

**The KDM Dairy Report – June 25<sup>th</sup>, 2010**

**What's Bullish:**

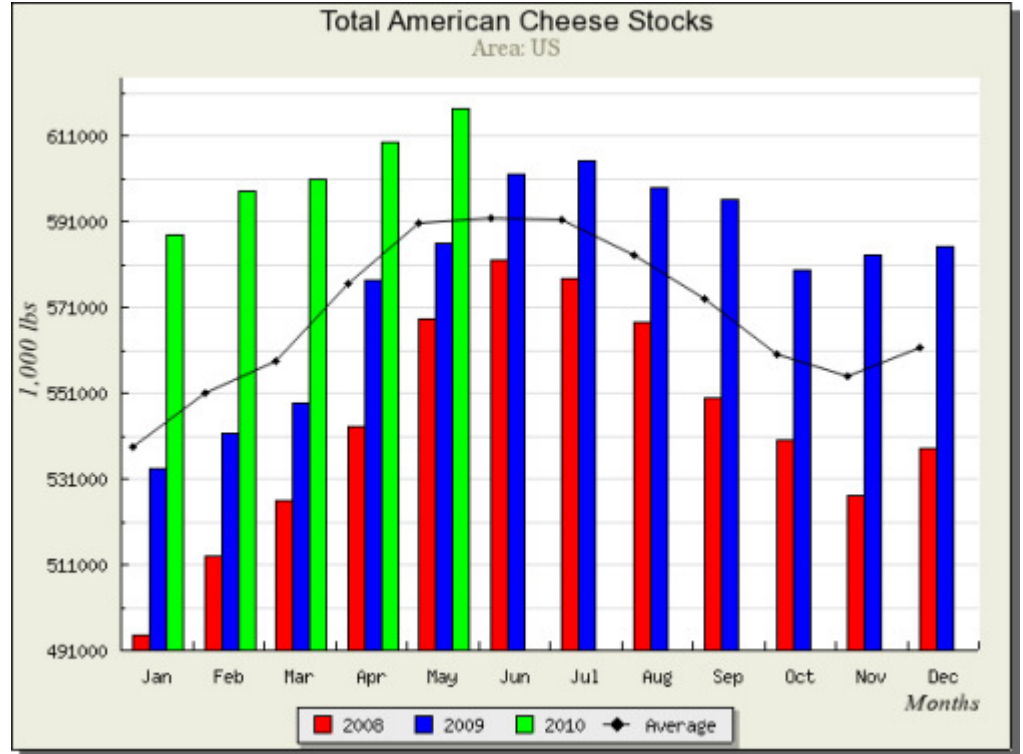
- Cash Market: Blocks managed a ½¢ gain for the week on light trading to settle at \$1.41/lb. Barrels picked up 1¢ to close at \$1.39½/lb. Trading was light with just 2 loads of blocks and 6 barrels exchanging hands. Butter jumped 8½¢ to settle at \$1.72/lb on 6 trades.
- Heat over much of the Eastern region is beginning to bring steep declines in milk production, according to Fluid Milk & Cream Review. In the Southeast, significant declines have been noted. Florida exported 216 loads of Grade A milk this week, down 133 loads from last week. Temp problems and plant rejections have been occurring on a few long haul tankers. Cream supplies continue to be tight, with declines in components, milk production and standardized cream volumes from Class I plants all listed as contributing factors. Demand for cream is good, especially from ice cream and cream cheese plants.
- Demand for cream in the Central region is "chaotic", according to Fluid Milk & Cream Review, with demand exceeding supply. Throughout much of the country, butterfat content on incoming milk supplies is the lowest in 20 years, generating less cream. In addition to lower fat tests, lower protein levels have reduced manufacturing yields.
- Fluid Milk & Cream Review reports milk production in CA is about even with a year ago, with improved milk per cow making up for lower cow numbers. Output in AZ and NM is lagging behind last year's production levels due to lower cow numbers and hot weather stressing the existing herd. Cream demand is strong as Western buyers are now looking across the country for supplies. Butterfat demand is also strong as ice cream production continues to ramp up.
- Butter makers in the Eastern region are only filling current orders and opting to sell any excess cream on the spot market, according to Dairy Market News. Strong demand from ice cream and cream cheese plants is pulling cream away from churns, leaving concerns over having adequate butter supplies this fall.
- Dairy Market News reports some Central butter plants are selling cream rather than churning. Cream remains tight so the plants are taking advantage of the return available for cream on the spot market.
- Western cream supplies are tight and demand is very good, according to Dairy Market News. Some churns are reducing production and selling their cream instead. Some in the industry believe there is a danger butter prices may go so high they slow consumer acceptance and reduce demand.
- Demand for dry whey in the Eastern region is good, with product being pulled at increasing volumes, according to Dairy Market News. In some cases, demand is outstripping supply, so spot loads from the Central region are being purchased in order to meet contracted volumes.
- Demand is good for most Italian type cheeses, aged cheddars and cream cheese in the Eastern region, according to Dairy Market News. Out West, cheese supplies are heavy but not described as burdensome. Contract sales continue to move the bulk of current production.
- International: Milk production in Western Europe is now past its peak while butter remains tight, according to Dairy Market News. Cheese production is heavier, but it is in response to improved internal EU demand and solid exports, often to Russia.
- International: The milk production season in New Zealand has all but ended, with most plants shut down for winter maintenance, according to Dairy Market News. Current milk receipts are being used for local fluid and consumer product demand. Whole milk powder and butter are particularly tight and overall, inventory levels are well below a year ago. In Australia, weather has been favorable for a good end to milking season and rain has helped replenish depleted reservoirs, however, much more rain is needed after recent years of drought. Current milk output is shifting more and more to domestic market use with less being made into export products.

