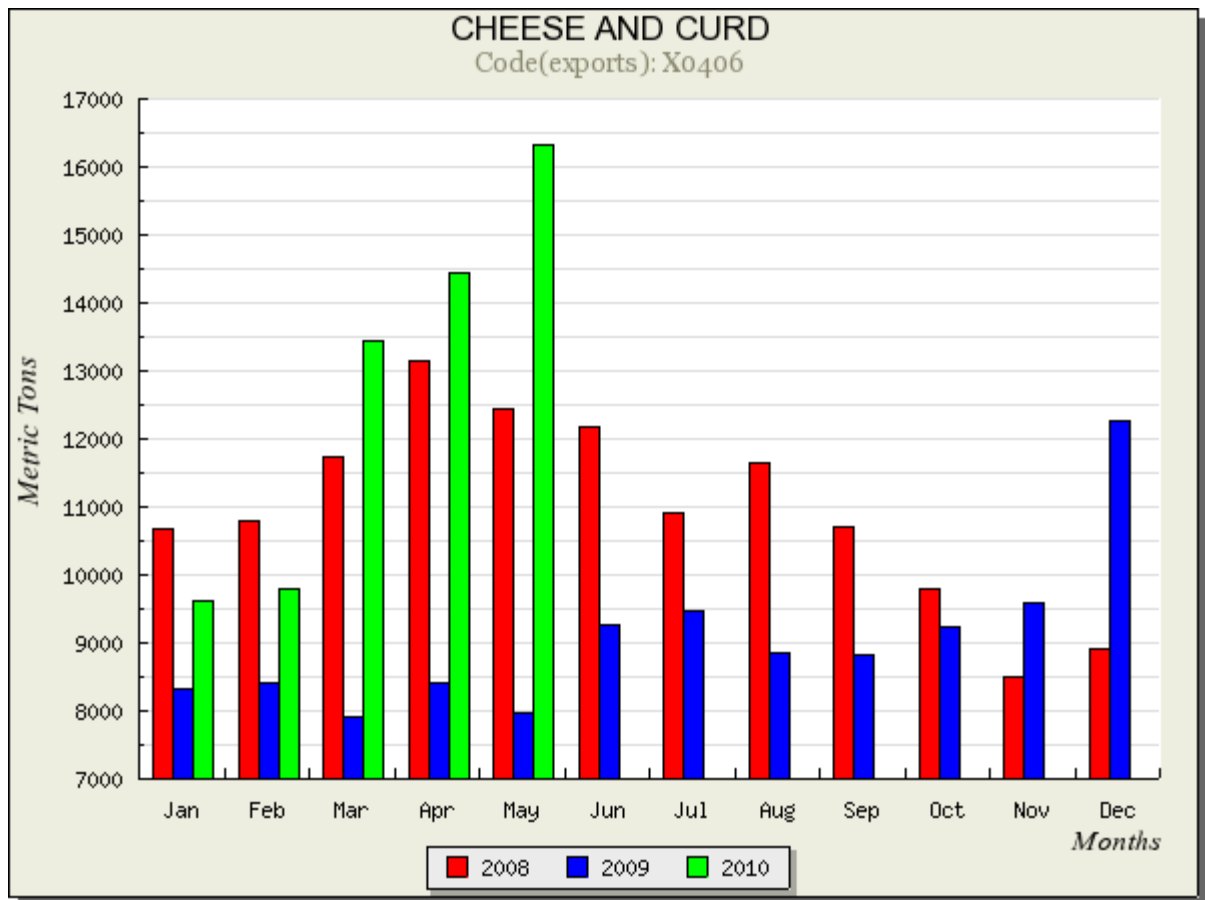


The KDM Dairy Report – August 13th, 2010

What's Bullish:

- Cash Market: After being flat the prior week, bidders were able to inch cheese prices higher on low volume. Blocks and barrels increased 1¾¢ to \$1.62/lb and \$1.58½/lb respectively. There were just 2 block and 1 barrel trade. Butter was more impressive with a jump of 6¾¢ to settle at \$1.91¾/lb on just 1 trade.
- Most Class III components were higher in this weeks NASS survey. Both blocks and barrels averaged \$1.58/lb, with blocks up 3.7¢ and barrels up 2.3¢ from last week. Butter increased 3.2¢ to average \$1.80/lb, nonfat dry milk inched 0.2¢ higher to \$1.18/lb, and dry whey gave up 0.6¢ to 35.9¢/lb.
- For the period 08/01 through 08/09, butter holdings at USDA selected storage centers declined 8%, or 776,000 lbs. Cheese holdings fell 53,000 lbs.
- Butter stocks at CME-approved warehouses fell 4 million lbs for the week ending 08/07. This compares to a 480,000 lb increase during the same period last year. Total stocks on hand are down to 39.6 million lbs, vs. the 94.9 million lbs we had on hand a year ago at this time.
- Dairy cow slaughter for the week ending 07/31 totaled 56,700 head, up 8,200 head from a year ago, and the highest weekly cull in 20 weeks.
- Milk production declines in the Mid Atlantic and Southeast were more pronounced this week due to extended periods of heat and humidity, according to Fluid Milk & Cream Review. Milk shipments into the area are expected to increase over the next couple weeks as the bulk of schools begin their fall term. Securing trucking is becoming an issue as additional supplies are located from greater distances. Output in Florida is declining as many producers dry off their cows in preparation to freshen. Production declines and lower components are combining to make cream supplies very tight, with some plants having trouble meeting their contract minimums.
- Fluid Milk & Cream Review reports manufacturing milk supplies are tighter in the Midwest, with some cheese operations unable to acquire extra volumes, which typically leads to reduced current cheese supplies. Cream demand remains good despite tight supplies and higher prices, as ice cream and mix production are generally solid with weather conducive to consumption. Milk receipts

