

The KDM Dairy Report – Jan 20th, 2012

What's Bullish:

- Dairy Market News reports overall, butter orders in the Central region are stronger than many producers and handlers anticipated for the early part of 2012. Conversations are starting to occur between buyers and suppliers about upcoming Easter/Passover needs. Current food service orders are typical to slightly stronger in the Central part of the country as winter weather patterns have been quite favorable for away from home eating patterns.
- Dry whey prices in the Central region are unchanged to fractionally higher this week, according to Dairy Market News. The market is edgy, but market participants, theorize that today's market differs from 2007 in that the tight supply is the major factor currently influencing price. Spot load availability from manufacturers is light. Western dry whey prices are higher as contract formulations continue to ratchet prices upward. Supplies of whey are reported to be very tight for any supplies above previously contracted amounts. Spot activity therefore is limited. In the Northeast, nearly all supplies are moving through contracts, leaving resale opportunities as the only alternative to secure additional loads. The market undertone remains very firm with good domestic and export demand.
- Dairy Market News reports hay supplies west of the Rockies continue to be a concern for dairy farms. Stocks are surveyed twice a year at the end of May and at the end of December by NASS. The results indicate that U.S. stocks total 90.7 million tons, down 11.4 million tons or -11.2% from December 1, 2010, and the lowest stocks reported since 1988. Alfalfa production for the United States for 2011 is 65.3 million pounds, down 3.9% from 2010.
- Data through November indicates U.S. dairy exports were up 45% over a year ago, according to the Foreign Ag Service. Sales to China, Mexico and South Korea were sharply higher. Exports of non-fat dry milk, a popular Chinese import largely for use in making infant formula, have overtaken those of dry whey to become America's largest dairy export type, by volume. The US exported 50% of its production of non-fat/skim milk powder in the first 11 months of last year, up from 47% the year before.
- International: Most dairy products were higher in this week's Global Dairy Trade auction. SMP increased 2.7% to \$1.52/lb, AMF was up 2.8% to \$1.85/lb and cheddar cheese gained 2.1% to \$1.71/lb.

Futures Month	Class III 01/20	Class III 01/13	Change	Dry Whey 01/20	Dry Whey 01/13	Change	Cheese 01/20	Cheese 01/13	Change
Jan-12	\$17.10	\$17.11	(\$0.01)	68.75¢	68.50¢	0.25¢	\$1.612	\$1.615	(\$0.003)
Feb-12	\$16.41	\$17.08	(\$0.67)	70.75¢	71.00¢	(0.25¢)	\$1.539	\$1.600	(\$0.061)
Mar-12	\$16.69	\$17.34	(\$0.65)	68.75¢	70.40¢	(1.65¢)	\$1.575	\$1.640	(\$0.065)
Apr-12	\$16.71	\$17.31	(\$0.60)	63.70¢	67.25¢	(3.55¢)	\$1.605	\$1.660	(\$0.055)
May-12	\$16.78	\$17.35	(\$0.57)	59.50¢	63.75¢	(4.25¢)	\$1.643	\$1.696	(\$0.053)
Jun-12	\$17.15	\$17.44	(\$0.29)	55.50¢	60.00¢	(4.50¢)	\$1.703	\$1.710	(\$0.007)
Jul-12	\$17.24	\$17.42	(\$0.18)	51.50¢	54.50¢	(3.00¢)	\$1.749	\$1.738	\$0.011
Aug-12	\$17.26	\$17.46	(\$0.20)	50.50¢	54.50¢	(4.00¢)	\$1.747	\$1.743	\$0.004
Sep-12	\$17.23	\$17.45	(\$0.22)	49.00¢	51.50¢	(2.50¢)	\$1.749	\$1.742	\$0.007
Oct-12	\$17.14	\$17.24	(\$0.10)	48.00¢	51.25¢	(3.25¢)	\$1.740	\$1.735	\$0.005
Nov-12	\$17.12	\$17.18	(\$0.06)	48.00¢	50.00¢	(2.00¢)	\$1.740	\$1.720	\$0.020
Dec-12	\$17.15	\$17.19	(\$0.04)	48.00¢	50.00¢	(2.00¢)	\$1.745	\$1.715	\$0.030
12 Mo Avg	\$17.00	\$17.30	(\$0.30)	56.83¢	59.39¢	(2.56¢)	\$1.679	\$1.693	(\$0.014)

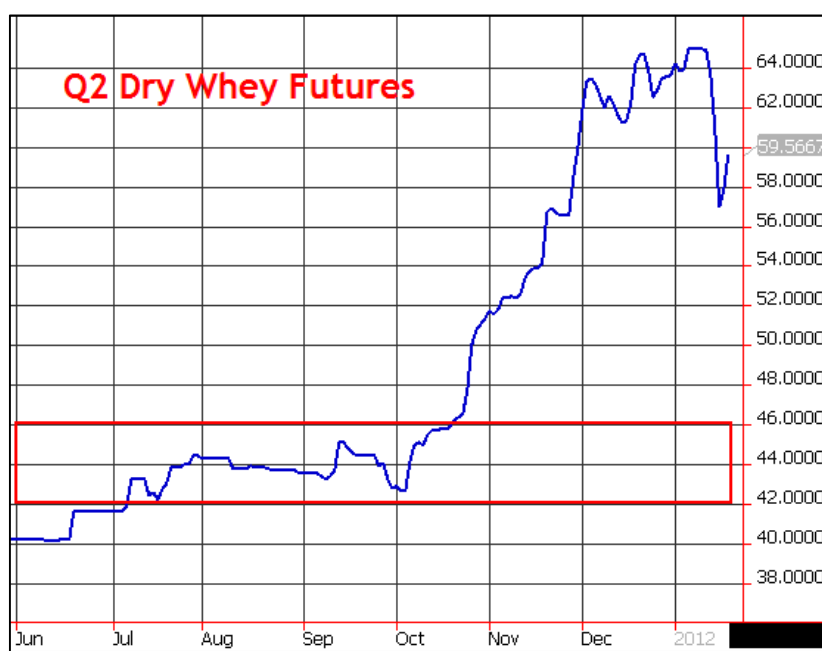
What's Bearish:

