

The KDM Dairy Report – Mar 12th, 2010

What's Bullish:

- Butter stocks at CME-approved warehouses fell 494,000 lbs for the week ending 03/06. The drawdown is anti-seasonal and compares to a net increase of 2.5 million lbs during the same period a year ago. With stocks on hand of 59.9 million lbs, butter levels have not been this low for this time of year since 2001.
- Fluid Milk & Cream Review reports milk production is increasing in the Northeast and Mid Atlantic as the first signs of spring arrive. However, manufacturing milk supplies are steady to lower due to strong pulls from Class II plants. Milk production in Florida is reaching its spring peak and production levels are lower than last year. Hay and feed stocks are stretched thin and the weather is cool and wet. Some plants which are normally used only during the flush may not open at all this year. Cream supplies are tight and Class I sales are steady. Florida exported 90 loads of Grade A milk this week, down 42 loads from last week.
- Finances remain a big issue for producers in the Midwest, according to Dairy Market News. Those needing credit for feed or spring planting inputs are facing challenges securing loans. In the Pacific Northwest, high quality hay is in short supply. Demand for top quality hay is good, but price and ability to pay are issues of concern. Ag lenders are keeping a close eye on individual operations as farmers begin preparations for spring planting and securing new forage supplies.
- Cream is in strong demand in the Northeast, according to Dairy Market News. Cheese and other Class II schedules have increased, and plants have less time to prepare for the Easter/Passover holiday with it occurring earlier this year than last.
- Orders for cream cheese, sour cream, whipping cream and other cream-based products are good in the Central region, according to Dairy Market News. Some retailers are stating that they are placing heavier butter orders and are anticipating running features as the holiday nears. Food service orders are also stronger as they prepare to serve holiday menus.
- Dairy Market News reports demand is good for current supplies of Western butter. Cream prices have firmed as production of cream-based items increases for the holidays, while food club and retail sales accounts are active.
- Western and Central dry whey supply and demand are about in balance, but stocks are still tight in the Northeast, according to Dairy Market News. More plants are focusing on production of whey protein concentrates, but are looking to the Midwest for additional supplies.
- Stocks of Western nonfat dry milk are light to moderate, according to Dairy Market News. Some sellers have cleared their inventory and raised prices for new product slightly, to portray better market conditions. In the Central and East, spot load interest is more active, with both Class III and export buyers returning to the market. Some NDM producers feel the market has reached its low point and they are now comfortable holding on to inventories for higher prices.
- Exports for most dairy products were sharply higher in Jan vs. a year ago, led by dry whey exports which were up 35%.
- January fluid milk sales were up 0.3% compared to Jan '09, according to USDA.
- Economy: Retail sales in Feb were up unexpectedly, according to the Commerce Department. Retail and food sales increased 0.3% from Jan, when most analysts had predicted it would fall 0.2%. The surprise sparked hopes that the economy is finally gaining traction.
- International: Australia butter production in Jan was down 29.7% vs. last Jan, and is down 19.9% in the current production season, according to Dairy Australia. Cheese output during the month was 6.7% lower than a year ago and

Futures Month	Class III 03/12 Close	Class III 03/05 Close	Change	Dry Whey 03/12 Close	Dry Whey 03/05 Close	Change
Mar-10	\$12.84	\$12.89	(\$0.05)	37.75¢	37.75¢	0.00¢
Apr-10	\$12.78	\$12.89	(\$0.11)	33.75¢	32.95¢	0.80¢
May-10	\$13.26	\$13.14	\$0.12	32.75¢	30.00¢	2.75¢
Jun-10	\$13.90	\$13.95	(\$0.05)	32.50¢	29.75¢	2.75¢
Jul-10	\$14.24	\$14.55	(\$0.31)	32.50¢	30.00¢	2.50¢
Aug-10	\$14.74	\$15.10	(\$0.36)	32.00¢	31.00¢	1.00¢
Sep-10	\$15.12	\$15.23	(\$0.11)	33.00¢	31.00¢	2.00¢
Oct-10	\$15.12	\$15.20	(\$0.08)	33.25¢	31.50¢	1.75¢
Nov-10	\$15.00	\$14.98	\$0.02	34.00¢	32.25¢	1.75¢
Dec-10	\$14.90	\$14.94	(\$0.04)	32.50¢	30.75¢	1.75¢
2010	\$14.19	\$14.29	(\$0.10)	33.40¢	31.70¢	1.71¢
Jan-11	\$14.47	\$14.55	(\$0.08)	30.50¢	29.00¢	1.50¢
Feb-11	\$14.20	\$14.30	(\$0.10)	30.00¢	28.50¢	1.50¢
Mar-11	\$14.36	\$14.37	(\$0.01)	31.00¢	31.00¢	0.00¢
Apr-11	\$14.25	\$14.45	(\$0.20)	26.00¢	26.00¢	0.00¢
May-11	\$14.60	\$14.70	(\$0.10)	25.50¢	25.50¢	0.00¢
Jun-11	\$14.85	\$14.75	\$0.10	26.00¢	26.00¢	0.00¢
Jul-11	\$15.07	\$15.10	(\$0.03)	26.50¢	26.50¢	0.00¢
Aug-11	\$15.10	\$15.10	\$0.00	27.00¢	27.00¢	0.00¢
Sep-11	\$15.14	\$14.85	\$0.29	27.50¢	27.50¢	0.00¢
Oct-11	\$15.40	\$15.40	\$0.00	28.00¢	28.00¢	0.00¢
Nov-11	\$15.50	\$15.50	\$0.00	28.25¢	28.25¢	0.00¢
Dec-11	\$15.60	\$15.60	\$0.00	28.50¢	28.50¢	0.00¢
2011	\$14.88	\$14.89	(\$0.01)	27.90¢	27.65¢	0.25¢

