

The KDM Dairy Report – Feb 5th, 2010

What's Bullish:

- Dairy Products Report: Cheddar cheese output in Dec fell 8.3% compared to Dec '08, and total cheese output was down 0.1% over the same period. Butter output declined 4.3%, and nonfat dry milk output dropped 18.6%.
- Most Class III components were higher in this weeks NASS survey, but it might be short lived. 40-lb blocks averaged \$1.45/lb, down 1.4¢ from last week, but 500-lb barrels jumped 2.6¢ to \$1.50/lb. Butter increased 1.9¢ to average \$1.40/lb, nonfat dry milk jumped 4.1¢ to \$1.13/lb and dry whey inched 0.3¢ higher to average 38.9¢/lb.
- Butter stocks at CME-approved warehouses are staying below year-ago levels and increasing at a slower rate. 52.9 million lbs were on hand for the week ending 01/30, compared to 60.4 million lbs last year. A net 1.6 million lbs were added, but that was less than the 3 million lbs added during the same period a year ago.
- Fluid Milk & Cream Review reports in several rural areas of the Southeast, storm-related delays resulted in trucks unable to reach farms to pick-up milk for several days. In other areas, tankers were stalled for 18-24 hours due to roads being closed.
- Orders for dips and sour cream products for Super Bowl use were good, according to Dairy Market News. Churning remains active with demand for butter solid.
- Concerns over sustainability are growing over much of the Western region, as Class III futures continue to decline, according to Fluid Milk & Cream Review. While feed and hay prices are often lower, with futures prices below \$14.00 for the first half of 2010, it provides little concession. The first-half average is now below production costs, with breakeven levels around \$15.00/cwt in the Pacific Northwest. Dairies are looking hard for cash to purchase feed supplies and continue milk production.
- Demand for milk from some cheese plants in the Eastern region is reported as "good", according to Dairy Market News.
- Contacts in TX and NM are telling us the wet weather is causing the cows to drop fast. Lots are muddy and the hospital pens are filling up. In WI, a producer tells us that more and more patrons are getting assignments that are larger than their milk checks. Some are cashing in life insurance policies to stay afloat and others have not yet paid last year's planting loans. Come spring we could start seeing the first of real financial hardship in the Midwest.
- International: July-Dec milk production in Australia is figured to be about 6% lower than a year ago, according to Dairy Market News. Milk handlers state that it will take a number of consecutive positive years to regain a portion of what has been lost over the past 6-7 years. Traders indicate that dairy product prices are trending lower, but not because of supply/demand, but international price weakness. Stocks of manufactured dairy products are in close balance to tight, and demand for butterfat remains strong, with customers asking for more than suppliers are able to supply.
- International: Australian cheese output in December was 5.2% below year ago levels, according to Dairy Australia. YTD, output has fallen 2.1%. Butter production was down an even sharper 23.7% in Dec and is down 18% for the current milking season. Within the cheese output decline, cheddar production in Dec fell 12.4% and is down 13.8% for the year. While output is down, cheddar exports Jul-Dec are up 9.8% vs. 2008, a sign of good international demand.
- Economy: January unemployment in the U.S. fell to 9.7%. It was the first decline in seven months. However, it was cautioned that seasonal adjustments could have made the difference.

Futures Month	Class III 02/05 Close	Class III 01/29 Close	Change
Feb-10	\$14.10	\$14.05	\$0.05
Mar-10	\$13.55	\$13.62	(\$0.07)
Apr-10	\$13.24	\$13.55	(\$0.31)
May-10	\$13.40	\$13.90	(\$0.50)
Jun-10	\$14.00	\$14.50	(\$0.50)
Jul-10	\$14.76	\$15.20	(\$0.44)
Aug-10	\$15.06	\$15.50	(\$0.44)
Sep-10	\$15.37	\$15.78	(\$0.41)
Oct-10	\$15.32	\$15.71	(\$0.39)
Nov-10	\$15.25	\$15.55	(\$0.30)
Dec-10	\$15.26	\$15.56	(\$0.30)
2010	\$14.48	\$14.81	(\$0.33)
Jan-11	\$15.20	\$15.49	(\$0.29)
Feb-11	\$15.25	\$15.55	(\$0.30)
Mar-11	\$15.20	\$15.50	(\$0.30)
Apr-11	\$15.15	\$15.50	(\$0.35)
May-11	\$15.25	\$15.60	(\$0.35)
Jun-11	\$15.25	\$15.60	(\$0.35)
Jul-11	\$15.30	\$15.65	(\$0.35)
Aug-11	\$15.37	\$15.80	(\$0.43)
Sep-11	\$15.35	\$15.70	(\$0.35)
Oct-11	\$15.67	\$15.81	(\$0.14)
Nov-11	\$15.77	\$15.80	(\$0.03)
Dec-11	\$15.80	\$15.80	\$0.00
2011	\$15.38	\$15.65	(\$0.27)

