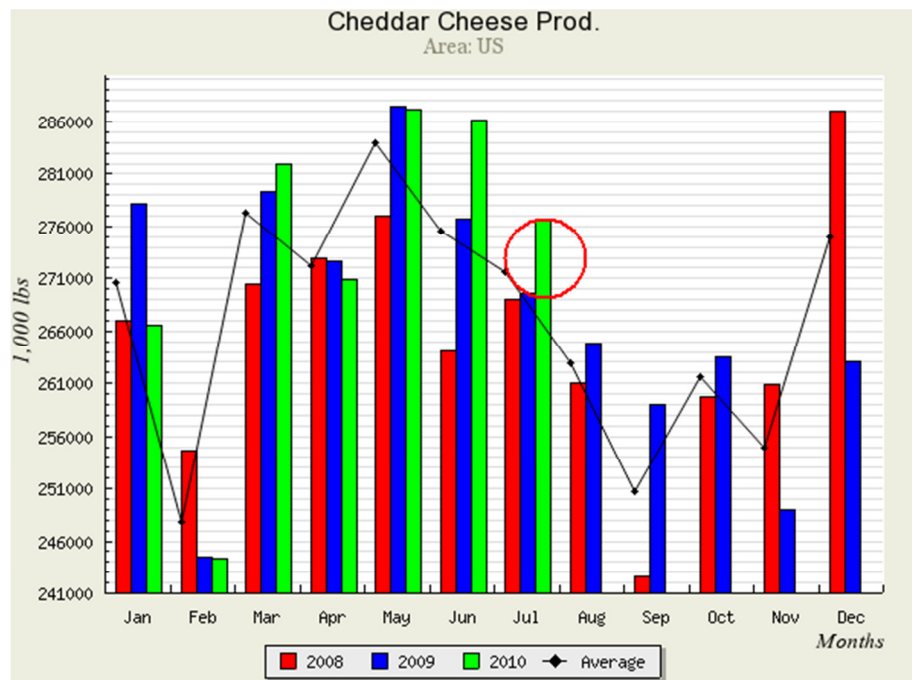


The KDM Dairy Report – September 3rd, 2010

What's Bullish:

- Cash Market: Blocks picked up 2½¢ to settle at \$1.72/lb this week, while barrels gained 2¢ to close at \$1.68½/lb. There was just 1 block trade for 5 barrel trades during the week. Butter marched 4½¢ higher to settle at \$2.22½/lb on just two trades.
- NASS butter and cheese prices continued to climb in this week's survey as they play "catch up" to cash. Butter jumped 7.2¢ to average \$1.97/lb, 40-lb blocks increased 2.2¢ to \$1.62/lb and 500-lb barrels were up 0.9¢ to average \$1.62/lb. Dry whey prices inched 0.3¢ higher to average 35.8¢/lb, but nonfat dry milk decreased 0.8¢ to \$1.14/lb.
- CME warehouses had a net movement OUT of 5 million lbs of butter for the week ending 08/28. Last year 2.2 million lbs went IN. Just 28.6 million lbs of butter are on hand, compared to 99.2 million lbs last year.
- Churning activity across the country continues to lag desired levels, according to Dairy Market News. In many instances, butter producers are choosing to sell a portion of their cream supply versus churn. Reduced churning is not generating sufficient fresh butter volumes to fulfill current demand so suppliers are reaching into inventory. For many butter producers and handlers, inventories are at much lower levels than most desire for this time of the season. Many butter producers and handlers are voicing concern about having sufficient butter stocks for domestic need between now and the end of the year when butter demand is typically the strongest.
- Fluid Milk & Cream Review reports more schools in the Northeast are opening or preparing to open, increasing Class I demand and tightening manufacturing milk supplies. Balancing plants in the Northeast and Mid-Atlantic regions are covering contracts with limited additional supplies for manufacturing. Cream supplies continue to be tight and demand for cream is very strong as cream cheese and butter orders have increased.
- Even in the upper Midwest, bottlers have to make more than just a phone call to get needed volumes from manufacturers, according to Fluid Milk & Cream Review. Manufacturing milk interest is good as cheese prices are at 2010 highs. Tight milk supplies and low seasonal yields have caused current supplies to tighten. Few manufacturers are able to secure additional milk volumes as supplies are very limited, and if a truck is available, any extra fluid volumes are readily absorbed.
- Fluid Milk & Cream Review reports CA milk production was lower over the last week as hot temperatures covered much of the state. Early indications were that intakes were down 1-3% across a wide section.
- Central dry whey prices were steady this week, but Class I sales to schools have reduced manufacturing supplies and tightened whey inventories, according to Dairy Market News. Demand is picking up as more buyers prepare for fall orders. Export interest has reemerged from China and the Far East. Stocks are tight in some instances.

