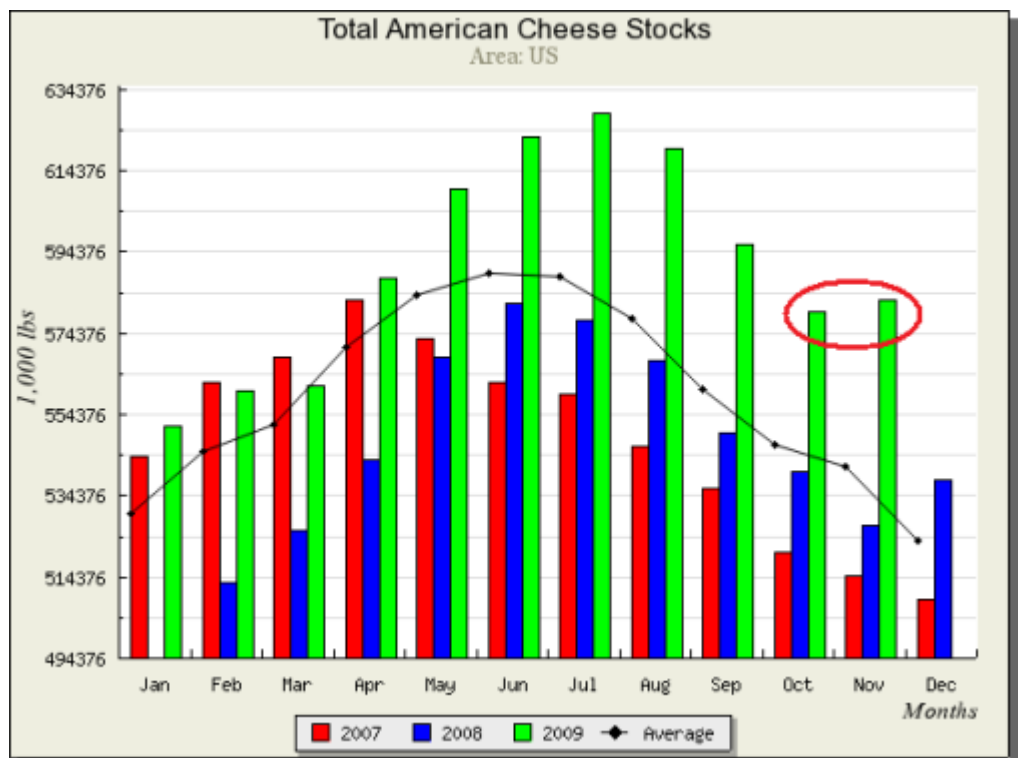


The KDM Dairy Report – Dec 24th, 2009

What's Bullish:

- Cheddar blocks jumped 5.2¢ to average \$1.67/lb in this week's NASS survey. Barrels were just 0.3¢ higher at \$1.51/lb. Butter decreased 1.7¢ to average \$1.44/lb, but nonfat dry milk gained 1.7¢ to \$1.29/lb and dry whey tacked on 0.4¢ to 36.8¢/lb.
- Weekly cold storage numbers continue to reflect a strong butter drawdown at USDA selected storage centers. For the period 12/01 through 12/21, butter holdings fell 37%, or 3.5 million lbs. Cheese holdings over the same period declined less than 1%, or 373,000 lbs.
- Dairy cow slaughter for the week ending 12/12 was a solid 52,000 head. YTD the dairy cull is now 240,000 head above last year.
- Livestock Slaughter Report: 208,900 cows exited the milking herd in Nov, up just 700 head from last Nov. However, Jan-Nov 2.58 million head have been culled, up 222,000 head from 2008.
- There was a big draw for milk in the Midwest this week, as stores stocked up for an expected winter storm, according to Fluid Milk & Cream Review. This was helpful to manufacturing plants trying to clean out raw product inventory. Orders were also surprisingly strong for high fat items such as dips and sour cream.
- Recent price increases have helped ease immediate financial needs to producers in the Pacific Northwest, but bankers remain reluctant to offer financial support, according to Fluid Milk & Cream Review. Many are cautious due to new regulations for farm operating loans.
- Central dry whey prices continued to move higher this week, averaging 37¢/lb, according to Dairy Market News. The market is firm and spot loads are easily clearing. Western dry whey prices remain steady, with continued good demand from both domestic and export interests. Supplies remain tight in the Northeast as whey demand continues to be strong. Supplies have very little uncommitted inventories and are sourcing product from the Midwest and West to satisfy demand.
- International: Most EU countries are reporting milk volumes behind previous year levels, according to Dairy Market News. While there will be extra milk over the holidays, traders anticipate buyer interest will pick up in the New Year.
- International: Milk output in Oceania is not as high as original forecasts expected. As a result, Dairy Market News reports manufacturing plants are juggling milk volumes towards products of most need and best returns. Some handlers state there are supply gaps in all manufactured dairy products, with some looking to outside sources to supplement local stocks. Cheese demand is strong and prices are firm in the region, with cheddar approaching \$2.27/lb. Some believe if milk continues to drop off, cheese output will be in jeopardy.

