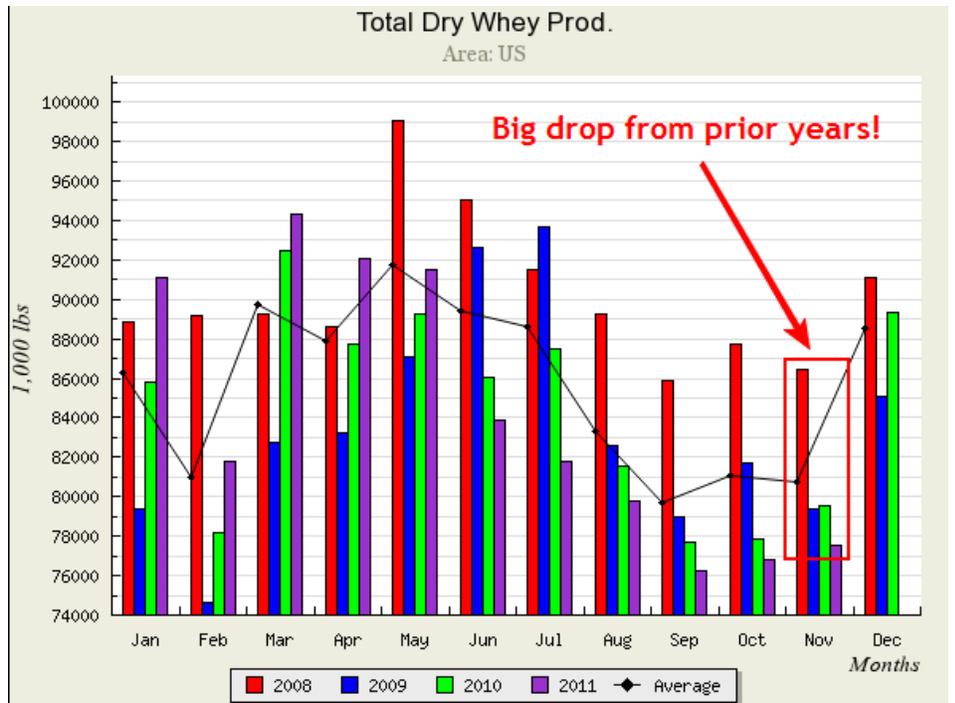


The KDM Dairy Report – Jan 6th, 2012

What's Bullish:

- Cash Market: 21 loads of blocks exchanged hands this week as buyers demand more cheese. The block price increased 4¼¢ to \$1.61/lb. Barrels traded just one time, settling at \$1.59/lb, up a penny for the week. Butter picked up 1 cent as well, closing at \$1.60½/lb on 3 trades.
- Dairy Products Report: Cheddar cheese output in November was down 1.7% vs. a year ago while Total Cheese output increased just 0.3%. Dry whey output fell 2.5%, its lowest output level since 1986 (see chart at right).
- Dairy cow slaughter for the week ending 12/24 totaled 59,600 head, up 8,800 head from last year. Through the 52nd week, the 2011 cull is up 121,200 head vs. 2010.
- Fluid Milk News. In the Pacific Northwest, forage availability and price have proven to be worrisome to dairy producers. Mid-month U.S. prices for baled alfalfa hay were \$199/ton, \$78/ton more than last year.
- Dry Whey Spotlight: Week 1 of 2012 brought higher prices to the firm Central dry whey market. Many manufacturers indicate their contracted quantities for this production year are closely aligned with total dry whey production projections. Because of that, manufacturers forecast offers of spot market loads throughout the year will be intermittent, at best. In the Northeast, available supplies are moving through contracts, spot market activity is very limited. Resale prices have increased ahead of the contract prices with some resale prices nearing 75¢/lb. The market undertone remains very firm with good domestic and export demand.
- Midwest Cheese: Milk production volume called into post-holiday bottling has increased, making somewhat less milk available for cheese manufacturing. Process cheese manufacturing orders are booked into coming months in some areas. Natural cheese sales from manufacturers are moving well to strong.
- Western Cheese: Cheese plants were busy over the holiday period handling some extra milk. Overall production is only marginally greater than last year and demand is clearing most inventories through contract sales.
- International: China whole milk powder imports in November were nearly double the levels they purchased in the preceding months, according to Global Trade Atlas. Dry whey imports hit a record high at 85.4 million lbs and skim milk powder purchases increased by 73%.
- International: Although trading has been slow, many traders in the EU did indicate that sales activity was stronger than anticipated. Many attribute the continued sales activity to the span of time between Christmas and New Year along with the holidays occurring on weekends.
- International: In Australia milk volumes are decreasing, and in recent days, temperatures maintained high levels which could significantly impact milk output. Temperatures in Northern Victoria reached 109F during the past week and are maintaining high levels. Milk handlers are indicating that it is too early to get a real good picture on the potential negative impact on milk output, but from previous high temperature trends, milk volumes suffered and often were not recoverable. Cheese markets and prices in