Futures Month	Class III 08/13 Close	Class III 08/06 Close	Change
Aug-10	\$15.05	\$15.05	\$0.00
Sep-10	\$15.40	\$15.31	\$0.09
Oct-10	\$15.04	\$14.92	\$0.12
Nov-10	\$14.74	\$14.68	\$0.06
Dec-10	\$14.56	\$14.60	(\$0.04)
2010	\$14.96	\$14.91	\$0.05
Jan-11	\$14.21	\$14.28	(\$0.07)
Feb-11	\$14.10	\$14.20	(\$0.10)
Mar-11	\$14.09	\$14.23	(\$0.14)
Apr-11	\$14.20	\$14.40	(\$0.20)
May-11	\$14.20	\$14.46	(\$0.26)
Jun-11	\$14.24	\$14.41	(\$0.17)
Jul-11	\$14.50	\$14.59	(\$0.09)
Aug-11	\$14.70	\$14.68	\$0.02
Sep-11	\$14.91	\$14.90	\$0.01
Oct-11	\$14.94	\$14.90	\$0.04
Nov-11	\$14.95	\$14.88	\$0.07
Dec-11	\$14.92	\$14.88	\$0.04
2011	\$14.50	\$14.57	(\$0.07)



continue to slip, even with many of the larger producers with more extensive heat abatement equipment. Cows are tired of the weather and components are slipping. Some are reporting record low butterfat tests on incoming supplies.

- After a brief reprieve, hot and humid conditions have returned to Arizona and output is steady to lower, according to Fluid Milk & Cream Review. Milk continues to move out of state to supply deficit areas of the country, which is leaving less available for dairy product production. Supplies of cream remain tight and not able to fill all demand. In the Pacific Northwest, weather has not been a problem, but hay quality has been a negative. Cream is getting harder to find and butter production is declining rapidly.
- Dairy Market News reports churning schedules across the country are lower as cream supplies remain tight. Fat and solids levels in incoming milk are lower than expected. Some handlers state they are reaching deeper into inventories which are already lighter than desired. Most butter producers anticipate cream supplies will remain tight for the balance of the year. Despite higher prices, orders are holding up quite well.
- Northeast cheese production remains fairly steady, with good demand for mozzarella, provolone, aged cheddar and low fat cheddar, according to Dairy Market News. In the Midwest, current cheese supplies have tightened, particularly barrels. Milk receipts have wilted in the heat and humidity, and processors are looking for extra cheese solids, including undergrades. Spot loads of manufacturing milk are increasingly harder to find.
- Dry whey supplies are described as tight in the Northeast, according to Dairy Market News. Declines in cheese production and increases in Class I demand were cited as factors. Export interest has increased.
- Grains: Despite a bearish crop report on the numbers, outside influences such as the drought in Russia and parts of the U.S. have brought a dramatic rise to grain prices. Dec corn hit \$4.29/bu today while Nov bean reached \$10.44/bu. This will increase input costs for those dairy operations that purchase a majority of their feed.
- International: U.S. dairy exports reached record levels in the 2nd quarter, according to the Foreign Ag Service. U.S. suppliers boosted market their share around the world, with a 66% jump in dry ingredient, cheese and butterfat exports over a year ago, by volume. The total export value increased 84%. Cheese exports have established new monthly highs four months in a row, with second quarter shipments up 87% from last year (see chart above). Sales to the Middle East/North Africa were up 336%.

What's Bearish:

- World Ag Supply & Demand Report: USDA raised their milk production forecast for 2010 and 2011, citing higher cow numbers and rate of growth in milk per cow. As a result, they lowered their Class III price forecast from last month's estimate by 25¢/cwt to an average of \$14.65/cwt.
- California milk production has not seen the decline much of the rest of the country has, due to good weather conditions across the state, according to Fluid Milk & Cream Review. Totals are running about 2% higher than last year.
- Dairy Market News reports the tone for the nonfat dry milk market remains weak. Sales are tightening supplies but offerings remain available.
- Most Western cheese producers indicate they have plenty of milk, according to Dairy Market News. Heat stress has been below normal, so cheese yields in the West are better than most of the rest of the country. Demand remains good, but some are worried that the higher prices may soon begin to curtail buying interest.
- Economy: The stock market finished its worst performing week in the last six and poor economic data soured trader's risk appetites. Jobless claims jumped to 484,000 this week, above analyst expectations of a 469,000 increase. And in this week's FOMC meeting, the Federal Reserve spooked investors by downgrading its assessment of the economy.

Recommendation:

Heat is beginning to play a more significant factor as it hangs around longer than expected over much of the country. Reports we're hearing direct from our producers indicate even larger operations with fans and misters are seeing declines; right when school demand is around the corner. While butter and cheese prices have seen plenty of upside in the last month, nonfat dry milk and dry whey prices have not. We wonder if it's a matter of time before dry whey in particular starts to increase. With every penny move higher adding 6¢ to the Class III formula, less cheese production and a strong pull for Class I fast approaching, dry whey could get much tighter in the month or two ahead. Butter continues to be price inelastic with orders hanging in there and is bound to help support our market. Looking at the big picture, the near term looks somewhat bullish, but with a milk production report next week likely to show a larger herd and increases in milk per cow, the long term may not be so rosy. However, one must be impressed with the latest export numbers. CWT incentives have likely played a role in this, but there's no denying that a resumption of solid exports could lift our market, or at least minimize the risk of sub \$13 milk for quite some time. We continue to recommend getting a light start on 2011 hedging with orders to sell up to 20% of Jan-Jun at \$14.75 avg or higher. For the remainder of 2010, consider put options only for now. If we get a short-term market spike, be ready to pull the trigger and sell or buy higher-level put options than are available now.

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