

The KDM Dairy Report – August 6th, 2010

What's Bullish:

- NASS cheese prices increased in this week's survey as they continue to catch up to the spot market. 40-lb blocks averaged \$1.55/lb, up 4.7¢, while 500-lb barrels picked up 4.4¢ to \$1.56/lb. Butter decreased 0.1¢ to average \$1.77/lb and nonfat dry milk lost 1.1¢ to \$1.18/lb, but dry whey increased 0.4¢ to average 36.5¢/lb.
- Dairy cow slaughter for the week ending 07/24 totaled 53,400 head, up from 49,700 head during the same period last year.
- Butter stocks at CME-approved warehouses fell 2.2 million lbs during the week ended 07/31. Last year at this time stocks fell just 1.6 million lbs. Stocks on hand are down to 43.66 million lbs, less than half the 95.73 million lbs we had a year ago at this time.
- Dairy Products Report: Butter output in June was 5.6% lower than a year ago and down a sharp 9.3% from May.
- Milk output in the Eastern region of the U.S. is declining and in many areas quite sharply, according to Fluid Milk & Cream Review. Reports indicate solids levels continue to be lower than usual for this time of year. Milk handlers state volumes are sufficient to maintain current processing schedules, but won't in a few weeks once school bottling programs resume. The Southeast became a milk-deficit area with 35 loads being shipped in this week, while Florida exported nothing for the first time this season. At the current pace of milk declines, some are speculating that imports into the region will be much heavier this year. The cream market remains firm as handlers state there is basically no cream available for sale.
- Milk shipments from the Midwest to the Southeast continue to reduce manufacturing volumes, according to Fluid Milk & Cream Review. Cream supplies are tight and buyers struggle to cover needs. Churning is minimal as many operations sell their cream to other users for better returns compared to butter. Manufacturing milk supplies are tighter and demand exceeds interest. Muggy, hot summer weather is causing reduced intakes and lower components on incoming milk volumes.
- The call for milk from cheese producers in California remains good, according to Fluid Milk & Cream Review. Output is about steady and plants are running at expected levels. Output in Arizona has leveled off with some milk being moved to other areas. Demand for fluid milk is picking up as bottlers prepare for school openings. In the Pacific Northwest, comfortable weather patterns are keeping milk production steady, but manufacturing plants are seeking more milk to reach maximum efficiencies in many cases.
- The butter market remains firm as tight supplies of cream and good demand have reduced butter production. Butter inventories are often much lighter than they have been in recent years. Cream supplies remain very tight due to a good call from Class II operations, declining components on incoming milk, and seasonally declining milk production. In many instances, cream demand continues to outpace supply. Cream suppliers state that there just is not any cream around.
- Dairy Market News reports Midwest-sourced cheese has tightened due to declines in milk output and reduced yields. Current barrels are in shorter supply than blocks, while the anticipation of schools reopening is expected to reduce manufacturing milk supplies further.
- International: Dairy Market News reports Oceania cheese stocks are seasonally low and will clear quickly as supply commitments are well placed in order books.

Futures Month	Class III 08/06 Close	Class III 07/30 Close	Change	Dry Whey 08/06 Close	Dry Whey 07/30 Close	Change
Aug-10	\$15.05	\$14.94	\$0.11	36.00¢	35.75¢	0.25¢
Sep-10	\$15.31	\$15.40	(\$0.09)	36.00¢	35.25¢	0.75¢
Oct-10	\$14.92	\$15.08	(\$0.16)	35.00¢	34.75¢	0.25¢
Nov-10	\$14.68	\$14.86	(\$0.18)	34.00¢	33.50¢	0.50¢
Dec-10	\$14.60	\$14.72	(\$0.12)	34.50¢	34.00¢	0.50¢
2010	\$14.91	\$15.00	(\$0.09)	35.10¢	34.65¢	0.45¢
Jan-11	\$14.28	\$14.43	(\$0.15)	33.50¢	32.50¢	1.00¢
Feb-11	\$14.20	\$14.30	(\$0.10)	31.60¢	30.50¢	1.10¢
Mar-11	\$14.23	\$14.37	(\$0.14)	30.00¢	30.00¢	0.00¢
Apr-11	\$14.40	\$14.42	(\$0.02)	27.10¢	28.00¢	(0.90¢)
May-11	\$14.46	\$14.52	(\$0.06)	29.00¢	28.00¢	1.00¢
Jun-11	\$14.41	\$14.49	(\$0.08)	29.00¢	30.00¢	(1.00¢)
Jul-11	\$14.59	\$14.55	\$0.04	32.00¢	32.00¢	0.00¢
Aug-11	\$14.68	\$14.66	\$0.02	33.00¢	33.00¢	0.00¢
Sep-11	\$14.90	\$14.86	\$0.04	34.00¢	34.00¢	0.00¢
Oct-11	\$14.90	\$14.87	\$0.03	33.00¢	33.00¢	0.00¢
Nov-11	\$14.88	\$14.87	\$0.01	34.00¢	34.00¢	0.00¢
Dec-11	\$14.88	\$14.87	\$0.01	33.00¢	33.00¢	0.00¢
2011	\$14.57	\$14.60	(\$0.03)	31.60¢	31.50¢	0.10¢