Futures Month	Class III 01/06	Class III 12/30	Change	Dry Whey 01/06	Dry Whey 12/30	Change	Cheese 01/06	Cheese 12/30	Change
Jan-12	\$17.26	\$17.26	\$0.00	68.75¢	67.73¢	1.03¢	\$1.635	\$1.635	\$0.000
Feb-12	\$17.75	\$17.43	\$0.32	71.75¢	69.00¢	2.75¢	\$1.670	\$1.661	\$0.009
Mar-12	\$17.87	\$17.46	\$0.41	70.00¢	69.25¢	0.75¢	\$1.673	\$1.660	\$0.013
Apr-12	\$17.72	\$17.36	\$0.36	68.25¢	66.58¢	1.68¢	\$1.679	\$1.667	\$0.012
May-12	\$17.50	\$17.25	\$0.25	65.00¢	63.60¢	1.40¢	\$1.679	\$1.663	\$0.016
Jun-12	\$17.50	\$17.12	\$0.38	61.50¢	60.73¢	0.77¢	\$1.690	\$1.662	\$0.028
Jul-12	\$17.40	\$17.24	\$0.16	56.50¢	56.50¢	0.00¢	\$1.712	\$1.700	\$0.012
Aug-12	\$17.44	\$17.30	\$0.14	55.00¢	55.00¢	0.00¢	\$1.719	\$1.715	\$0.004
Sep-12	\$17.48	\$17.32	\$0.16	53.30¢	52.25¢	1.05¢	\$1.740	\$1.720	\$0.020
Oct-12	\$17.18	\$17.07	\$0.11	52.68¢	52.00¢	0.67¢	\$1.720	\$1.710	\$0.010
Nov-12	\$17.13	\$16.99	\$0.14	51.50¢	52.45¢	(0.95¢)	\$1.720	\$1.705	\$0.015
Dec-12	\$17.16	\$17.05	\$0.11	51.90¢	52.40¢	(0.50¢)	\$1.720	\$1.719	\$0.001
12 Mo Avg	\$17.45	\$17.24	\$0.21	60.51¢	59.79¢	0.72¢	\$1.696	\$1.685	\$0.012



the Oceania region are steady to firm. Many manufacturers and handlers are indicating that cheese order books are in good shape and within budget.

What's Bearish:

- Cash Market:
- Butter News: Butter production for the past two weeks has been seasonally strong. Cream supplies were readily available to local churns from local and out of area sources over the yearend holiday period. Most butter operations maintained near capacity levels. In most instances, butter generated during this holiday period ended up in inventory for future use. Buying patterns during the holiday period were significantly lower than expected.
- Fluid Milk News: Manufacturing milk supplies were very heavy over the holiday period, keeping churns and dryers operating at near capacity levels in the Northeast and Mid-Atlantic regions. Class I demand has not returned to expected levels coming off the weekend and has resulted in a continuation of heavy manufacturing milk supplies. Florida's milk production continues to rise with significant increases noted. This week Florida exported 45 spot loads this week, compared to 20 last week. Nearly all auxiliary manufacturing plants to remain in use.
- Fluid Milk News: Farm milk intakes in the Central region are trending slightly higher as the production season advances. A few plants indicate bottler demand has not resumed to any degree and some Class II plants are still on hiatus. At those locations, plants are at full capacity and trying to keep up with intakes. In addition, milk from the East continues to clear into the Central region this week. Some milk handlers report Central milk loads cleared within the region at discounted prices, a continuation of holiday pricing trends, with early in the week prices ranging to \$4 below Class III, delivered.
- Nonfat Dry Milk: Western nonfat dry milk pricing levels are lower and the market tone is unsettled to weak. NDM buying interest is generally light and spot interest is limited for some fill in needs. U.S. offering prices are often being reduced to be competitive with international pricing. Domestic contract volumes appear to be lower overall. NDM production remained heavy into midweek as processors were still working through surplus milk generated over the holiday weekend. Stocks remain moderate to heavy.
- Northeast Cheese: Cheese makers had more milk over the holiday period and thus made more cheese. Inventories have expanded, but supplies with the exception of Swiss cheese are not burdensome. Demand and sales remain fairly good for aged cheeses and low fat cheddar.
- International: New Zealand milk producer and handlers continue to anticipate a 3-4% annual increase in milk output from last year.

Recommendation:

Both domestic and international demand appears to be better than what anyone thought. China made big purchases in Q4 and is probably out buying more in Q1. Everywhere from Europe, to Oceania, to the U.S., with the exception of some soft spots, demand appears to be about in balance with supply. That's not necessarily bullish on its own, but for this time of year, right after the holidays, it's impressive. Combine that with a white-hot dry whey market and spot cheese at "only" \$1.60, you still get about \$17.15 Class III. With producers generally unwilling to sell 2012 contracts in the low \$17s and downside seen as limited with spot prices now over \$17, futures finally came alive with gains across the board. The 2012 average picked up 21¢ for the week and now sits at \$17.45. We would anticipate further strength next week, which could produce a short-covering rally. But, we don't believe this is the start of a long bull rally in 2012; at least yet. We continue to hear about a lot of new Western milk coming online in the next couple months. While demand has been surprisingly resilient thus far, it's going to have to continue to be strong to absorb the additional supply. Secondly, as prices approach \$18.00 on the front months, producers may start more actively hedging (which they should!), limiting gains. We would continue to patiently wait, but be ready to cover more of your output on the next surge higher. Consider putting in a long-term order to buy the Apr-Dec 17.00 PUT and sell the 19.00 CALL on 25% of your production.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.