Futures Month	Class III 06/25 Close	Class III 06/18 Close	Change	Dry Whey 06/25 Close	Dry Whey 06/18 Close	Change
Jun-10	\$13.63	\$13.58	\$0.05	36.75¢	36.75¢	0.00¢
Jul-10	\$13.55	\$13.34	\$0.21	36.00¢	35.00¢	1.00¢
Aug-10	\$13.85	\$13.80	\$0.05	34.50¢	35.25¢	(0.75¢)
Sep-10	\$14.64	\$14.45	\$0.19	35.00¢	35.50¢	(0.50¢)
Oct-10	\$14.68	\$14.61	\$0.07	35.00¢	35.50¢	(0.50¢)
Nov-10	\$14.59	\$14.55	\$0.04	35.00¢	34.00¢	1.00¢
Dec-10	\$14.50	\$14.55	(\$0.05)	35.00¢	34.75¢	0.25¢
<b>2010</b>	<b>\$14.21</b>	<b>\$14.13</b>	<b>\$0.08</b>	<b>35.32¢</b>	<b>35.25¢</b>	<b>0.07¢</b>
Jan-11	\$14.45	\$14.55	(\$0.10)	36.00¢	33.53¢	2.48¢
Feb-11	\$14.33	\$14.55	(\$0.22)	34.50¢	31.75¢	2.75¢
Mar-11	\$14.40	\$14.49	(\$0.09)	36.00¢	32.50¢	3.50¢
Apr-11	\$14.24	\$14.47	(\$0.23)	35.00¢	31.50¢	3.50¢
May-11	\$14.32	\$14.54	(\$0.22)	34.00¢	32.50¢	1.50¢
Jun-11	\$14.33	\$14.47	(\$0.14)	35.00¢	30.00¢	5.00¢
Jul-11	\$14.40	\$14.69	(\$0.29)	39.00¢	30.00¢	9.00¢
Aug-11	\$14.53	\$14.64	(\$0.11)	40.00¢	30.00¢	10.00¢
Sep-11	\$14.60	\$14.74	(\$0.14)	40.00¢	31.50¢	8.50¢
Oct-11	\$14.70	\$14.85	(\$0.15)	42.00¢	33.00¢	9.00¢
Nov-11	\$14.84	\$14.85	(\$0.01)	42.00¢	33.00¢	9.00¢
Dec-11	\$14.84	\$14.85	(\$0.01)	42.00¢	34.00¢	8.00¢
<b>2011</b>	<b>\$14.50</b>	<b>\$14.64</b>	<b>(\$0.14)</b>	<b>37.96¢</b>	<b>31.94¢</b>	<b>6.02¢</b>

- International: Dairy Market News reports butter demand is strong as buyers continue to search the world to find needed stocks. Supplies are held with confidence and the current forecast has butter remaining in tight supply through Oct/Nov and possibly into January.

### What's Bearish:

- Cold Storage Report: Both American and total cheese stocks in May were 5% higher than a year ago, and 1% higher than in April. Butter stocks in May were down 16% vs. 2009.
- Livestock Slaughter Report: Just 209,100 head were culled from the dairy herd in May, down from 211,700 a year ago and the lowest monthly total since Nov, 2009.
- Cheese stocks increased 1% and butter stocks jumped 9% over the first 21 days of June, according to Weekly Cold Storage stats.
- Only 48,900 head were culled during the week ending 06/12, according to weekly slaughter numbers. That compares to a CWT-enhanced 60,500 head during the same period a year ago.



- Fluid Milk & Cream Review reports some operations in the Central region are having a hard time handling all their milk supply. Most plant operators are unwilling to take on extra supplies and cheese production remains active as a means to process all the milk.
- Milk production in Washington and Oregon is up this week as higher cow numbers and improved milk per cow combine to increase output. Production is also higher in Utah and Idaho. So far, manufacturers have been able to handle the increased supply locally.
- Dairy Market News reports Western dry whey prices are weak. Domestic supplies are building as cheese manufacturers are operating on full schedules and buyers appear content to acquire additional supplies as needed.
- Cheese supplies are adequate to fully ample for needs in the Midwest, according to Dairy Market News. Traders feel that the current supply/demand situation will make it hard for cheese prices to increase in the short term. Demand is fair at best, while mozzarella supplies are building at some operations.
- Rabobank released their quarterly global dairy report this week with the prediction that dairy prices will ease from current levels. An increase in world dairy supply and a slowdown in demand growth were cited as reasons.

### Recommendation:

Cheese prices continue to rise and fall between \$1.35/lb and \$1.45/lb and may do so for some time. Cheese stocks remain high (see graph above) which will continue to limit substantial price appreciation in the near term. Longer term, butter remains the star and should eventually have a beneficial affect on cheese, but that could be months away. Cream is tight and butterfat is at its lowest level in 20 years. After aggressive trading in the spot market last week, trading was light this week and bidders were allowed to bump prices slightly higher. With the tight range that cheese is trading in, Class III futures are also locked in a range. During periods of low price volatility like this, producers may want to consider putting on a fence strategy as a hedge on a percentage of their production. For example, you could buy the Aug-Dec \$13.50 PUT and sell the \$15.50 CALL for a net cost of about 5¢ per month. The equivalent cheese prices would be about \$1.44 floor and \$1.65 cap. If prices were to stay "non-volatile" for the rest of 2010, this would be very inexpensive insurance. The cost to protect 1 million lbs per month Aug-Dec would be just \$2,500. With cheese inventories continuing to weigh on the market, this strategy could work out quite well for a producer who can cash flow at \$13.50 base price.

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