

The KDM Dairy Report – July 16th, 2010

What's Bullish:

- Cash Market: Blocks picked up 4¾¢ for the week, settling at \$1.57½/lb, while barrels gained 2½¢ to close at \$1.52½/lb. There was just 1 block trade and no barrel trades all week, as bidders pushed prices higher. Butter increased 1¼¢ to settle at \$1.77½/lb on 2 trades.
- NASS cheese prices increased in this week's survey, following recent strength in the cash market. 40-lb blocks averaged \$1.41/lb, up 0.9¢ while 500-lb barrels were up 1.9¢ to \$1.42/lb. Butter increased 1.7¢ to average \$1.72/lb, but nonfat dry milk gave up 4.8¢ to \$1.23/lb and dry whey lost 1.0¢ to average 36.2¢/lb.
- For the first 12 days of July, both cheese and butter stocks fell at USDA selected storage centers. Butter stocks declined 575,000 lbs, or 6%, while cheese stocks fell 676,000 lbs, or 1%.
- Butter keeps getting yanked out of storage. For the week ending 07/10, 1.2 million lbs were pulled from CME-approved warehouses, compared to a 480,000 lbs increase last year at this time. Over the last five weeks, stocks in storage have dropped 18.7 million lbs. This is the second largest five-week drop in the last 10 years for this time period. Stocks on hand are down to 49.7 million lbs, less than half the 100.9 million lbs we had a year ago, and the lowest level for this time of year since 1998.
- Significant milk production declines due to hot, humid weather were noted in the Eastern region of the country, according to Fluid Milk & Cream Review. Some plants in the New England area had inadequate milk supplies and needed to short orders. Manufacturing milk supplies were still adequate, but hauler's tanks are getting lighter and farm pick-up routes will soon be altered. Cream supplies are very tight with nearly everything committed. Some plants anticipate next week's cream supplies will be inadequate to cover needs and orders will need to be shorted.
- Fluid Milk & Cream Review reports cream supplies in the Central region remain very tight and expensive. Butterfat levels on incoming milk continue to decline and will likely head below levels of recent years. Manufacturing milk interest has improved as milk volumes decline, with premiums now being paid on surplus milk instead of discounts. Milk intakes are all lower as summer temps and some humidity have blanketed the region.
- California milk output has been impacted by hot weather as processing plants are running on reduced schedules, according to Fluid Milk & Cream Review. The stressful conditions are also causing fat and protein levels to drop which is affecting yields of finished dairy products. Milk production in Arizona is lower to sharply lower as heat and humidity are making a big impact. Temps above 115 degrees and humidity over 35% are common. Increasing night time lows are also stressing the cows. In New Mexico, output is trending lower with the hotter weather and components are declining as well. Bottled milk demand is steady to higher. The cream market is firming, with good demand and tightening supplies.
- Butter supplies in the Northeast remain tight. Cream supplies are short of needs as milk components drop. Most butter plants are only churning to meet current orders and selling excess cream on the spot market. Future cream availability and inventory concerns continue as butter makers look to the fall and holiday season.
- Butter stocks in the Central region are much lighter than desired for this time of year, according to Dairy Market News. Cream supplies remain tight and the CME cash price is at its highest level since the fall of 2004. Most butter plants anticipate that butterfat will remain competitive and tight of the balance of the summer and into fall.
- Dairy Market News reports for Western butter producers, it's more attractive to price and sell cream than to churn butter. Meanwhile, butter sales for the first half of the year were good. Cream supplies remain tight.
- Central whey prices are steady and product is moving with minimal push back from contract buyers, according to Dairy Market News. Inventories range from tight to comfortable. Out West, whey prices are steady to lower, while production levels are down due to seasonal milk supply reductions. Export sales are absorbing excess supplies. Whey supplies in the Northeast are rather tight and those seeking additional loads have to look to the Central region.

Futures Month	Class III 07/16 Close	Class III 07/09 Close	Change	Dry Whey 07/16 Close	Dry Whey 07/09 Close	Change
Jul-10	\$13.76	\$13.64	\$0.12	36.50¢	36.50¢	0.00¢
Aug-10	\$14.90	\$14.53	\$0.37	35.75¢	35.25¢	0.50¢
Sep-10	\$14.98	\$14.82	\$0.16	35.25¢	34.50¢	0.75¢
Oct-10	\$14.92	\$14.84	\$0.08	35.00¢	33.75¢	1.25¢
Nov-10	\$14.68	\$14.70	(\$0.02)	33.50¢	33.00¢	0.50¢
Dec-10	\$14.72	\$14.57	\$0.15	34.00¢	33.00¢	1.00¢
2010	\$14.66	\$14.52	\$0.14	35.00¢	34.33¢	0.67¢
Jan-11	\$14.44	\$14.48	(\$0.04)	32.50¢	33.00¢	(0.50¢)
Feb-11	\$14.42	\$14.40	\$0.02	29.50¢	30.00¢	(0.50¢)
Mar-11	\$14.53	\$14.47	\$0.06	30.00¢	30.75¢	(0.75¢)
Apr-11	\$14.50	\$14.38	\$0.12	30.00¢	31.00¢	(1.00¢)
May-11	\$14.52	\$14.40	\$0.12	31.00¢	31.00¢	0.00¢
Jun-11	\$14.43	\$14.30	\$0.13	30.00¢	31.00¢	(1.00¢)
Jul-11	\$14.50	\$14.48	\$0.02	32.00¢	33.00¢	(1.00¢)
Aug-11	\$14.52	\$14.60	(\$0.08)	33.00¢	35.00¢	(2.00¢)
Sep-11	\$14.65	\$14.70	(\$0.05)	35.00¢	35.00¢	0.00¢
Oct-11	\$14.80	\$14.80	\$0.00	33.00¢	35.00¢	(2.00¢)
Nov-11	\$14.80	\$14.80	\$0.00	34.00¢	40.00¢	(6.00¢)
Dec-11	\$14.80	\$14.80	\$0.00	33.00¢	38.00¢	(5.00¢)
2011	\$14.58	\$14.55	\$0.02	31.92¢	33.56¢	(1.65¢)

