

The KDM Dairy Report – Dec 31st, 2009

Review of the decade:

Over the last 10 years:

- Dairy exports have grown by over 400% becoming a significant part of price discovery. We are in a world market for dairy products. At the beginning of the decade, most of the export activity was enabled through the DEIP (Dairy Export Incentive Program). Currently we are competing in the world market without using government subsidies (DEIP) for exporting dairy products.
- Average yearly prices have been below 10.00 per CWT and above 18.00 per CWT, producing big swings in profitability for the dairy producer.

What's Bullish:

- The recovery of international dairy prices has moved from a short-term turn around to thoughts of longer holding pattern. The price for NFDM is at \$3000 per metric ton (1.36 per lb.) with butter prices trading above \$4000 per metric ton (1.81 per lb.). Both were priced below \$2500 per metric ton 6 months ago.
- Oceana milk production expectations are mixed. We hope that prices rise in a reasonable manner to avoid a slow down in demand.
- GDP globally shrank by 2.2% in 2009; predictions are for world GDP growth at 7% for 2010.
- On December 29, the Kansas City Commodity Office announced solicitation for 31.2 million pounds of cheddar and mozzarella cheese for March - December 2010 delivery. Offers are due January 12. The purchase is funded by the \$60 million included in the 2009 Agriculture Appropriations Bill according to Dairy Market News.
- Demand for aged Cheddar, provolone, mozzarella and cream cheese remains strong.

What's Bearish:

- Cash Market: Blocks declined 25 cents in the last five days of trading, bringing the price spread between blocks and barrels to a 2 cent difference. Blocks 1.45 over barrels 1.43. This calculates to a 13.56 Class III milk price.
- Current cheese interest is light as buyers wait until January to rethink their inventory levels.
- Mid Atlantic regions are experiencing substantial surplus milk, as Class I and Class II demand has declined due to the year-end holidays according to Eastern Fluid Milk and Cream Review.
- Available milk supplies for cheese manufacturing are being absorbed and in some cases building inventory. Sales of Swiss and Mozzarella are good, allowing producers some flexibility in the manufacturing mix according to Dairy Market News West.

Recommendation:

As we end this year it seems that cheese buyers and all end users are content with their inventories and will resume orders after the New Year. This is not unusual but does create some extra inventory for the processor at year-end. Block and barrel cheese have moved back to a normal spread of 2 cents. This will remove the pressure on barrel cheese makers as profitability disappeared when the spread grew to 27 cents. We should be able to begin exporting cheese, which appears likely due to the current competitive US prices as compared to the world market price. If you have sold milk to your plant or on the board, this would be a good time to buy calls to protect your positions. Target 1450 February call at 25 cents, 1550 March call at 30, and 1600 April call at 25 cents.

Note: Our offices will be closed Friday in observance of New Year's Day. KDM Trading, Inc. wishes each of you a happy and prosperous New Year!

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Futures Month	Class III 12/31 Close	Class III 12/24 Close	Change	Dry Whey 12/31 Close	Dry Whey 12/24 Close	Change
Jan-10	\$14.22	\$14.31	(\$0.09)	37.75¢	36.75¢	1.00¢
Feb-10	\$13.89	\$14.23	(\$0.34)	38.25¢	35.00¢	3.25¢
Mar-10	\$14.49	\$14.69	(\$0.20)	38.50¢	35.25¢	3.25¢
Apr-10	\$14.77	\$14.80	(\$0.03)	38.00¢	36.50¢	1.50¢
May-10	\$15.15	\$15.12	\$0.03	37.00¢	35.00¢	2.00¢
Jun-10	\$15.58	\$15.60	(\$0.02)	38.50¢	36.75¢	1.75¢
Jul-10	\$15.96	\$15.96	\$0.00	38.53¢	35.75¢	2.78¢
Aug-10	\$15.99	\$16.02	(\$0.03)	38.00¢	34.75¢	3.25¢
Sep-10	\$16.11	\$16.14	(\$0.03)	36.50¢	35.48¢	1.03¢
Oct-10	\$16.07	\$16.05	\$0.02	37.00¢	34.75¢	2.25¢
Nov-10	\$15.87	\$15.85	\$0.02	35.00¢	34.75¢	0.25¢
Dec-10	\$15.92	\$15.95	(\$0.03)	35.00¢	33.50¢	1.50¢
2010	\$15.34	\$15.39	(\$0.06)	37.34¢	35.35¢	1.98¢