KDM Trading, Inc.
877.695.8538 www.kdmtrading.com
Dan Schindler, Mark Potter, Keith Schnese & Nick Potter

The KDM Dairy Report – May 21st, 2010

What's Bullish:

Futures Month	Class III 05/21 Close	Class III 05/14 Close	Change
May-10	$13.39	$13.33	$0.06
Jun-10	$13.88	$13.88	$0.00
Jul-10	$14.10	$14.53	($0.43)
Aug-10	$14.56	$15.06	($0.50)
Sep-10	$14.85	$15.19	($0.34)
Oct-10	$14.85	$15.06	($0.21)
Nov-10	$14.81	$14.98	($0.17)
Dec-10	$14.75	$14.93	($0.18)
2010	**$14.40**	**$14.62**	**($0.22)**
Jan-11	$14.62	$14.80	($0.18)
Feb-11	$14.65	$14.80	($0.15)
Mar-11	$14.67	$14.80	($0.13)
Apr-11	$14.73	$14.63	$0.10
May-11	$14.83	$14.73	$0.10
Jun-11	$14.74	$14.63	$0.11
Jul-11	$14.84	$14.70	$0.14
Aug-11	$14.90	$14.72	$0.18
Sep-11	$15.00	$14.88	$0.12
Oct-11	$15.10	$14.98	$0.12
Nov-11	$15.10	$15.10	$0.00
Dec-11	$15.10	$15.10	$0.00
2011	**$14.86**	**$14.82**	**$0.03**

- Cash Market: Blocks gained 3¾¢ this week to settle at $1.50/lb, while barrels shot up 6¢ to $1.47¾/lb. Buyers were aggressive, collecting 15 loads of blocks, but just 4 barrels. Butter fell 3½¢ to $1.58/lb on just 8 trades.
- Prices for most Class III components were higher this week. 40-lb cheddar blocks averaged $1.39/lb, down 1.4¢ from last week, but 500-lb barrels increased 0.7¢ to $1.40/lb. Butter gained 0.3¢ to average $1.59/lb, nonfat dry milk jumped 1.5¢ to $1.25/lb and dry whey inched 0.5¢ higher to 36.5¢/lb.
- Cheese demand appears solid so far in May. Over the first 17 days of the month, cheese stocks at USDA selected storage centers fell 6%, nearly 8 million lbs. Butter stocks have declined 4% over the same period.
- For the 9th week in a row, weekly dairy cow slaughter numbers have exceeded year ago levels. 51,900 head were culled during the week ending 05/08, up 1,400 head. YTD the 2010 cull is now only 33,000 head behind 2009.
- Butter stocks at CME-approved warehouses increased 2.5 million lbs for the week ending 05/15, but that was less than half the increase of 5.1 million lbs during the same period last year. Stocks on hand are falling further behind, with 65 million lbs in storage, compared to 89.5 million lbs a year ago. Stocks have not been this low for this week since 2001.
- Cream supplies are increasingly tight and while demand is good, according to Dairy Market News. Production of cream cheese, dips and ice cream are on the rise ahead of the Memorial Day Holiday.
- While milk production in the Central region has not yet hit its peak, there is less cream than most manufacturers desire, according to Fluid Milk & Cream Review. Many ice cream plants didn't start production early enough and are now running full out to generate inventory needed for the summer. Cream supplies are tight and sellers are in control. Buyers looking for supply contracts have had them rejected as sellers are able to demand premium prices. Butter plants are attempting to churn all they can now to build inventory for the future.
- Fluid Milk & Cream Review reports California milk output is flat and plant supplies are tightening. Additional milk and components are being sought and bought. Arizona output is trending lower and plant schedules are being reduced as less milk moves into manufacturing operations, while milk production in New Mexico is past its peak. Western cream prices are firm and supplies are tightening. Demand is good and extra loads are hard to secure.
- Western butter producers are receiving extra interest for product, according to Dairy Market News. End users are looking to add supplies for later summer use; while current stocks are able to meet immediate demand, it is the anticipation of tighter supplies later in the year that is motivating buyers.
- Dairy Market News reports Western nonfat dry milk stocks are light and mostly committed. The market tone remains mostly firm and offerings are light to moderate.
- Memorial Day Weekend orders as well as national pizza promotions have stimulated demand for both process and mozzarella cheese in the Midwest, according to Dairy Market News. Cheddar is available, but generally not in larger volumes. Interest in aged cheddar is up as well; it appears many firms may not have been as aggressive as last year in putting cheddar into aging programs.
- Increased cheese prices this week have not loosened much Western cheese, according to Dairy Market News. In many cases, producers are holding stocks in firm hands. Plants seem to be happy with current inventories as contract demand remains good. Mozzarella sales to pizza makers have been strong and retail demand is moving product at a good pace. The CWT export program is also helping to clear extra inventories.
- Cold Storage Report: Butter stocks in April were down 14% compared to 2009, but up 6% from March, according to USDA.
- Livestock Dairy & Poultry Outlook Report: Improved demand is expected for dairy products, and the outlook is for producer returns to be higher for the balance of this year and into 2011. However, higher output per cow and falling feed prices will limit milk price increases. Export demand is forecast to improve as global economic recovery in Asian nations increases appetites for protein.
- Livestock Slaughter Report: 234,700 dairy cows were culled in April, up 19,600 head vs. April '09, a 9.1% increase.
- The Foreign Ag Service reported this week that Jan-Mar butter exports totaled 21.1 million lbs, up 75% compared to 2009. Cheese exports over the same period totaled 72.4 million lbs, a 33% increase.

