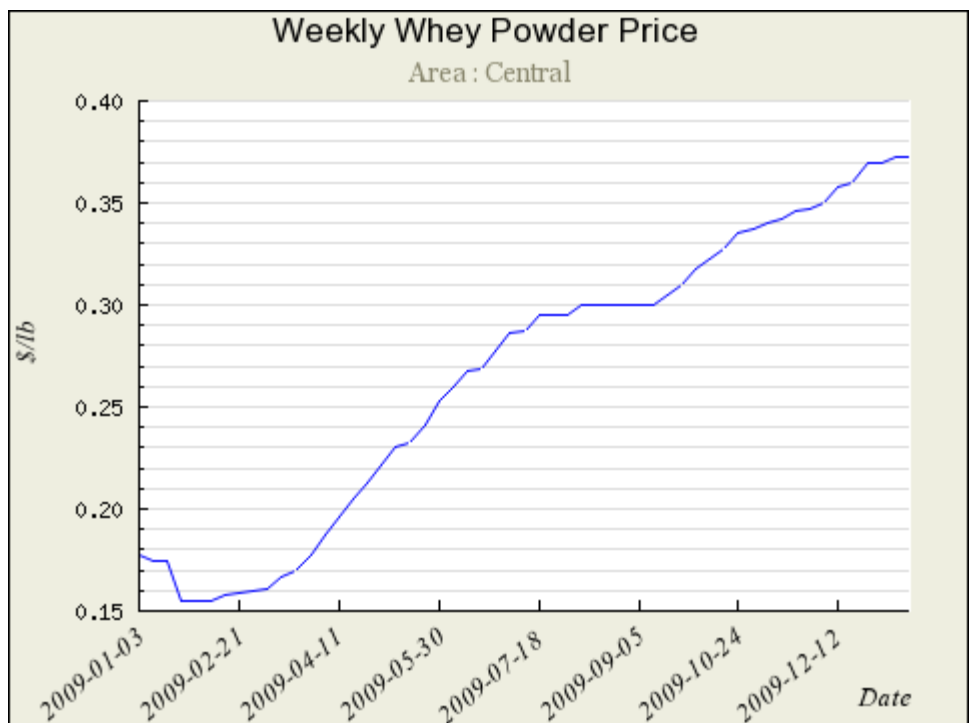


**The KDM Dairy Report – Jan 15<sup>th</sup>, 2010**

**What's Bullish:**

- Cash Market: After several weeks being stuck in the "bear" column, the spot market makes a return to the "bulls". Blocks gained just ½¢ for the week to settle at \$1.41½/lb, but barrels picked up ¾¢ to \$1.46½/lb and the real star, butter marched 18¢ higher to \$1.52½/lb. 19 loads of blocks, 3 barrels and 26 loads of butter exchanged hands.
- Butter stocks at CME-approved warehouses remain well below year ago levels. Stocks increased just 5 million lbs during the week ending 01/09, leaving 46.6 million lbs on hand. A year ago stocks increased 11.2 million lbs with 55.7 million lbs on hand.
- Churning activity has eased across the country as cream supplies have tightened, leaving a firm butter market, according to Dairy Market News. Current production is clearing through good butter sales, while surplus is being cleared to inventory and held with confidence. Buyers are trying to hedge against higher prices in the future and possible shortages later in the year. There also remains good export interest for butter.
- Western dry whey supplies remain on the tighter side, despite increased production schedules, according to Dairy Market News. Spot loads are hard to come by, even in the face of higher prices, with some demand going unfilled.
- Fluid Milk & Cream Review reports Class I demand is strong in the Northeast, which is limiting manufacturing milk supplies. In the Mid Atlantic, Class I and II demand is pulling nearly all available milk supplies and has resulted in most churns and dryers being shut down. The Southeast needed to import 25 loads of Grade A milk this week after seeing Class I demand surpass fall school startup needs. Milk is moving in from as far away as Wisconsin. In Florida, no loads were exported from the state, after having shipped out 100 loads last week. The unprecedented cold spell has substantially increased fluid milk consumption.
- Milk from Wisconsin, Michigan and Ohio is heading South, according to Fluid Milk & Cream Review. Early orders from bottlers also look strong for next week. In southern areas of the Central region, milk volumes are lower than anticipated due to culling, either voluntary or through CWT.
- California milk output is rising but remains several percentage points below year ago levels, according to Fluid Milk & Cream Review. Processors are running on moderate schedules with extra capacity to handle more milk. Output in Arizona is moving slightly higher, with a direct correlation to the feedstuffs being fed to cows. Producers are looking for ways to keep going, while plants have capacity to handle additional supplies.
- Cheese production schedules in the Northeast are steady to reduced due to increased Class I and II demand, according to Dairy Market News. Some plants have interrupted production schedules to pursue post holiday maintenance.
- Dairy Market News reports cheese orders in the Midwest have generally improved from last week, as buyers take advantage of the big decline in the weekly average price.

