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The KDM Dairy Report – May 14th, 2010

What's Bullish:

Futures Month	Class III 05/14 Close	Class III 05/07 Close	Change
May-10	$13.33	$13.24	$0.09
Jun-10	$13.88	$13.64	$0.24
Jul-10	$14.53	$14.37	$0.16
Aug-10	$15.06	$15.15	($0.09)
Sep-10	$15.19	$15.35	($0.16)
Oct-10	$15.06	$15.15	($0.09)
Nov-10	$14.98	$15.17	($0.19)
Dec-10	$14.93	$15.01	($0.08)
2010	**$14.62**	**$14.64**	**($0.02)**
Jan-11	$14.80	$14.75	$0.05
Feb-11	$14.80	$14.80	$0.00
Mar-11	$14.80	$14.79	$0.01
Apr-11	$14.63	$14.70	($0.07)
May-11	$14.73	$14.80	($0.07)
Jun-11	$14.63	$14.70	($0.07)
Jul-11	$14.70	$14.76	($0.06)
Aug-11	$14.72	$14.72	$0.00
Sep-11	$14.88	$14.88	$0.00
Oct-11	$14.98	$14.98	$0.00
Nov-11	$15.10	$15.10	$0.00
Dec-11	$15.10	$15.10	$0.00
2011	**$14.82**	**$14.84**	**($0.02)**

- Cash Market: Blocks gained 8¼¢ to settle at $1.46¼/lb while barrels notched a 4½¢ increase to close at $1.41¾/lb. 6 blocks and 15 barrels exchanged hands. Butter picked up a penny to settle at $1.61½/lb on just one trade.
- The weekly cold storage holdings report shows cheese stocks at USDA selected storage centers are down 6%, or 7.3 million lbs, for the period 05/01 through 05/10. Butter stocks over the same period have increased 1%.
- International: Dairy Market News reports strong demand for European cheese continues from Russian buyers. Eastern European milk production is still lagging the usual growth pattern for this time of year, so new manufactured dairy product stocks are often lighter than desired. Butterfat is tight and butter producers are scrambling to procure cream volumes to maintain steady production.
- Milk production in the Southeast is now at or past the peak, according to Fluid Milk & Cream Review. Recent heat and humidity is resulting in some marginal declines in milk output, with manufacturing milk supplies now at much more manageable levels, along with increased Class I sales. Auxiliary cheese plants still remain in production, but at reduced schedules. Cream supplies have tightened as ice cream, cream cheese and dip production have increased. Some butter plants are running near maximum levels, which is also competing for available cream.
- Butter plants in the Central region are generating additional stocks for future use, according to Dairy Market News. Most are not surprised at butter's price recovery and are comfortable with current trends. Many anticipate cream will become much more competitive following the Memorial Day holiday. Food service orders have been active as restaurants and food outlets prepare for the unofficial opening of the summer vacation season.
- Dairy Market News reports Western butter prices are pushing to higher levels, and cream supplies are tightening despite increased amounts of milk. Butter churns are active and producers are optimistic about future prices. Domestic demand is steady, though butter stocks are lower than desired.
- Butter stocks at CME-approved warehouses increased just 685,000 lbs for the week ending 05/08. A year ago stocks jumped 2.9 million lbs. The 62.6 million lbs now on hand is the lowest for this time of year since 2001.
- The market remains firm for Western nonfat dry milk, according to Dairy Market News. Domestic buyers have slowed down their purchases as prices increased, but export demand continues to clear product at higher prices to the top end of the range. Stocks are often light with most committed for near-term sales.
- Despite Western cheese makers running on heavy schedules as spring flush brings in more milk, contract sales have been good and are expected to keep supplies in check, according to Dairy Market News. The market is displaying continued strength despite heavier inventories.
- NASS butter and powder prices increased in this week's survey. Butter jumped 3.7¢ to average $1.59/lb, nonfat dry milk increased 2.2¢ to $1.24/lb and dry whey gained 0.3¢ to average 36.1¢/lb.
- Slaughter numbers were up again this week. 52,800 head were culled during the week ending 05/01, up from 47,300 head during the same period a year ago.
- Economy: U.S. retail sales and industrial production rose in April, evidence that the economic recovery was strengthening during the month. April's retails sales was double what many analysts had expected.
- The Foreign Ag Service reported this week that dry whey exports Jan-Mar were up 12.5% compared to last year. The biggest increase was seen from Southeast Asia, which imported 50% more than a year ago. Nonfat dry milk exports were up 7.4% over the same period.
- International: Adverse weather conditions in New Zealand's north island have resulted in milk production dropping sharply in recent weeks. Dairy Market News reports milk production projections are now being pegged as flat with last year, as the season winds down. Manufactured dairy products are in very close balance to short of projected needs.

What's Bearish:

- Economy: Stocks fell sharply on Friday on concerns over whether European countries can pay their public debt obligations. The euro dropped to a 19-month low vs. the dollar.

