

The KDM Dairy Report – May 28th, 2010

What's Bullish:

- CWT announced another herd retirement program this week. Bids are due by 06/25 with no set target on the number of animals to be removed from the herd.
- Cheese prices were higher in this week's NASS survey. Blocks increased 0.9 cents to average \$1.40/lb, while barrels were up 1.5 cents to \$1.42/lb. Butter slipped 0.6 cents to average \$1.58/lb and dry whey was down 0.1 cents to 36.5 cents/lb, but nonfat dry milk increased 1.9 cents to average \$1.27/lb.
- Weekly cold storage numbers continue to reflect a drawdown of both butter and cheese stocks. For the period 05/01 through 05/24, cheese holdings at USDA selected storage centers fell 5.5 million lbs, or 4%. Butter holdings declined 1.3 million lbs, or an even stronger 12%.
- Weekly dairy cow slaughter numbers continue to outpace year-ago levels. 52,400 head were culled during the week ending 05/15, compared to just 47,600 during the same period last year.
- 4.1 million lbs of butter were pulled from CME-approved warehouses during the week ending 05/22. That compares to a net increase of 3.1 million lbs during the same period last year. Stocks on hand total 60.7 million lbs, far less than the 92.6 million lbs in storage a year ago at this time.
- Commercial Disappearance: Decent numbers were released by USDA this week concerning commercial demand for dairy products. Commercial butter use in May was up 6.4% compared to May 2009, and up 2% for Q1. Use of nonfat dry milk jumped 20.6% in May and was up 9.8% in Q1. Use of milk in all products increased 2.9% in May and was up 1.7% in Q1. Commercial use of American cheese in May was unchanged from a year ago, but down 3.2% for the quarter. Other cheese use increased 5.5% in May and was up 5.8% for Q1.
- Fluid Milk & Cream Review reports cream supplies are tight in the Northeast. Demand has been good from ice cream plants as they increase production.
- Competition for cream in the Central region is strong, according to Fluid Milk & Cream Review. Class II production is heavier for dips, sour cream and cottage cheese for the holiday weekend on good demand. Churning is lighter and cream prices sharply higher. Truck availability is an issue and higher trucking rates are being charged.
- Butter producers continue to generate as much butter as they can for current and futures needs. Dairy Market News reports inventory levels remain lighter than desired and inventories are held in confidence. Cream offerings are expected to tighten further in June, after the holiday weekend, and as ice cream production ramps up for the summer.
- Dairy Market News reports Western cheese inventories are not described as burdensome. Good contract demand is able to handle most production increases. Demand for cut and wrap into retail accounts remains good, as well as for process products. Export interest is lighter due to the strong USD, but the CWT export program is continuing to help clear supplies.
- International: After early estimates of a 2-3% increase, with just days left in the 2009-2010 milking season in New Zealand, the prediction is now that volumes will be about flat with last season.

Futures Month	Class III 05/28 Close	Class III 05/21 Close	Change
May-10	\$13.35	\$13.39	(\$0.04)
Jun-10	\$13.60	\$13.88	(\$0.28)
Jul-10	\$13.50	\$14.10	(\$0.60)
Aug-10	\$14.00	\$14.56	(\$0.56)
Sep-10	\$14.49	\$14.85	(\$0.36)
Oct-10	\$14.57	\$14.85	(\$0.28)
Nov-10	\$14.55	\$14.81	(\$0.26)
Dec-10	\$14.61	\$14.75	(\$0.14)
2010	\$14.08	\$14.40	(\$0.32)
Jan-11	\$14.58	\$14.62	(\$0.04)
Feb-11	\$14.60	\$14.65	(\$0.05)
Mar-11	\$14.70	\$14.67	\$0.03
Apr-11	\$14.61	\$14.73	(\$0.12)
May-11	\$14.62	\$14.83	(\$0.21)
Jun-11	\$14.62	\$14.74	(\$0.12)
Jul-11	\$14.70	\$14.84	(\$0.14)
Aug-11	\$14.70	\$14.90	(\$0.20)
Sep-11	\$14.80	\$15.00	(\$0.20)
Oct-11	\$14.95	\$15.10	(\$0.15)
Nov-11	\$15.00	\$15.10	(\$0.10)
Dec-11	\$15.00	\$15.10	(\$0.10)
2011	\$14.74	\$14.86	(\$0.12)

What's Bearish:

- Cash Market: After reaching \$1.50/lb, blocks gave up 3.5 cents in spot trade this week to settle at \$1.46½/lb. Barrels fell 4.75 cents to \$1.43/lb. Trade volume was average, but offers hung over the market all week. 8 blocks and 14 barrels exchanged hands. Butter shed 2.25 cents to close at \$1.55¾/lb on just 1 trade all week.
- Ag Prices Report: The milk to feed ratio in May climbed to 2.20, while April was revised higher to 2.18. Lower feed costs are helping the ratio climb.
- Fluid Milk & Cream Review reports output in the Northeast continues to be strong, with the first hot spell yet to affect production. Manufacturing milk supplies are heavy and Class I sales continue to be sluggish. Florida exported 287 loads of Grade A milk this week, up from 258 last week and 172 a year ago. Auxiliary cheese plants continue to be used to absorb surplus milk.
- Hot, muggy weather did little to slow down milk intakes in the Midwest, according to Fluid Milk & Cream Review. Plants in the region are full and surplus milk is being discounted from \$1-3 below class as it tries to find a home over the holiday weekend.

