, milk supply constraints in low-cost production regions, largely in the Southern Hemisphere, are likely to push up global prices and increase calls for exports from the U.S. and EU that have capacity to expand.

Futures Month	Class III 12/11 Close	Class III 12/04 Close	Change	Dry Whey 12/11 Close	Dry Whey 12/04 Close	Change
Dec-09	\$14.83	\$14.73	\$0.10	36.68¢	36.03¢	0.65¢
Jan-10	\$14.93	\$14.54	\$0.39	37.50¢	38.00¢	(0.50¢)
Feb-10	\$15.00	\$14.62	\$0.38	38.00¢	37.80¢	0.20¢
Mar-10	\$15.39	\$15.08	\$0.31	38.25¢	38.00¢	0.25¢
Apr-10	\$15.48	\$15.30	\$0.18	39.00¢	38.75¢	0.25¢
May-10	\$15.52	\$15.50	\$0.02	37.03¢	36.78¢	0.25¢
Jun-10	\$15.85	\$15.79	\$0.06	38.53¢	37.98¢	0.55¢
Jul-10	\$16.20	\$16.14	\$0.06	36.95¢	38.50¢	(1.55¢)
Aug-10	\$16.27	\$16.20	\$0.07	37.50¢	38.75¢	(1.25¢)
Sep-10	\$16.30	\$16.17	\$0.13	37.75¢	39.00¢	(1.25¢)
Oct-10	\$16.12	\$16.06	\$0.06	36.10¢	37.25¢	(1.15¢)
Nov-10	\$16.03	\$15.95	\$0.08	36.25¢	36.75¢	(0.50¢)
Dec-10	\$16.05	\$15.98	\$0.07	35.00¢	36.50¢	(1.50¢)
<b>2010</b>	<b>\$15.76</b>	<b>\$15.61</b>	<b>\$0.15</b>	<b>37.32¢</b>	<b>37.84¢</b>	<b>(0.52¢)</b>

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

- Dairy cow slaughter for the week ending 11/28 totaled just 40,500 head, nearly 14,000 head fewer than a week ago and less than the 43,800 head during the same period in 2008.
- The Midwest cheese market remains the weakest of the three regions. Manufacturers noted a reduction in buyer interest for aging programs and that export interest for cheddar is weak. The wide block – barrel spread is causing further uncertainty in the cheddar market, with some manufacturers reducing production.
- Fluid Milk & Cream Review reports milk supplies in the Northeast and Mid-Atlantic are adequate for balancing plants. Some bottlers and cheese plants even pushed milk back.
- Despite a major winter storm that left 12-20 inches of snow in much of the Midwest, very little impact was felt on the milk supply, according to Fluid Milk & Cream Review. Production is starting to trend higher in some areas, while many bottlers are expected to reduce their schedules for the upcoming holiday period.
- Dairy Market News reports butter demand is expected to drop off very soon, since Christmas/New Year's is just three weeks away. Butter producers anticipate that cream offerings will soon increase once holiday item production declines.

### **Recommendation:**

Last week the pendulum was swinging bearish as the idea of a wide spread between blocks and barrels in a weak barrel market brought sellers to Class III futures. However, despite blocks giving up  $1\frac{3}{4}\phi$ , the further we got into the week with blocks basically holding steady with buyers snapping up any offers and barrels refusing to fall further, the pendulum swung back as sellers covered positions and new buyers jumped in. With the cash price stuck close to \$15.00/cwt equivalent milk price, Jan futures at one point dipped below \$14.40 in early week trading. But again, as the cash market refused to break, Jan and Feb futures were quickly brought back close to parity. Where we go from here is hard to say in the short run. We are probably still long barrels, but with pretty positive global dairy news being backed up by actual October export numbers, put us back in the Bull camp. That's not to say producers should sit idly by. Big players could dump product at any time, but we are saying that the long-term outlook appears good. Keep an eye on the U.S. dollar, however. It made strong gains against the Euro and other currencies this week as U.S. economic data is improving. A strong dollar will make dairy exports more expensive, despite their current discount to world prices. We would not be milk sellers at this point, but would defend prices with PUT options. The Jan-Mar 14.50 PUTs average 28¢ each. Target to buy them at an average 25¢ next week. As more market participants come under the realization that perhaps the bear run is over, be prepared for more volatility ahead!

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