

**The KDM Dairy Report – April 1<sup>st</sup>, 2010**

**What's Bullish:**

- Cash Market: Blocks gained 14¢ in a short week, to settle at \$1.43/lb today. Barrels increased 8¾¢ to close at \$1.37½/lb. Trading was light with just 2 blocks and 2 barrels exchanging hands. Butter picked up 1½¢ to settled at \$1.49½/lb on 7 trades and Grade A nonfat dry milk jumped 7½¢ on 10 trades to close at \$1.22½/lb.
- Dairy Products Report: American cheese output fell 0.6% in February vs. Feb '09, and was down 8.2% from January, according to USDA. Total cheese output increased 1.0 compared to a year ago, but fell 7.7% from Jan. Butter production declined 3.1% year-over-year and dropped 12.9% from Jan.
- Ag Prices Report: The milk-to-feed ratio fell to 2.26 in March, down from 2.35 in February, according to USDA. Declines in the milk price more than offset cheaper feed, making profitability more difficult.
- Weekly cold storage stats show cheese stocks fell 11% during the month of March. It will be interesting to see if the 16 million lb drawdown is reflected in the monthly Cold Storage Report due later in April.
- Dairy cow slaughter for the week ending 03/20 totaled 55,300 head, up 1,200 head from a year ago.
- Butter stocks at CME-approved warehouses fell 2.5 million lbs for the week ending 03/27. A year ago butter stocks actually increased 482,000 lbs. Stocks in CME Group storage at this time of year have not been this low since 2001.
- Central butter producers are already concerned about where prices will be in the fall and are taking a hedge with additional inventory, according to Dairy Market News. Right now producers are churning more than current demand, but are clearing to inventory with confidence. They realize that cream volumes will tighten in the near future as demand for ice cream starts to build. Unusually warm temperatures in the Midwest could cause demand to increase sooner than in years past. Many retailers are indicating that promotions are clearing good volumes.
- Central nonfat dry milk offerings are somewhat limited and the market tone is stronger, according to Dairy Market News. Some dryers are indicating limited or sold out positions of low heat NDM through April. Demand is stronger, with some buyers trying to restock holding in case prices move higher in the near term. Manufacturers are building inventories with confidence. With Central NDM offerings being limited, some buyers are looking to Western manufacturers for product.
- Dairy Market News reports the Northeast cheese market has a firm undertone, supported by the consensus that cheese prices have bottomed out. Production is about steady, with good demand for cream cheese, mozzarella and aged cheddar.
- The Midwest cheese market is firm, though unsettled, according to Dairy Market News. Contacts report new interest for acquiring dry, white cheddar 40# blocks, likely for export. Supplies of current varieties have tightened as buyers returned to try and beat any short term price increases. Process demand is steady to improved as food service accounts and resellers prepare for grilling season.
- Sales of Western cheese are reported as good, according to Dairy Market News. Buyers are purchasing for immediate needs, while increased cheese prices at the CME Group are stimulating some extra orders as future needs are assessed. Demand at grocery outlets is good and warmer weather is stimulating cookout activity. Export activity has also picked up due to the reactivated CWT program.
- Commercial Disappearance: Commercial use of butter in January shot up 8.7% in January, according to USDA stats released this week. Use of nonfat dry milk increased by 8.2% over the same period. Finally, "use of milk in all products" increased 3.8% over the prior year.
- Economy: New jobless claims fell last week and factory activity in March hit its highest level in 5½ years, according to the Labor Department.
- International: Cold and wintry conditions in Western Europe extended further into early spring than is usual, according to Dairy Market News. Current milk production levels are lower than projected, so most is being steered into cheese production. Strong cheese demand is the major factor in this, but that is limiting other manufactured dairy product output, such as butter, skim and whole milk powder, to less than desired levels. Stocks of these products are often

Futures Month	Class III 04/01 Close	Class III 03/26 Close	Change
Mar-10	\$12.78	\$12.78	\$0.00
Apr-10	\$12.72	\$12.62	\$0.10
May-10	\$13.28	\$13.28	\$0.00
Jun-10	\$14.00	\$14.07	(\$0.07)
Jul-10	\$14.49	\$14.41	\$0.08
Aug-10	\$14.80	\$14.80	\$0.00
Sep-10	\$15.08	\$15.10	(\$0.02)
Oct-10	\$14.94	\$14.93	\$0.01
Nov-10	\$14.87	\$14.70	\$0.17
Dec-10	\$14.59	\$14.53	\$0.06
<b>2010</b>	<b>\$14.16</b>	<b>\$14.12</b>	<b>\$0.03</b>
Jan-11	\$14.47	\$14.41	\$0.06
Feb-11	\$14.37	\$14.38	(\$0.01)
Mar-11	\$14.50	\$14.50	\$0.00
Apr-11	\$14.55	\$14.41	\$0.14
May-11	\$14.80	\$14.63	\$0.17
Jun-11	\$14.90	\$14.90	\$0.00
Jul-11	\$15.02	\$15.02	\$0.00
Aug-11	\$15.02	\$15.02	\$0.00
Sep-11	\$15.10	\$15.10	\$0.00
Oct-11	\$15.35	\$15.35	\$0.00
Nov-11	\$15.45	\$15.45	\$0.00
Dec-11	\$15.55	\$15.55	\$0.00
<b>2011</b>	<b>\$14.92</b>	<b>\$14.89</b>	<b>\$0.03</b>

limited and tight. Strong internal demand for dairy products is also limiting volumes available for international buyer interest.