- Dairy Market News reports cheese production in the Northeast is steady; demand is good with strong orders for mozzarella and cream cheese. Cream cheese makers are looking to build inventories for the fall, while cheddar production for aging programs remains active with good retail demand.
- In the Midwest, summer weather has lowered cheese yields, which is reducing fresh cheese entering the pipeline, according to Dairy Market News. Some customers are reporting that the availability of upper Midwest sourced blocks has tightened and most of the "cheap milk cheese" has cleared. Spring flush surplus milk has disappeared, reducing the volume of cheese produced.
- Dairy Market News reports sales of Western cheese are good. Some buyers are looking to make additional purchases as prices are moving up. Inventories are manageable, although manufacturers are expressing concern about maintaining adequate levels as milk solids drop.
- International: The Foreign Ag Service this week reported butter exports Jan-May 2010 were up 121% compared to a year ago. Exports of dry whey were up 23%, nonfat dry milk up 37% and cheese and curd up 55% over the same period.

What's Bearish:

- CWT culling hasn't kicked in yet. Weekly dairy cow slaughter for the week ending 07/03 totaled 46,600 head, down 6,000 head from the same week a year ago.
- Despite some areas reaching temps in the 90's, milk output in the Pacific Northwest has been reasonably steady, according to Fluid Milk & Cream Review. Cool nights have helped to keep milk production levels up. Good quality hay supplies are being replenished and are readily available, while producers continue to introduce fresh heifers to the herd.
- The Western nonfat dry milk market tone remains weak, according to Dairy Market News. Prices remain under light pressure as producer holdings are heavy and both domestic and international interest is soft. Buyers appear reluctant to make purchases at current levels and many end users have stocks for their needs and are not looking for further coverage.
- Fluid milk sales in May were 0.7% lower than in May 2009, according to Dairy Market News.
- Economy: Consumer sentiment dropped to its lowest level in 11 months on a resurgence of fears over the economy. It was a strong reversal to last month, in which the survey had reached its highest level in nearly 2½ years. The stock market shed over 2% of its value on Friday in response.
- Economy: The senate passed a final version of the 2010 Financial Reform Bill this week, and it's expected to be signed into law by the President. The bill's 2,300 pages adds over 200 new regulators and 243 new rule makings that seem hardly able to make the economy more efficient.

Recommendation:

Heat continues to draw the spotlight this week as milking conditions change around the country. Butter remains tight and even the cheese updates this week mention current supplies starting to tighten up. Export numbers were great and much of Europe is even now gripped in a heat wave which could curb milk production there. No doubt there is much more bullish news this week than bearish, but we'd again caution against declaring victory over low prices. From folks we've talked to in the biz this week, things could remain strong over the next 2-3 weeks or so, but don't expect an uninterrupted ride higher from here. We still have historically high cheese inventories and an economy looking very fragile at the moment. Consumers sense this and were decidedly bearish in this month's survey of sentiment. Plugging in current cash prices yields a Class III price of about \$14.70/cwt, so Aug settlement today at \$14.90 is not pricing in much premium. Futures sold off mildly today, even though cheese pushed higher. The cause was most likely due to the first sale of the week in blocks, and short-term profit taking at the end of the week in the run higher. So, what do you do with this? We would continue to aggressively purchase put options to get a floor under your milk. Sep-Dec 14.25 put options settled today at an avg 38¢ ea. Offer to buy them at 35¢ or better. If you have a lot of milk yet to be marketed, consider selling a small percentage outright between 15.25 to 15.50, with scale-in selling on more every 25¢/cwt higher. Current fundamentals argue for more strength in the short term, but the poor economy and burdensome cheese supplies in the warehouses should limit gains. We're starting to get questions and think about hedging in 2011. We're not ready to sell yet but anticipate a rally later this summer / early fall will be a prime time to get coverage in Q1 and possibly Q2. Stay tuned.

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