is down 2.5% for the season. Within the drop in cheese output, Cheddar production fell 11.1% in Jan vs. the prior year and is down 13.4% vs. last season.

What's Bearish:

- Cash Market: Blocks lost 3¢ during the week to settle at \$1.26¾/lb, but barrels gained 1¼¢ to close at \$1.26¼/lb. Butter gained ½¢ to settle at \$1.45½/lb. Sellers kept up the pressure for the most part as trading was very active. 25 loads of blocks, 35 loads of barrels and 36 cars of butter exchanged hands.
- World Ag Supply & Demand Report: USDA increased their milk production forecast for 2010, citing the following factors: cow slaughter numbers are low and Jan milk cow numbers were higher than expected. Also, dairy exports are lower due to weaker-than-expected international demand so far this year. As a result, they reduced their Class III price forecast 75¢/cwt from last month, to \$14.50/cwt.
- Cheese prices tumbled in this week's NASS price survey, following recent weakness in the cash market. 40-lb blocks fell 5.4¢ to average \$1.44/lb and 500-lb barrels lost 6.9¢ to \$1.40/lb. Butter gained 5.2¢ to average \$1.41/lb, but nonfat dry milk decreased 0.3¢ to \$1.04/lb and dry whey fell 0.6¢ to 38.4¢/lb.
- Dairy cow slaughter for the week ending 02/27 at 57,300 head was unchanged from the prior week and below year ago levels.
- Manufacturing milk interest remains light in the Central region, according to Fluid Milk & Cream Review. Some spot loads are being offered at sharp discounts. Class I interest is flat as promotional activity has been limited. Plant operators remain wary to add more milk in an effort to limit inventory building.
- Milk production in California is trending seasonally higher, according to Fluid Milk & Cream Review. Weather has been moderate, aiding cow comfort, but the biggest impact is from heifers entering the milking string. Output in Arizona and New Mexico is moving closer to year ago levels with plants running on steady schedules to process the available supply. In the Pacific Northwest, spring weather is making for comfortable cows and some production increases. Butter and cheese plants continue to operate on busy schedules.
- Cheese plants in the Northeast are still trying to limit inventory building through reduced production schedules, according to Dairy Market News. Foodservice sales are lackluster, but lower cheese prices have spurred mozzarella sales.
- Dairy Market News reports the Midwest cheese market remains weak. Sales are quieter than usual for this time of year, which is typically slow anyway. Many plants have extra loads of standard varieties of cheese available, and lead times for specialty varieties are normal. With milk supplies increasing seasonally, most plants are running on heavy schedules in order to process the milk.
- Western cheese plants are running on normal schedules, but trying to limit production, according to Dairy Market News. Buyers are cautious as they wait for the market to settle, while export demand is moderate.
- Economy: Consumer sentiment in March dropped for the second consecutive month, according to the University of Michigan's Consumer Confidence Index. Analysts had expected it to rise. Auto sales tumbled 2%, the steepest skid since Sep 2009.

Recommendation:

Bidders in the cash market were valiant this week, taking on a lot of product, with several days leaving unfilled bids. But with all the "buy" interest, sellers seemed to have the answer as blocks were down and barrels up a bit at the end of the week. We're obviously seeing a level of support for cheese, where buyers are seeing value and are willing to take on product here. On the other hand, sellers seem to have everything they can handle. Talking to our contacts this week, we're hearing about coolers full of mozzarella so some are switching to over varieties that they can store longer. We're also hearing there are still lots of barrels out there. Support in Class III futures is seen when cheese holds in the cash session, but it appears to be mainly short-covering. Plugging in the cash cheese prices and current butter and whey prices, we get about \$11.78/cwt milk. With so much cheese still in the pipeline and April starting it's calculation next week, it's hard to believe it settled at \$12.78 today, a full \$1 premium to cash. If you still need to get some April milk covered, we wouldn't hesitate to sell some here, even at a loss. \$12.78 is better than sub \$12. Of course, cheese could stage a small rally; anything's possible – the Vikings might even win a Superbowl. But it appears to us that the more likely scenario is we stay steady to lower in cheese for the time being. We were very successful getting 13.00 and 13.25 floors this week. We would continue to cover May-Dec with some kind of floor price protection. Get it done next week, as the little relief rally we've had the past couple trading days could end very quickly. This is an opportunity that you don't want to let slip by. It is very difficult to buy PUT options on a down day. Give us a call!

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