Futures Month	Class III 09/03 Close	Class III 08/27 Close	Change	Dry Whey 09/03 Close	Dry Whey 08/27 Close	Change
Sep-10	\$16.16	\$15.88	\$0.28	36.25¢	36.95¢	(0.70¢)
Oct-10	\$15.63	\$15.60	\$0.03	37.00¢	36.75¢	0.25¢
Nov-10	\$14.94	\$15.01	(\$0.07)	35.50¢	35.50¢	0.00¢
Dec-10	\$14.50	\$14.56	(\$0.06)	35.00¢	35.00¢	0.00¢
2010	\$15.31	\$15.26	\$0.04	35.94¢	36.05¢	(0.11¢)
Jan-11	\$14.04	\$14.17	(\$0.13)	34.50¢	34.50¢	0.00¢
Feb-11	\$13.80	\$13.98	(\$0.18)	32.50¢	33.25¢	(0.75¢)
Mar-11	\$13.90	\$14.04	(\$0.14)	30.80¢	29.50¢	1.30¢
Apr-11	\$13.84	\$14.00	(\$0.16)	30.00¢	28.75¢	1.25¢
May-11	\$13.90	\$14.10	(\$0.20)	30.00¢	29.00¢	1.00¢
Jun-11	\$13.95	\$14.12	(\$0.17)	30.00¢	29.00¢	1.00¢
Jul-11	\$14.20	\$14.40	(\$0.20)	30.75¢	31.00¢	(0.25¢)
Aug-11	\$14.50	\$14.60	(\$0.10)	31.75¢	32.00¢	(0.25¢)
Sep-11	\$14.58	\$14.80	(\$0.22)	32.75¢	33.00¢	(0.25¢)
Oct-11	\$14.53	\$14.80	(\$0.27)	31.50¢	31.00¢	0.50¢
Nov-11	\$14.40	\$14.80	(\$0.40)	33.50¢	33.75¢	(0.25¢)
Dec-11	\$14.40	\$14.80	(\$0.40)	32.75¢	33.00¢	(0.25¢)
2011	\$14.17	\$14.38	(\$0.21)	31.73¢	31.48¢	0.25¢



- Dairy Market News reports Western whey production levels are tight as other whey products take more of the whey stream. Production is adequate for current needs with little product being offered onto the spot market. Those offerings that are available have been clearing readily.
- Domestic demand for Eastern dry whey remains good as users are asking for increases in their contracted volumes, according to Dairy Market News. Export interest also continues to be active. Inventories in the Northeast continue to be tight with those seeking additional loads looking to the Midwest to fill their need.
- Dairy Market News reports prices for Western nonfat dry milk are sharply higher. The changes reflect sellers increasing prices after recent lower priced sales transactions cleared product to domestic and export accounts. In addition, the higher world market prices are helping to bolster U.S. pricing levels as producers become more optimistic about market conditions. Stock levels are light to moderate and being held with more confidence than in August.
- Central and Northeast nonfat dry milk prices are firmer as interested has improved and supplies have tightened, according to Dairy Market News. Strong Class I demand is resulting in lower manufacturing milk supplies and an overall reduction in nonfat dry milk production. Recent export activity has significantly reduced inventories and product availability. Some plant managers have concerns regarding having adequate inventory for later in the year.
- Current cheese supplies have tightened with a few orders being shorted or delayed due to the tight milk supplies, according to Dairy Market News. Supplies continue to move from storage in order to meet interest. Demand for mozzarella has increased as most schools and universities are now open.
- One word: GRAINS
- International: Fonterra's Global Dairy Trade auction results were strong across the board this week, up 16.9% against last month's basket index.

What's Bearish:

- Dairy Products Report: Cheese output was strong in July, which should come as no surprise given impressive milk production that month. American cheese output was 4% higher than July 2009, while total cheese production jumped 4.7%. Butter output fell 2.9% over the same period.
- Ag Prices Report: The August milk-feed ratio increased to 2.36, from 2.32 in July, according to USDA. It's the highest the ratio has been since Jan, 2008, and the 6th consecutive monthly increase.
- Weekly cold storage numbers are showing both butter and cheese stocks increased in August at selected storage centers. Cheese holdings increased 2.5 million lbs, or 2%, while butter holdings jumped 2.35 million lbs, up 24%.
- Slaughter numbers this week were anything but inspiring, especially considering we're supposed to be in the midst of a CWT cull. 50,700 head were removed for the week ending 08/21, compared to 58,200 during the same week last year. YTD we are now 75,000 head behind 2009.
- Milk output in AZ and NM is steady to higher this week, with overall levels several percentage points ahead of last year, according to Fluid Milk & Cream Review. In the Pacific NW, cow comfort levels are good and milk production remains above a year ago.
- International: Milk output is strong in Germany, France, the UK, and Ireland by as much as 3% over last year, according to Dairy Market News. The holiday season is nearing an end and demand is beginning to pick up, but suppliers and handlers of manufactured dairy products indicate that stocks are available for immediate and future needs.

Recommendation:

Milk is still tight in much of the country, manufacturing milk supplies are down, cheese, butter and powder prices up, and..... Class III futures down for the week! Like we said last week, there are still a lot of fundamentally supportive factors out there to help in the short term, but there is just a huge level of disbelief that it will last. Producer selling was active this week out in 2011 months, pushing the average down 21¢. We had been recommending producers sell, but at this point, we would hold off on further outright sales. Corn is at a 23-month high and grains in general are in quite a rally due to the Russian drought and Informa crop ratings. If grain prices hold or go higher, they will support the milk complex. We would still consider getting coverage in Q1, but use a fence strategy so you can participate in some upside. Or, sell direct to your plant, but buy call options to protect the upside. Our recommendations last week to sell Oct at 15.90 or higher and Nov at \$15.10 or higher would have filled. October high for the week was \$16.00 and Nov hit \$15.25. We would put those in again next week. Current cash prices for cheese, butter and whey work out to about \$16.50 milk. Considering that next week's trade is shortened a day due to the Labor Day holiday, and many traders take the week off, we may (maybe not) see a quiet week in cheese, with prices possibly even inching higher. October's settlement at \$15.63 places it at quite a large discount and it could jump right back up to \$16+ next week. We continue also to watch the powder complex as both dry whey and nonfat dry milk supplies look ready to tighten. Enjoy a safe weekend! KDM's offices will reopen Tuesday.

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