Futures Month	Class III 01/15 Close	Class III 01/08 Close	Change	Dry Whey 01/15 Close	Dry Whey 01/08 Close	Change
Jan-10	\$14.43	\$14.33	\$0.10	38.50¢	38.50¢	0.00¢
Feb-10	\$14.25	\$13.83	\$0.42	37.00¢	38.75¢	(1.75¢)
Mar-10	\$14.62	\$14.18	\$0.44	37.00¢	38.00¢	(1.00¢)
Apr-10	\$14.75	\$14.38	\$0.37	35.75¢	37.73¢	(1.98¢)
May-10	\$15.18	\$14.83	\$0.35	34.50¢	36.25¢	(1.75¢)
Jun-10	\$15.65	\$15.36	\$0.29	37.50¢	37.73¢	(0.23¢)
Jul-10	\$15.97	\$15.71	\$0.26	36.70¢	38.25¢	(1.55¢)
Aug-10	\$16.15	\$15.82	\$0.33	37.00¢	38.25¢	(1.25¢)
Sep-10	\$16.26	\$16.05	\$0.21	36.58¢	37.25¢	(0.67¢)
Oct-10	\$16.26	\$16.01	\$0.25	36.00¢	36.23¢	(0.23¢)
Nov-10	\$15.99	\$15.82	\$0.17	36.00¢	35.73¢	0.27¢
Dec-10	\$15.93	\$15.83	\$0.10	36.00¢	35.48¢	0.52¢
<b>2010</b>	<b>\$15.45</b>	<b>\$15.18</b>	<b>\$0.27</b>	<b>36.54¢</b>	<b>37.34¢</b>	<b>(0.80¢)</b>



- Western cheese makers are running at near capacity, but inventories are clearing well, according to Dairy Market News. Buying interest has improved with recent lower prices, while retail cheese sales have increased due to football playoff parties. Cheese makers remain optimistic about sales.
- Dairy Market News reports fluid milk sales in November were up 1.5% compared to a year ago. Sales of flavored whole milk, 2%, 1%, flavored low-fat, organic fat-reduced and buttermilk all increased.
- International: The Foreign Ag Service reported this week that dry whey exports through the first 11 months of 2009 were up 2%. But, within the increase, exports to China, the top importer, increased 17%, a possible sign that their economy is recovering. The total volume of exports amounts to 42.1% of total dry whey production.

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

- This week's NASS price survey reflects recent weakness in the spot cheese market. 40-lb blocks averaged \$1.64/lb, down 6¢ from last week, while 500-lb barrels fell 0.9¢ to \$1.48/lb. Butter decreased 0.7¢ to \$1.33/lb, but nonfat dry milk gained 7¢ to \$1.35/lb and dry whey inched 0.2¢ higher to average 38.8¢/lb (see chart above).
- Dairy cow slaughter for the week ending 01/02 totaled just 43,600 head, compared to 50,100 taken out of the milking herd during the same period last year.
- Processors in the Pacific Northwest are running cheese and butter operations on full schedules, according to Fluid Milk & Cream Review, allowing them to build inventory.
- Nonfat dry milk prices were sharply lower this week, as some manufacturers discounted prices in order to move inventory. Dairy Market News reports stocks are building in most regions of the country.
- International: The Foreign Ag Service reported that nonfat dry milk exports for the first 11 months of 2009 declined 37% from 2008. Cheese and curd exports over the same period fell 21%.
- World Ag Supply & Demand Report: USDA lowered their Class III price forecast from last month, citing an expectation for lower cheese prices not being completely offset by stronger whey prices. In addition, they increased their 2010 milk production forecast due to the slow pace of cow liquidation late in 2009.

#### **Recommendation:**

Class III futures settled 22-30 higher over most 2010 contracts today, led by a sharp move up in cash butter, continued support in cash cheese, and a short-covering rally. First half contracts, badly battered the past couple weeks, picked up the bulk of the gains, but trading was strong in the second half as well. With most of U.S. butter production coming out of the Southwest, it appears buyers are trying to buy now due to the perception of a possible shortage later in the year. There still seems to be plenty of block cheese available, so gains in the cheese complex are likely to remain muted. However, with a butter price now higher than cheese and barrels priced above blocks, the bid for blocks should remain, giving us that free put option we talked about last week. Plugging in current cash numbers, we come out with about \$13.80/cwt Class III. With Feb settling at \$14.25 today and beginning its calculation next week, if the rally continues we would look to get some coverage on, selling Feb at \$14.50 or higher. For that matter, all of Q1 remains vulnerable due to current cheese availability. Take advantage of a further rally to buy PUT options Feb-Apr. Those that have purchased call options in the last two weeks should have their orders in to sell milk. Again, while we remain long-term supportive of milk prices, we remain concerned about Q1 and Q2. Don't waste this opportunity – call us next week!

**Note:** The CME Group, other exchanges, banks and the post office are all closed on Monday in observance of Martin Luther King Day. Our offices will be closed as well but will reopen Tuesday with the resumption of trading.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.