What's Bearish:

- Cash Market: Cheese prices remain pretty much stuck where they are. Blocks ended the week unchanged at \$1.60¼/lb while barrels managed to gain a penny to settle at \$1.56¾/lb. Butter picked up 3½¢ to close at \$1.85/lb. No blocks traded, but 6 loads of barrels and 6 cars of butter exchanged hands.

- Dairy Products Report: Cheddar cheese output in June jumped 3.5% vs. a year ago while total cheese output was up an even stronger 5.2%.
- Ag Prices Report: The milk-feed ratio for July increased slightly to 2.31, the fourth month in a row of gains in the index.
- Weekly cold storage number show both butter and cheese stocks rising during the month of July. Butter holdings at selected storage centers increased 2%, or 151,000 lbs, while cheese stocks increased 1%, or 1.33 million lbs.
- International: Dairy Market News reports recent heat in Western Europe did impact milk production, but volumes remain good for this time of year. Cheese output had eased, but is now gearing back up. Stocks of manufactured dairy products are available for both domestic and international buyer interest. Overall, sales are light as buyers are cautious with purchases and stepping away from the marketplace.
- Nonfat dry milk prices continue to trend lower in a weak market, according to Dairy Market News. Domestic demand is light and export interest is fair to low. Stocks are moderate to heavy and mostly building.
- Economy: The U.S. economy shed 131,000 jobs in July, far more than the 63,000 that was expected. The figures were seen as yet another sign that the US economic recovery is stagnating, and that the jobs market may take years to get back on its feet. Revisions to June figures made things look even worse. The Labor Department said 221,000 jobs had been lost versus the 125,000 earlier reported.
- International: The new milking season is about to begin in Oceania. Moisture has been plentiful during the winter months, greatly enhancing depleted water levels. Milk producers are optimistic and looking for a 3-4% increase in New Zealand and about a 1-2% increase in Australia. Opening pay prices are also giving encouragement to producers.

Recommendation:

The spot cheese market continues to show reluctance to move any higher. While trade volume was low, no blocks and only six barrels, neither were bidders anxious to push prices up. Heat and humidity continue to play a role and may help support prices in the near term, but we can't help but start worrying a bit over our next milk production report, due out on the 18th. A third consecutive report showing increased cow numbers would be bearish Q4 milk prices as well as the first half of 2011. For that reason, we feel producers should look to get more of their milk covered. If the profit margin is there, we would sell Sep at 15.50 and again at 15.75. We would also sell Oct-Dec at 14.90 avg or better (currently at 14.73), covering up to 25% of production, and every 25¢ increment higher. Holiday demand does not last forever, so we are growing more concerned over the affect of higher cow numbers on 2011 prices. The Jan-Jun 13.50 by 15.50 fence was actively traded this week, for about 55¢. Assuming prices are heading slightly higher in the near term, we would try to get 25% of your production covered using this strategy, bidding up to 50¢ for this spread. If successful, you would have an effective floor at 13.00 base price and a cap at 15.00. Or, if you are comfortable with current margins, this six month pack could be sold at 14.30 avg. Don't ignore 2011 before it's too late to do anything.

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