

The KDM Dairy Report – July 9th, 2010

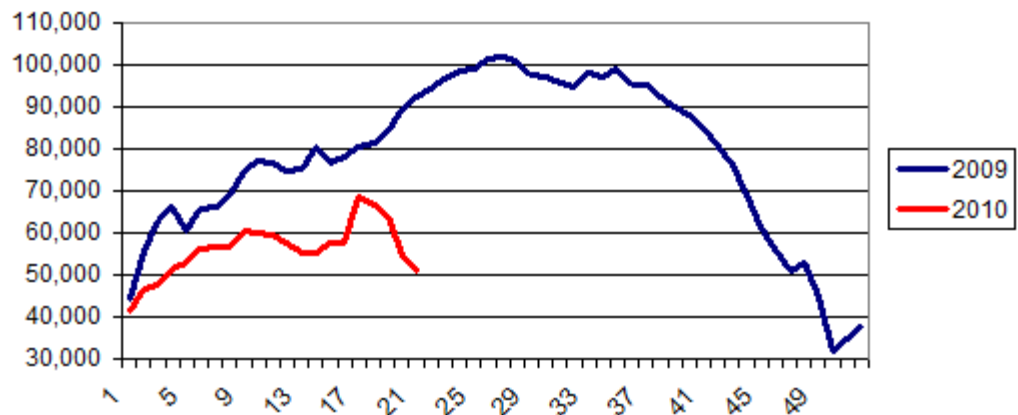
What's Bullish:

- Cash Market: Bidders pushed blocks up 7¼¢ for the week, to settle at \$1.52¾/lb. Barrels were bid 10¢ higher to close at \$1.50/lb. Sellers were non-existent until Friday, with just one trade each in blocks and barrels. Butter inched up another 1¼¢ to reach \$1.76¼/lb on no trades.
- CWT announced this week the acceptance of 194 bids and will retire 34,442 cows. Most of the culling will happen in August.
- Most Class III components were higher in this week's NASS survey. 40-lb blocks decreased 0.4¢ to average \$1.40/lb, but 500-lb barrels increased 1.2¢ to \$1.40/lb, butter shot up 5.4¢ to \$1.70/lb, nonfat dry milk jumped 6.6¢ to \$1.28/lb and dry whey nudged 0.9¢ higher to average 37.3¢/lb.
- Butter keeps flying off the shelves at CME-approved warehouses. For the week ending 07/03, stocks fell nearly 4 million lbs, leaving 50.9 million lbs on hand. A year ago butter stocks increased 648,000 lbs and stocks on hand were more than double current levels, at 102 million lbs (see graph below).
- With temperatures approaching 100 degrees, the heat wave in the Eastern region of the country has caused significant production declines, according to Fluid Milk & Cream Review. Declines in Class I demand added to manufacturing milk supplies, but the heat is causing crop and cow stress, resulting in major changes in output. Some cows are being dried off earlier than normal. Florida exported 206 loads of Grade A milk this week, down from 264 last week.
- Bottlers in the Central region are struggling to meet the minimum fat content in some fluid milk varieties due to low components, according to Fluid Milk & Cream Review. Surplus milk volumes are disappearing, aided by elevated temperatures and humidity in many parts of the country.

- Fluid Milk & Cream Review reports milk output in California has moved lower due to recent heat. Temps reaching 110 degrees in Arizona has output on the decline there as well, and humidity levels are beginning to rise.
- The butter market remains firm as prices near levels not seen since 2004, according to Dairy Market News. Cream remains tight while butterfat tests continue to run lower than last year at this time. Many producers are pulling butter from inventory to fill current orders, leaving overall butter stocks short of desired levels.