Futures Month	Class III 12/24 Close	Class III 12/18 Close	Change	Dry Whey 12/24 Close	Dry Whey 12/18 Close	Change
Dec-09	\$14.84	\$14.83	\$0.01	36.28¢	36.50¢	(0.23¢)
Jan-10	\$14.31	\$14.76	(\$0.45)	36.75¢	37.25¢	(0.50¢)
Feb-10	\$14.23	\$14.68	(\$0.45)	35.00¢	37.00¢	(2.00¢)
Mar-10	\$14.69	\$15.02	(\$0.33)	35.25¢	38.03¢	(2.78¢)
Apr-10	\$14.80	\$15.25	(\$0.45)	36.50¢	38.00¢	(1.50¢)
May-10	\$15.12	\$15.35	(\$0.23)	35.00¢	37.05¢	(2.05¢)
Jun-10	\$15.60	\$15.77	(\$0.17)	36.75¢	37.00¢	(0.25¢)
Jul-10	\$15.96	\$16.10	(\$0.14)	35.75¢	36.50¢	(0.75¢)
Aug-10	\$16.02	\$16.13	(\$0.11)	34.75¢	36.00¢	(1.25¢)
Sep-10	\$16.14	\$16.16	(\$0.02)	35.48¢	36.75¢	(1.28¢)
Oct-10	\$16.05	\$16.02	\$0.03	34.75¢	35.50¢	(0.75¢)
Nov-10	\$15.85	\$15.95	(\$0.10)	34.75¢	35.00¢	(0.25¢)
Dec-10	\$15.95	\$15.99	(\$0.04)	33.50¢	35.00¢	(1.50¢)
2010	\$15.39	\$15.60	(\$0.20)	35.35¢	36.59¢	(1.24¢)



What's Bearish:

- Cash Market: Blocks broke 13¼¢ for the week to close at \$1.56¾/lb while barrels gave up 2¢ to settle at \$1.44/lb. 27 loads of blocks and 6 barrels exchanged hands. Butter lost 2¢ to close at \$1.32¾/lb on 12 trades.
- Cold Storage Report: American cheese stocks in November were 11% higher than in 2008, according to USDA. Total cheese stocks were 17% higher and butter stocks 19% higher over the same period. Additionally, American cheese stocks increased anti-seasonally from Oct to Nov, a rare occurrence (see chart above).
- Butter stocks at CME-approved warehouses jumped 2.9 million lbs for the week ending 12/19. Ending stocks pulled even with year-ago levels at 34.8 million lbs.
- Milk supplies in the Northeast are expanding due to reduced Class I demand, according to Fluid Milk & Cream Review. Churns and dryers will handle most of the extra milk, and manufacturing plants do not expect bottleneck problems. Cheese production increased in the Southeast as processors deal with additional fluid supplies, and balancing plants expect to be at capacity soon. Demand is weak as many plants have filled holiday orders and are now shut down or running reduced schedules.
- Fluid Milk & Cream Review reports more milk moving into CA balancing plants this week as schools recess for the holidays. Fluid needs have slowed, though processors expect few issues handling the milk. AZ milk is trending higher, which manufacturing plants are welcoming, and balancing plants in NM are beginning to receive surplus milk.
- Churning activity is building as cream supplies increase across the nation, according to Dairy Market News. Butter sales slowed greatly this week as buyers pause until after the holidays to assess their supply situation. Food service buyers indicate that traffic flow through restaurants has improved since Thanksgiving, but still remains below levels of previous years.
- The Midwest cheese market continues to be weak as extra barrels are readily available, according to Dairy Market News. Buyers have been expecting weakness, so have become even more patient and reluctant to purchase blocks to replenish aging programs. Holiday orders have been shipped and cheese production remains active as surplus milk volumes purchased at a discount arrive.
- Western manufacturers report good inventory of block cheese, while being long on barrels. Dairy Market News reports additional supplies of milk will be available for the next week or two and will most likely be turned into Swiss or Mozzarella, which are good alternatives to cheddar.

Recommendation:

Blocks played the Grinch and delivered a lump of coal for Christmas to dairy farmers this week. After sitting at \$1.70/lb plus for more than two weeks, buyers finally stepped away and sellers took control. Class III sold off in a hurry, with the largest losses in the Jan-Apr contracts. Losses in the last half of 2010 were minimal as a return to lower prices in Q1 lends support to higher prices later. It appears that the large cheese inventories are finally making an impact. Despite much higher international prices, the fact is, according to the Cold Storage Report, we have too much cheese. Class III prices remained resilient while block buyers continued to pay up, but now that holiday demand is nearly over, the fact that we actually increased the amount of cheese in storage from Oct to Nov is disconcerting. With a plentiful supply still available, block buyers apparently threw in the towel, for now. While we warned about possible pressure in the near term, we certainly were not expecting the collapse in the cash market this week. Nonetheless, we're hopeful that some of you were able to put on some protection in Q1. Going forward, with two weeks worth of surplus milk available through the holidays, it's likely we're headed into a period of weaker prices. However, with international prices and demand as strong as they are and production problems in Oceania, our long-term view is unchanged. We still think 2010 result in much higher milk prices than in 2009. As far as hedge recs this week, we don't see a lot more downside to prices in Q1. Consider buying call options Feb-Jun, then place fixed orders to sell into them. Leave the 2nd half of 2010 and beyond alone.

Note: Our offices will be closed Friday in observance of Christmas. On behalf of all of us at KDM Trading, Inc., we wish you and your families a very Merry Christmas. We appreciate you!

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