What's Bearish:

- Dairy cow slaughter for the week ending 01/23 totaled 59,500 head, down from 65,200 head during the same period a year ago.
- Florida exported 110 loads of Grade A milk this week, up from 27 last week, according to Fluid Milk & Cream Review. In the Mid-Atlantic, last minute bottled milk orders late in the week in preparation of a Nor'easter storm did not result in more retail sales, forcing some of the milk back into manufacturing.

- Spot interest in milk for cheese production in the Central region remains fairly light, according to Fluid Milk & Cream Review. Some producers are looking around for new milk buyers, but few operations are looking to add significant supplies in the upper Midwest.
- California milk production continues to trend higher while solid's levels are also increasing, according to Fluid Milk & Cream Review. Weather conditions are nearly ideal in Arizona, allowing for milk output to increase on a weekly basis.
- Churning activity across the country remains seasonally active, according to Dairy Market News, as available cream offerings are often keeping butter operations at desired levels. As the cash price declines, buyer interest has slowed. In many instances, buyers are procuring for very short term needs with longer term purchases being put on hold at this time. Buyers are waiting until the current trend stabilizes. Butter stocks are readily available and currently are entering inventory programs at a faster pace than in recent weeks.
- Dairy Market News reports although spot offerings of Western dry whey are tight, the feeling amongst buyers is that supplies are building and that prices could show weakness in the near future.
- The sharp decline in NDM prices and, to lesser degree, butter prices may cause extra milk volumes to shift to cheese production in the Midwest, according to Dairy Market News. Additional replacement heifers are likely to increase milk cow numbers in the not too distant future, adding more milk to the supply. Cheese orders are lighter as prices started to decline this week.
- Cheese production in the West continues at a brisk pace, according to Dairy Market News. Cooperatives and independent producers continue to supply cheese plants with additional supplies of milk, while cheese yields are reported to be favorable. Plants are running at near full schedules, and manufacturers are keeping a close eye on inventory as buyers remain cautious concerning near term price levels. Any excess supplies are being offered as spot sales or to the CME Group in Chicago.
- International: The new milk production season in Europe is off to a slow start due to winter weather conditions, but stocks of dairy products remain available for current needs, according to Dairy Market News. The majority of available stock is still from last season and prices are trending lower.
- International: There are fears global dairy prices will continue to fall after the Chinese government took steps to limit imports, according to a new article this week. Fonterra's global dairy sale has recorded a second straight monthly drop, with prices now almost 10 per cent down since the year started. The latest fall comes after China issued an import alert over surging volumes of foreign dairy products. Rabobank analyst Tim Hunt says Chinese demand still appears strong, but that may not continue.
- Economy: While unemployment numbers were down, payroll numbers declined in January, indicating all is not well with the economy. Troubled economies in the Euro zone, particularly Greece, increased pessimism about the global economy and commodities across the board were lower. Oil prices touched a two-month low. Meanwhile, the U.S. dollar is strengthening against other currencies, making commodities less attractive to investors. The USD hit a nine month high vs. the Euro this week.

Recommendation:

Class III prices were hit hard again this week, after a brief rally mid-week. Oceania seems to be the lone bright spot in what increasingly looks like a weak market through Q2. A high number of replacement animals, lower feed costs and slowing demand are hampering any type of rally. The Dow, after recovering from a low of 6,547 on March 9th, 2009, broke well above 10,000, only to break below 10,000 today. The mood on Wall Street is glum and could translate into weak domestic demand if the stock market turns overly bearish again. Producers should consider selling up to 50% of the second half of 2010 if it is profitable, but MUST purchase call options to protect those positions. For the first half of 2010, continue buying call options, but after purchasing, get more aggressive on your sales. This week we bought the following calls for producers: Mar 13.75, Apr 14.00, May 14.50 and Jun 15.25, all for 25¢ or less. Better deals should be available next week but act quickly. For example, once the Mar 13.75 call is purchased, go ahead and sell the milk. Mar settled at 13.55 today, so you'll be giving up less than 50¢ upside risk if the market rallies. Get it done.

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