- World Ag Supply & Demand Report: USDA increased their 2011 milk production forecast, citing producers' response to improving returns. They also lowered their remaining 2010 Class III price forecast from last month. They expect Class III to average $14.20/cwt, down 15¢/cwt from April's estimate.
- NASS cheese prices declined in this week's survey. 40-lb blocks were down 2.2¢ to average $1.40/lb and 500-lb barrels decreased 0.1¢ to $1.39/lb.
- Manufacturing milk supplies continue to run heavy in the Northeast and Mid Atlantic regions, due to sluggish Class I sales and increased milk production, according to Fluid Milk & Cream Review. The Northeast has yet to reach its peak, and the heavy manufacturing supplies are forcing most plants to produce low heat nonfat dry milk in order to more easily clear the milk volumes. Balancing plants are running "flat out" to handle the surplus milk.
- Fluid Milk & Cream Review reports manufacturing plants in the Central region are running on increasingly heavier schedules in order to handle the seasonal increase in milk receipts. Some handlers are setting up manufacturing homes for the extra loads, often through mid-June. Interest for spot loads of manufacturing milk is spotty.
- Milk output in California is trending higher seasonally, and narrowing the deficit to year-ago levels, according to Fluid Milk & Cream Review. Current weather conditions are favorable in Arizona, with processing plants running on expected schedules. Class I sales are stable, but some declines in school accounts are beginning to be seen. Milk supplies are heavy in most areas of the Pacific Northwest, as weather conditions have been ideal for cows. High cull cow prices are allowing producers to swap out older cows for replacement heifers, increasing production per cow levels. Feed costs are anticipated to be lower than last year, and farm milk price increases have helped strengthen the bottom line.
- Dairy Market News reports current cheese offerings in the Midwest are adequate to generally ample for needs. Peak milk production is still about a month away, and the upcoming closing of schools is lending to abundant milk supplies and heavy manufacturing schedules.
- International: Milk production in Western Europe is rebounding surprisingly well, according to Dairy Market News. After a cold, wet spring, producers and handlers state the milking herd is making up for lost time. In many countries, milk volumes are now running higher than last year at this time. This is generating manufactured dairy products that are often clearing to inventory. Heavy cheese production is generating strong volumes of whey, giving a weak undertone to the market. Price weakness in dry whey is also being attributed to the weakening Euro.

Recommendation:

There's been a lot of bullish news for dairy as of late, especially in the butter/powder side of things where global stocks are getting tighter. We've said for months that an uptick in exports would be needed to improve milk prices, and it appears to be doing so, despite domestically still being awash with milk in the Eastern and Midwest regions of the country. Though the dairy industry has historically tended to be insular, focusing primarily on the domestic market, those days are now passed. Whether we like it or not, global fundamentals are affecting prices more than ever before. Witness what happened to our nonfat dry milk prices after the past two Global Dairy Trade auctions! The point in bringing this all up is that economies around the world are in jeopardy, and that is why it is first in this week's "bearish" list. The euro has fallen 18.4% vs. the dollar since the first of the year. That is making our exports more expensive. And the problem is, the fall of the euro has most likely only just begun. If you've been watching the news, you're hearing about Greece's junk debt problems and fears that Spain, Portugal and Ireland are next. There are even rumors of some countries pulling out of the EU. A trillion euro rescue package (similar to our TARP program) has been "guaranteed" buy the European Central Bank, but it is made up of bankrupt euro countries, plus France and Germany. Traders are seeing through this and punishing the currency mercilessly. And it is affecting the U.S. In the past couple weeks, including today, we have seen dramatic daily declines in the stock market as traders fret over European debt concern and how it will affect the U.S. economy. Granted, it is not likely to change dairy fundamentals in the next month or two or three, but what about later? It all seems so far away and remote, but this really is a BIG deal. No one knows how it will play out or what affect it will have on the U.S., not to mention our OWN growing debt obligations and sputtering economy. This is all to say that as supportive as long-term dairy fundamentals appear to be, they could all be wiped out. Will our dairy products still be competitive on the world market if they cost, say, 25-45% more than they did in Jan? Weaker global currencies could also fuel inflation, pushing milk, grain and oil prices higher. There are so many uncertainties in this uncharted landscape. For this reason, we would HIGHLY recommend getting PUT option coverage. July-Dec 14.00 PUTs traded for an average 40¢ today. That yields a base price floor of $13.60 and keeps you open to 100% upside. Sell Jun milk at $14.00 or higher. Current cash prices work out to about $13.50 and we still have some very high production months ahead of us, school closings and high cull cow prices enabling fresh heifers to enter the milking string. June starts it's calculation on Monday. In order for June to settle at $14.00, cheese will have to rally to $1.50/lb and stay there for the next 4 weeks, and bear in mind that whey prices are weakening. Get your operation covered for the unknowns ahead!