

The KDM Dairy Report – Jan 13th, 2012

What's Bullish:

- World Ag Supply & Demand Report: USDA increased their Class III price forecast for 2012 by 20¢/cwt from last month, and now expects the year to average \$17.50/cwt. A higher whey price is expected to more than offset lower cheese prices, resulting in a higher forecast Class III.

Futures Month	Class III 01/13	Class III 01/06	Change	Dry Whey 01/13	Dry Whey 01/06	Change	Cheese 01/13	Cheese 01/06	Change
Jan-12	\$17.11	\$17.26	(\$0.15)	68.50¢	68.75¢	(0.25¢)	\$1.615	\$1.635	(\$0.020)
Feb-12	\$17.08	\$17.75	(\$0.67)	71.00¢	71.75¢	(0.75¢)	\$1.600	\$1.670	(\$0.070)
Mar-12	\$17.34	\$17.87	(\$0.53)	70.40¢	70.00¢	0.40¢	\$1.640	\$1.673	(\$0.033)
Apr-12	\$17.31	\$17.72	(\$0.41)	67.25¢	68.25¢	(1.00¢)	\$1.660	\$1.679	(\$0.019)
May-12	\$17.35	\$17.50	(\$0.15)	63.75¢	65.00¢	(1.25¢)	\$1.696	\$1.679	\$0.017
Jun-12	\$17.44	\$17.50	(\$0.06)	60.00¢	61.50¢	(1.50¢)	\$1.710	\$1.690	\$0.020
Jul-12	\$17.42	\$17.40	\$0.02	54.50¢	56.50¢	(2.00¢)	\$1.738	\$1.712	\$0.026
Aug-12	\$17.46	\$17.44	\$0.02	54.50¢	55.00¢	(0.50¢)	\$1.743	\$1.719	\$0.024
Sep-12	\$17.45	\$17.48	(\$0.03)	51.50¢	53.30¢	(1.80¢)	\$1.742	\$1.740	\$0.002
Oct-12	\$17.24	\$17.18	\$0.06	51.25¢	52.68¢	(1.43¢)	\$1.735	\$1.720	\$0.015
Nov-12	\$17.18	\$17.13	\$0.05	50.00¢	51.50¢	(1.50¢)	\$1.720	\$1.720	\$0.000
Dec-12	\$17.19	\$17.16	\$0.03	50.00¢	51.90¢	(1.90¢)	\$1.715	\$1.720	(\$0.005)
12 Mo Avg	\$17.30	\$17.45	(\$0.15)	59.39¢	60.51¢	(1.12¢)	\$1.693	\$1.696	(\$0.004)

- Fluid Milk & Cream Review reports Class I and II demand is returning to normal levels following the holiday period, resulting in reduced manufacturing milk supplies in the Northeast and Mid-Atlantic regions. Class I demand increased significantly this week in Florida as well. A hard freeze occurred last week and wiped out numerous hay fields. Class I plants in the Southeast region are adding on loads with schools back in session, eliminating the need to utilize auxiliary manufacturing facilities. Demand for cream has increased as numerous ice cream plants have resumed full production schedules following the holidays. Production of cream based dips has also increased ahead of the NFL playoffs and the Super Bowl.
- Feed costs remain a large concern for dairy farmers in the Pacific Northwest, according to Fluid Milk & Cream Review. Hay stocks on farms are reported by USDA's Crop Production report to be 11% below last year and the lowest December 1 stocks for the U.S. since 1988. Price and availability are both concerns.
- Dairy Market News reports Central dry whey prices moved higher this week. Demand is steady, with spot interest still evident. Most manufacturers indicate dry whey inventories are light, contract-related and curtailing spot marketing. Resales are reportedly clearing to active interest, with prices ranging from the \$.70's - \$.80's. Western dry whey prices are higher this week as first quarter contracts reflect tighter supplies for the New Year. The whey stream supply is increasingly diverted to higher protein concentrates and therefore less is available for dry whey production. Spot offerings of dry whey are light with most of the available supplies tied to contract fulfillment. Export demand is good and Western manufacturers are continuing to maintain shipments to these customers. In the Northeast, prices are higher with resale trading from just under \$.80, with offers above. The market undertone is very firm with good domestic and export demand.
- Overall the Midwest cheese industry reports a good balance of manufacturing and sales this week, according to Dairy Market News. Natural cheese shows better interest than process, and there is continuing good cheese demand from pizza manufacturers. Cheese manufacturers report that Cheddar demand is strong, keeping some manufacturers "very busy". 40 pound block manufacturing is selling well, with some sales going for inventory building. Demand for Pepper Jack and party cheese is "very good" while Colby and Monterey Jack demand is considered a bit off. Processors and packagers report their business is steady, with "holiday recovery" keeping schedules full.
- Dairy Market News reports current price levels for Western cheese have increased demand from processors. Retail sales are moderate as Super Bowl orders are beginning to be placed. Mozzarella sales are good as pizza sales are typically favorable over the game weekend. Stocks of cheese are adequate with some export assistance from CWT helping to move surplus cheese.
- Cooperatives Working Together (CWT) announced this week assisted sales of 6.380 million pounds of Cheddar and Monterey Jack cheese to customers in Asia, the Middle East and North Africa for delivery January through June.
- International: Brazil's milk imports have soared as its farms struggle, according to an article in AgriMoney this week. Brazil's dairy farms have been hampered by tight margins and have failed to keep up with buoyant demand. Whole milk powder imports soared 35% to nearly 55,000 tons last year, which could see Brazil overtake Indonesia and Russia to become the world's third-ranked buyer of whole milk powder, behind China and Algeria, on US estimates. For skim milk powder, Brazil's imports jumped 120% to more than 31,000 tons. Brazil's own dairy farmers have struggled against margins squeezed by high feed prices. Brazilian milk output fell 1.4%, year on year, in October – the 13th successive month of contraction. Meanwhile, demand is being spurred by growth in Brazil's urban population. Analysts expect some recovery in domestic milk production early in 2012, but forecast it will still be insufficient to keep up with local demand growth.

