

The KDM Dairy Report – April 16th, 2010

What's Bullish:

- NASS cheese prices rebounded this week. 40-lb blocks increased 3.1¢ to average \$1.32/lb while 500-lb barrels were up an even stronger 6¢ to \$1.36/lb. Butter picked up 2.3¢ to average \$1.47/lb and nonfat dry milk jumped 4.5¢ to \$1.11/lb, but dry whey slipped 1.9¢ to 36.3¢/lb.
- Cash Market: While spot cheese prices fell, butter jumped 6¢ for the week on just 4 trades to close at \$1.56/lb. And Grade A nonfat dry milk was bid 2¾¢ higher to settle at \$1.29¼/lb, on 3 trades.
- Fluid Milk & Cream Review reports milk output in the Pacific Northwest is increasing seasonally, but manufacturing capacity is easily handling local milk supplies, with some plants looking for extra supplies.
- The Foreign Ag Service this week reported Jan-Feb butter exports were up 36% compared to last year, while dry whey exports increased 24% over the same period. Nonfat dry milk exports were down 18% Jan-Feb, but Feb exports alone were 22% higher than in 2009. Exports of cheese and curd over the same Jan-Feb period were up 16% compared to last year, with imports by Japan up 135%.
- Churning is active in the Northeast as cream supplies are increasing due to the spring flush, however current butter inventories in the Northeast are lagging year ago levels. Dairy Market News reports manufacturers are comfortable adding to their inventories as they see a possible tightening in the fall.
- Churning schedules are active in the Central part of the country, although lighter than many producers desire, according to Dairy Market News. Firm cream prices and tighter supplies are causing a slowing of churning activity. Many butter producers anticipate that cream supplies will be less available this fall than in recent years, so are generating butter now for use in the second half of 2010. Current butter demand is increasing, and some suppliers are warning that easing prices might not be in the works this year.
- Export inquires for Western-sourced butter are reported to be good, according to Dairy Market News. Butter manufacturers are aggressively pursuing available cream supplies for churning so they can put extra stocks away for later in the year. Food service accounts continue to lag as the economy recovers, but butter stocks are tighter than usual for this time of year.
- Improved dry whey sales into various Far East accounts are resulting in some heightened spot sale activity, according to Dairy Market News. Domestic demand has improved with an increase in ice cream and dry mix production.
- Western nonfat dry milk prices were higher across the board this week, as buyers continue to reflect on last week's Fonterra auction. Dairy Market News reports production schedules are busy as milk supplies increase, but buyers are looking to purchase ahead, and export demand is also increasing.
- Dairy Market News reports Central nonfat dry milk prices were higher this week in a firming market. Manufacturers in the region report demand has increased, partly due to light availability of Western NDM. Some brokers were able to clear product at prices several cents higher than last week, which may indicate end user concern for meeting production needs over the next few weeks.
- International: European milk production is growing but is 4-6 weeks behind, according to Dairy Market News. Dairy product availability is growing, but is lighter than desired for this time of year. Strong domestic demand for fresh dairy products is limiting volumes available to the international market. Traders indicate butter is tight and that imports from the U.S. are occurring.
- International: In New Zealand, the end of the milk production season has quickly deteriorated. Dairy Market News reports manufacturers and handlers are very concerned about fulfilling end of season commitments. Lack of moisture on the North Island is the major cause, where production has fallen 30-40% compared to last year at this time. The drop-off is 4-6 weeks earlier than usual. More farmers are switching to once a day milking schedules and while others are drying off their herds earlier than usual. In Australia, the milking season is also winding down and annual output (Feb-July) is 6.4% below last year. Dairy product handlers are very concerned about meeting end of season commitments.

Futures Month	Class III 04/16 Close	Class III 04/09 Close	Change
Apr-10	\$12.85	\$12.81	\$0.04
May-10	\$13.09	\$13.75	(\$0.66)
Jun-10	\$13.35	\$13.77	(\$0.42)
Jul-10	\$13.97	\$14.35	(\$0.38)
Aug-10	\$14.70	\$14.86	(\$0.16)
Sep-10	\$15.09	\$15.10	(\$0.01)
Oct-10	\$15.00	\$15.06	(\$0.06)
Nov-10	\$14.73	\$14.74	(\$0.01)
Dec-10	\$14.75	\$14.68	\$0.07
2010	\$14.17	\$14.35	(\$0.18)
Jan-11	\$14.67	\$14.53	\$0.14
Feb-11	\$14.61	\$14.51	\$0.10
Mar-11	\$14.65	\$14.50	\$0.15
Apr-11	\$14.54	\$14.62	(\$0.08)
May-11	\$14.59	\$14.75	(\$0.16)
Jun-11	\$14.57	\$14.75	(\$0.18)
Jul-11	\$14.92	\$15.02	(\$0.10)
Aug-11	\$14.85	\$15.02	(\$0.17)
Sep-11	\$15.05	\$15.10	(\$0.05)
Oct-11	\$15.35	\$15.35	\$0.00
Nov-11	\$15.45	\$15.45	\$0.00
Dec-11	\$15.55	\$15.55	\$0.00
2011	\$14.90	\$14.93	(\$0.03)