- As schools let out for the summer, demand for milk is declining over much of the Southwest, according to Fluid Milk & Cream Review. Milk utilization is changing, with more going into processing plants. Weather in CA, NM and AZ has been good for the most part, aiding in cow comfort. In the Pacific Northwest, farm production is above year ago levels, keeping balancing plants busy with the increased supply. Attractive cull cow prices are allowing for heifer replacement at prices not much above cull prices.
- Dairy Market News reports export demand for butter has weakened as the dollar has strengthened. Demand is also slowing for nonfat dry milk, as buyers take a cautious approach to the EU tendering intervention supplies and the stronger dollar making U.S. powder more expensive on the world market.
- Cheese production in the Northeast continues at increased levels, according to Dairy Market News. Cheddar production for aging programs is steady while mozzarella production is very active, following national features.
- Supplies of standard varieties of cheese, particularly cheddar, are readily available in the Midwest, according to Dairy Market News. Buyers are backing off as recent purchases are not clearing well to consumers. Cheese plants are running on extended schedules in the upper Midwest due to the milk supply, and milk is also flowing in from other states.
- International: News from Western Europe indicates milk handlers are not quite prepared for the rapid increase in output this season. Milk production was slow to develop due to winter-like weather that extended into spring, but has since rebounded dramatically. The Dairy Management Committee has approved the release of substantial butter and skim milk powder intervention stocks. Since butter and cream are tight, not much affect on price is expected and the stocks are welcomed. However, the release of the skim milk powder stocks has powder prices on the defense. There are reports of recent order cancellations as the additional stocks, combined with currency fluctuations, have buyers hesitant to make purchases. Cheese production remains strong and continues to absorb a significant portion of available milk supplies.
- International: Substantial rainfall has fallen on New Zealand's parched North Island, to the extent that the drought has been declared over. Water tables have been replenished, improving the outlook for the upcoming season. Australian milk production is finishing strong, with output 2.5% above last April. It has been a number of years since the conclusion of a milking season has been positive, which typically improves herd health and conditioning for the following season.

Recommendation:

USDA's weekly cheese updates are some of the strongest trending reports, meaning they don't typically flip-flop from one week to the next, but that's exactly what happened this week. After some fairly bullish news last week, the Midwest update, in particular, was decidedly bearish this week. After we predicted prices would head higher in last week's report, they did anything but. In a nutshell, sellers took over the spot cheese market, pressing prices lower with multiple offers on hand. At one point in today's session, 10 loads at a time were being offered. After staying fairly resilient most of the week, milk futures finally gave in with this signal and fell sharply lower. Two weeks ago we warned that the currency / liquidity crisis was a big deal, and it weighed on the market as well this week. Export interest is decided lower and the EU announcement about intervention supplies being released further damaged optimism. Markets rallied briefly after CWT made its announcement of the latest herd retirement program, but by the next morning, the reality of last week's milk production report showing high production and an increase in cow numbers regained control. Supplies do matter, and record cheese stocks are a further bearish fundamental to consider. This week was a classic reminder that producers can't stand on the sidelines when things "appear" to be headed in the right direction. Insurance in the form of PUT options just went up in price this week, and could have been purchased for less last week. Going forward (at the risk of being wrong again), it looks like cheese sellers will retain control when we come back on Tuesday. Plugging in current spot prices yields a Class III price of about \$13.50/cwt. June settlement at \$13.60 is not pricing in much premium, but further declines in the cheese price will drag on the front months. We would go after PUT options. Try to get the July 13.50 and the Aug 13.25 for 30 cents or less. Cheese made in June in July, months where we should have ample milk due to school closings, can be sold in July and Aug so these months are vulnerable. Get a floor in place. Then go after the Sep-Dec 13.25 puts for an average of 25 cents/month or less. If prices rally later this fall you can offset the cost of these puts by selling a call at an equivalent of \$1.70 to \$1.80 cheese; maybe better. Uncertainty is currently very high in a multitude of markets, not just milk futures. With uncertainty comes volatility, so be prepared for sharper daily moves ahead.

Note: Our offices will not be open on Monday in observance of Memorial Day. We hope you have a happy and safe weekend, enjoying the freedoms paid for with such a high cost.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.