- International: March cheese output in Australia declined 3.4% compared to a year ago, while whey powder fell 21%.

What's Bearish:

- Milk Production Report: April milk production increased 1.5% vs. 2009 in the U.S., and cow numbers increased 3,000 head from March, the fourth straight month of gains. Production per cow continues to benefit from a younger herd, jumping 61 lbs per cow from 2009. Most analysts had expected less than a 1% increase in production. Gains were led by WA up 7.2%, WI up 6.2% and MI up 5.1%. CA saw its first production increase in 17 months.
- Cold Storage Report: No surprises here. American cheese stocks in April were 6% higher than a year ago and 2% higher than in March. Total cheese stocks were 8% higher than last year's levels and 2% higher than the prior month.
- Milk production in the Northeast and Mid Atlantic regions continues at peak levels, according to Fluid Milk & Cream Review. Class I sales have been sluggish, adding milk volumes to manufacturing supplies, which are already maxing out some plants. There are reports of unloading delays, especially at drying operations. Some schools are beginning to close in the Southeast, decreasing Class I demand. Florida exported 258 loads of Grade A milk this week, up from 192 last week.
- There are concerns of the effects of a stronger U.S. dollar on future nonfat dry milk exports, according to Dairy Market News. That and the release of EU intervention stocks has lightened demand, while export deals are developing slower than anticipated.

Recommendation:

Currency volatility continued to rock the stock market this week, but milk futures proved remarkably resilient. Despite showing red at the end of the week for most months, prices were well off their lows. Things started out poorly on Monday with a milk production report that was a real shocker. Milk output up 1.5% was way above every analyst forecast out there, and it was the first production report in recent memory that did really affect the market. Futures sold off hard as the prospect of high cow numbers, more output per cow, upcoming school closings and USD strength added to the fear of surplus milk to come. Yet, by the next day, prices had recovered some. Some folks flat out deny the report is correct; either that or demand is phenomenal. This week's cheese and fluid updates may lend some credence to a possible USDA correction in the future. Yes, there is still plenty of milk out East and in the Midwest, but surprisingly, current cheese doesn't appear to be all that heavy and it looks like CA plants are getting short on milk! Even the cold storage report contained a silver lining. American cheese stocks were 6% higher in April than a year ago, but in March, stocks were 10% higher. Butter/cream tightness continues to play a role here as well. Putting this all together, we wouldn't be surprised to see spot cheese, which reached $1.50/lb this week for the first time since April, to continue to see some strength. Being there are still a lot of short (sold) positions being held, a rally could be forthcoming. Use that to your advantage and get those PUT options bought July-Dec, and if you have milk sold in the last half, get very aggressive at purchasing CALL options to cover your upside. We could go either way on this with all the uncertainty, but it appears in the near term prices are headed higher.