What's Bearish:

- Cash Market: Spot cheese continued to fall this week. Blocks fell 10¢ from last Friday to close at \$1.39¾¢/lb and barrels lost 7½¢ to settle at \$1.36½¢/lb. Block trading was light at just 2 loads but barrels traded 13 times.
- Manufacturing milk supplies in the Eastern region of the country are heavy and increasing, according to Fluid Milk & Cream Review. The flush is expanding and gaining strength, while Class I sales have been sluggish. Balancing plants in the Northeast and Mid-Atlantic are maxed out and unloading delays are occurring on weekends. Dryers are running on heavy schedules and auxiliary cheese plants are still being used to help handle the surplus. Milk volume is still heavy in the Southeast; 203 loads of Grade A milk were shipped out of Florida this week.
- Fluid Milk & Cream Review reports Class I interest was spotty this week and Class II products were uneven. Demand for manufacturing milk was good, but the early prospect for next week is not as positive. Manufacturing plants are operating on heavy spring schedules throughout most of the region.
- Milk output in California is increasing seasonally and in some parts is now even with last year, according to Fluid Milk & Cream Review. Weather conditions have been favorable for milk production and cheaper feed is helping producers service debt. An increase in cull cow prices is also helping; producers are replacing older animals with heifers. Milk production in AZ and NM remains close to last year's levels and plants are running on normal schedules. Increased product prices have raised farmer optimism and fresh forage supplies are increasing milk receipts.
- Cheese production in the Northeast has increased with the influx of spring flush milk, according to Dairy Market News. Heavy milk volumes continue to necessitate the utilization of auxiliary cheese plants to handle the increased volumes.
- Dairy Market News reports orders for cheese in the Midwest are mixed to slow, with buyers holding off for lower prices. Sales are sluggish with cut and wrap operations having difficulty filling a 40-hour week. More milk has been available for manufacturing in the past few weeks, and any extra cheddar produced will have 2-3 week's time to be offered on the CME Group cash cheese market.
- Current Western cheese stocks are above year ago levels, according to Dairy Market News. Buyers are waiting to see how the market will discount current inventories; especially as cheese output remains busy while spring flush is increasing milk supplies to plants. Contract needs are being met with current production, and spot offerings are encountering some resistance to price.
- Cheese stocks at USDA selected storage centers increased 5%, or 6 million lbs, during the first 12 days of April. Butter stocks increased 1%, just 92,000 lbs.

Recommendation:

So we go from bullish report 2 weeks ago, to bearish last week, back to bullish again this week. The volatility in the milk market speaks volumes about the uncertainty out there right now, but let us take a closer look. Exports are picking up steam with some solid numbers so far in 2010, Oceania is having production problems, Europe is off to a slow start, butter is tight and at its highest price since Nov '08 and milk powders are climbing post the Fonterra auction. Hmm, something out of sync here... Oh yes, cheese prices keep falling this week and the East coast is awash with milk. Despite the strong correlation between spot cheese market activity and Class III futures, only the front months suffered much in this week's trade. Cheese prices seem out-of-whack with the rest of the industry; other dairy product prices keep climbing while cheese keeps falling. It's this that makes it feel like the market is getting set to rebound. \$1.50 butter is going to attract more milk than \$1.38 cheese, and despite the amount of cheese out there in America's warehouses, if the rest of the dairy sector keeps climbing, eventually cheese prices will too. You see the same thing in the grain markets. We're not advocating for a reversal next week, just that things are setting up for one. In fact, with the cash price equal to about \$12.93 milk, both May and June could see more downside. However, if you have milk sold July-Dec and don't have it covered with CALL options, get it done next week. Don't wait around thinking the market will keep falling. It might, but it might not. If you wait for the bottom, you'll miss it, and when prices start heading back up, you'll see CALL premiums skyrocket. For any unhedged milk July-Dec, keep looking at PUT options but we wouldn't be sellers here, or in 2011.

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