- International: Milk production in parts of New Zealand has dropped sharply over the past few weeks, as the season continues to wind down, according to Dairy Market News. Lack of moisture is cited as a major contributing factor, with output dropping so quickly that some farmers are reducing their milkings to one per day, while others are drying off their herds early. Milk handlers and manufacturers are very concerned about end of season commitments. Milk production in Australia recovered some in February, but traders and handlers are stating that finished dairy product prices are firm. Lack of supply could be a major factor in pricing for the foreseeable future. Traders point out that a quick end to the production season in New Zealand, slow output development in Europe and an international market that needs dairy products might result in aggressive buyers as they fight to secure stocks.
- International: Australia cheese output in February was down 3.3% compared to last year, according to Dairy Australia figures. July-Feb, output is down 2.6%.

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

- Most Class III components were lower in this week's NASS survey. 40-lb blocks shed 3.3¢ from last week to average \$1.30/lb while 500-lb barrels gave up 1.2¢ to \$1.29/lb. Butter decreased 0.6 ¢ to average \$1.45/lb and dry whey inched 0.1¢ lower to 36.9¢/lb, but nonfat dry milk gained 0.9¢ to average \$1.05/lb.
- Commercial Disappearance: Commercial use of American cheese in January fell 4.8% vs. a year ago, according to USDA.
- Spring flush is on in the Mid Atlantic region with significant milk production increases, according to Fluid Milk & Cream Review. Haulers are adding trucks to routes to handle the increased supplies, and manufacturers are experiencing milk volumes comparable to the Christmas holiday period. Significant production increases are also noted in the Southeast, and with lighter Class I demand, is resulting in more manufacturing milk supplies. The Northeast is still a couple weeks away from spring production increases, but output is trending higher. Florida schools are on spring break and winter residents are beginning to move out of state, resulting in lighter Class I demand. 190 loads of Grade A milk were exported this week, up from 160 last week.
- Milk production in the Central region is increasing and plant capacity is again being pushed, according to Fluid Milk & Cream Review. Class I demand is weak and manufacturing milk interest is light as plant intakes continue to rise.
- Fluid Milk & Cream Review reports output in California continues to trend higher with plants running at expected levels. Production in Arizona is moving towards the seasonal peak and total intakes are close to year ago levels. In the Pacific Northwest, milk supplies are running ahead of year ago levels, with the spring flush still a few weeks off. Cheese and butter plants are utilizing extra supplies to try to build inventories.
- Central dry whey prices are mostly lower this week, according to Dairy Market News. Production is steady to higher while inventories are steady to building in the region. Resale loads are moving at discounts to the market.
- International: The potential for a large EU dairy surplus is a significant risk, according to a quarterly Rabobank report. Dairy consumption is weak among European consumers, while high unemployment and low consumer confidence undermine demand. And should the Euro continue to decline, a boost in European competitiveness could put downward pressure on international dairy prices.

### **Recommendation:**

Wow! After reading this week's international updates, a person could get bullish! At a minimum, the slow start in Europe and production issues in Oceania could help us avoid \$9-10 milk, but as we said last week, let's not get excited about \$18-20 milk just yet. As strong as the spot cheese market was this week, the gains from last Friday were very minimal, with a few contracts even lower. There is still a lot of nervousness in this market and an unwillingness to push futures prices any higher than they are. At the first sign of weakness, futures will be crushed. One look at our domestic situation helps explain things. The eastern region of the country is really cranking it out while the Midwest is about to hit its stride. Output in the northwest is actually higher than a year ago! Amazing! While it looks like we may see some increase in near term export activity, what we really need is sustained demand growth, both domestic and international, to support higher prices with current milk output and cow numbers. Early next week Global Dairy Trade, run by Fonterra, will host its next monthly auction. A strong move higher in dairy powder could support the market. Grade A NDM jumped in this week's spot market; we'll see if this was in anticipation of higher prices for this auction. Regardless, producers are being offered another opportunity to protect their milk prices. We would target 13.25 to 13.50 PUT options, May-Dec.

**Note:** Markets are closed Friday in observance of Good Friday. We wish you and your families a very happy Easter.

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