What's Bearish:

- Cash Market: Blocks gave up 1½¢ on heavy trading of 21 loads to settle at \$1.59½/lb. Barrels lost 4¢ to close at \$1.55/lb on just 4 trades. Butter bucked the trend, increasing ¾¢ to settle at \$1.61¼/lb on 6 trades.

- Cheese sales in the Northeast have declined following the holiday period with inventories building, according to Dairy Market News. Cheese makers see the down turn in sales as temporary and expect sales to pick up with the NFL playoffs. Demand for mozzarella from pizza makers will increase as many colleges will soon begin their spring semesters.
- Fluid Milk & Cream Review reports milk production in California continues to follow a slightly higher trend on a week-to-week basis. Weather conditions have been very favorable for this time of the year with limited precipitation and mild temperatures. Arizona milk production is trending slightly higher. Weather conditions remain good for cow comfort. Processing plants are operating under more normal schedules. There are additional offerings of condensed skim and cream. Demand for milk and components is light to fair. Cream supplies are available in the West as buying interest has been slow to develop after the holidays.
- Churning schedules across the country are active, but lighter than during the recent yearend holiday period, according to Dairy Market News. Cream supplies are often more available to the churn than anticipated. Churning schedules are generating bulk for future use and prints for current needs. Overall butter buying interest is fair at best.
- Dairy Market News reports nonfat dry milk prices are still near the bottom of both the range. Domestic NDM demand is fair. Additional offerings of condensed skim are also being seen. Interest for NDM from cheese producers is limited. Current export interest is fair, but U.S. pricing levels are higher than reported EU pricing.
- Fluid milk sales in November were 1.6% lower than in Nov '10, according to Dairy Market News.
- Grains: This week's Grain Stocks report surprised the majority of analysts, pushing corn limit down on Thursday. Further selling on Friday has corn flirting with the \$5 handle. The potential for cheaper feed would help lower cost of production.

Recommendation:

Milk futures in the front months were broadly lower this week as cheese sellers controlled the spot market. Although cheese updates this week paint a pretty friendly picture on both the demand and manufacturing sides, we are post-holiday and coming into a time of seasonal milk production increases. After the Super Bowl there will be even less demand. Dry whey is the star.....for now. Looking at futures, while we're trading in the 70¢ range in the nearby months, further out months are predicting a 20¢ correction by year's end. It could happen sooner if alternative ingredients begin to be used or dry whey production increases. Current spot cheese prices work out to about \$16.90 milk, so we could see more downside next week if cheese continues to stumble. Consider buying the Feb 17.00 PUT for 25¢ and the Mar 16.75 PUT for 30¢ if you need protection. Apr-Dec we would continue to recommend a min/max strategy on up to 25% of your production. Call us for specific quotes.

Note: Our offices will be closed on Monday in observance of MLK Jr. Day. Markets will be closed.

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