Futures Month	Class III 07/09 Close	Class III 07/02 Close	Change	Dry Whey 07/09 Close	Dry Whey 07/02 Close	Change
Jul-10	\$13.64	\$13.45	\$0.19	36.50¢	36.00¢	0.50¢
Aug-10	\$14.53	\$14.36	\$0.17	35.25¢	34.50¢	0.75¢
Sep-10	\$14.82	\$14.82	\$0.00	34.50¢	35.50¢	(1.00¢)
Oct-10	\$14.84	\$14.86	(\$0.02)	33.75¢	34.00¢	(0.25¢)
Nov-10	\$14.70	\$14.73	(\$0.03)	33.00¢	33.00¢	0.00¢
Dec-10	\$14.57	\$14.59	(\$0.02)	33.00¢	35.00¢	(2.00¢)
2010	\$14.52	\$14.47	\$0.05	34.33¢	34.67¢	(0.33¢)
Jan-11	\$14.48	\$14.45	\$0.03	33.00¢	34.50¢	(1.50¢)
Feb-11	\$14.40	\$14.43	(\$0.03)	30.00¢	31.50¢	(1.50¢)
Mar-11	\$14.47	\$14.42	\$0.05	30.75¢	34.50¢	(3.75¢)
Apr-11	\$14.38	\$14.37	\$0.01	31.00¢	32.00¢	(1.00¢)
May-11	\$14.40	\$14.33	\$0.07	31.00¢	32.00¢	(1.00¢)
Jun-11	\$14.30	\$14.32	(\$0.02)	31.00¢	32.00¢	(1.00¢)
Jul-11	\$14.48	\$14.46	\$0.02	33.00¢	35.00¢	(2.00¢)
Aug-11	\$14.60	\$14.53	\$0.07	35.00¢	36.00¢	(1.00¢)
Sep-11	\$14.70	\$14.66	\$0.04	35.00¢	35.75¢	(0.75¢)
Oct-11	\$14.80	\$14.75	\$0.05	35.00¢	37.00¢	(2.00¢)
Nov-11	\$14.80	\$14.76	\$0.04	40.00¢	42.00¢	(2.00¢)
Dec-11	\$14.80	\$14.77	\$0.03	38.00¢	42.00¢	(4.00¢)
2011	\$14.55	\$14.52	\$0.03	33.56¢	35.35¢	(1.79¢)

Butter Stocks - CME Warehouses



What's Bearish:

- World Ag Supply & Demand Report: USDA increased their 2010 and 2011 milk production forecasts from last month, and lowered their 2010 Class III price forecast. Milk cow numbers have remained higher than expected and milk per cow is expected to increase more rapidly.

- Weekly dairy cow slaughter numbers are still low, leading up to the CWT cull. Just 47,400 head were culled during the week ending 06/26, compared to 55,700 head during the same period a year ago.
- Dairy Market News reports that with the exception of butterfat, stocks of dairy end products in Europe are readily available. Sales activity is slow due to summer holiday season, while milk production is at levels slightly higher than last year.
- Despite temperatures reaching the 90's, milk production in the Pacific Northwest is at expected levels, according to Fluid Milk & Cream Review. Extra milk for manufacturing was available over the holiday weekend.
- The market tone is weaker for nonfat dry milk, according to Dairy Market News. Increased production and declining sales are being noted. Buyers are cautious and producer inventories are building. The recent Global Dairy Trade auction resulted in sharply lower powder prices, giving further reason for buyers to stay on the sidelines. The resale market is flush with offerings of current and older powders that are often being discounted to stimulate sales. Export interest is slow.
- Cheese offerings in the Midwest remain heavy and the current cheese pipeline is full, according to Dairy Market News. Cheese output is declining slowly, but demand is unsettled and buyers are reluctant to set up promotions. Retailers note sales have been sluggish unless promoted. Milk receipts are declining, but not enough to appreciably tighten cheese supplies.
- Economy: Wholesale sales fell unexpectedly in May for the first time in more than a year, according to the Commerce Dept. That lifted inventories to their highest level in 11 months. A slackening in demand may lead businesses to try to curb inventory buildup and weigh on economic growth.
- International: The milk production season is over in Oceania, but the outlook for the 2010-2011 season is quite positive. Projections for the upcoming season estimate New Zealand output to be as much as 14% higher, with Australia projecting a 2-3% increase.

Recommendation:

Heat is definitely taking hold of many areas of the country, but the big question is, will it last long enough to tip the balance in overall milk supplies and are the cows strong enough to recover? Other factors on the positive front include continued tightness in cream and butter supplies, poor feed quality in many areas and low component levels. CWT's announcement that they will get rid of 34,000 cows will help....but only a little. It works out to less than a normal week's cull. The cash market continues its up and down movement, but bidders took us to the highest block price since late December. Sellers were virtually non-existent. Next week will be crucial to determine if we continue higher from here or head back down. This week we were able to purchase Aug-Dec 13.50 puts for an avg 22¢/mo, yielding an effective base price floor of 13.28. With component pay, this will ensure break even or better cash flow for many operations. For some near term protection, we also purchased the Aug-Oct 14.00 PUTs and sold the 16.00 CALLs for a net cost of 15¢ per month. This effectively puts a "fence" around your milk price giving you an effective floor at 13.85 and max or cap of 15.85. In terms of cheese prices, it's about \$1.50/lb up to \$1.70/lb cheese. While we experienced a weekly net gain in most contracts this week, Class III futures did sell off on Friday. This should be a reminder; even though summer temps may continue to support this market in the near term, we are still dealing with historically high levels of cheese in storage and an economy that is far from recovered and may even double-dip. It is WELL worth it to get your price insurance in place and we would encourage you to contact us so we can help you put together a risk management plan tailored specifically to your operational costs.

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