- Cash Market: Blocks shed 9¢ this week to close at \$1.50½/lb on 13 trades, while barrels gave up 4¼¢ to settle at \$1.50¼/lb on 9 trades. Butter lost 4¼¢ to close at \$1.57/lb on unfilled offers.
- Cold Storage Report: Butter stocks in December were up 29% vs. the prior year and up 12% from Nov. American cheese stocks were down 5% compared to Dec 2010, but up 3% from Nov.
- Livestock Slaughter Report: 261,900 dairy cows were culled in Dec, according to USDA, down 2,900 head from 2010.
- Dairy cow slaughter for the week ending 01/07 totaled 58,200 head, down 9,200 head from a year ago, when 67,400 were culled.
- Cheese production in the Northeast remains steady for this time of year, according to Dairy Market News. However, inventories are expanding for most varieties. In the Midwest, most cheese manufacturers finished production for Super Bowl orders last week. Milk availability for cheese manufacturing is relatively good. One reason cited is the string of near record warm days in the last week which resulted in a noticeable increase in milk production. Cheese production in the West is mostly steady. Retail cheese sales are slowing somewhat after the holiday season. Cheese plants report available milk supplies are sufficient for current needs.
- Fluid Milk & Cream Review reports Class I demand has leveled off in most areas of the Northeast and Mid-Atlantic regions with some loads occasionally pushed back. Manufacturing milk supplies have increased and are more than adequate to fill demand needs as less milk is being shipped to the Southeast. Plant managers continue to see load weights increase as farm production increases. Cream supplies are readily available and are quickly exceeding demand needs with some cream loads being shipped to the Midwest at lower multiples. Butter production in the East is near capacity. Cream demand is in the doldrums, because it is too soon for cream based product manufacturers to increase production for Passover and Easter.
- In the Central region, bottler demand is level to somewhat lower, according to Fluid Milk & Cream Review. Additional spot loads of milk have some American-type cheese plants approaching production capacity. Some producers of Italian-type cheeses indicate slower-than-projected cheese sales have taken the edge off their milk demand. Central spot cream loads are readily available, with most loads clearing into the churns. Western cream is also moving to the Central to find processing capacity.

- Fluid Milk & Cream Review reports in California and Arizona, milk production continues to trend slightly higher on a week-to-week basis and levels are building towards the peak levels usually seen in the next month. Conditions are very favorable for milk cows, while cream supplies are heavy.
- Dairy Market News reports butter production in the Northeast exceeds current demand, with both bulk and print inventories expanding. Cream has become readily available with significant volumes heading to churns. Butter production is very active with most major manufacturing plants churning at near capacity.
- The market for butter in the Western region is weak following the holiday season at year end, according to Dairy Market News. Production schedules are heavy as cream is readily available. Print lines are running slower as retail demand has been reduced. Tight consumer finances are reported to be reducing demand for premium branded butters. Bulk butter production is heavy as churns are inventorying supplies.
- International: Dairy Market News reports milk production continues to increase in most Western European regions. Often, milk volumes are running heavier than last year at this time. Manufacturing schedules are also on the increase. Traders and handlers are reporting that sales activity remains quiet.
- International: New Zealand handlers continue to project a 3-4% annual increase over last season, according to Dairy Market News. In Australia, milk producers and handlers remain optimistic about the season and continue to project a 2-3% seasonal increase over last year. Traders and handlers of manufactured dairy products are indicating sales activity is slow to develop following the yearend holiday period.

Recommendation:

Though trade volume was light in the spot market, sellers continued to run the show this week as the hit nearly any bid that showed up. Volume in Class III was anything but light as we saw some violent moves in response to the weak cash market. After the initial push lower, we saw a classic short-covering rally over the past two sessions. Even today, Feb put in a high of \$16.90 and Mar hit \$17.08, only to settle near the lows of the day at \$16.41 and \$16.69 respectively. Fundamentals appear more bearish this week. Cheese sales are slow, milk production is increasing, cheese output is up and butter production is skyrocketing. Cream is everywhere and cheap. The holidays are over and football nearly so. Butter prices in particular could take a plunge with the massive output going on right now. About the only bright spot is dry whey, but one has to ask, can dry whey prices stay strong when about every other dairy product is weak? We don't think so. Check out all the "red" in the weekly price comparison at the top of the report. Dry whey looks ready to correct as well. The chart at right indicates a possible top has been made, with support in the mid 40-cent range (red rectangle). It would be wise, then, to discuss just "where" prices could go. We're hearing more talk of the possibility of cheese heading into the low \$1.40's due to the building inventory and slow sales. Plugging in \$1.45 blocks, \$1.42 barrels, \$1.50 butter and 45¢ whey yields a Class III price of \$14.07. While we may not head that low, we could easily see prices decline into the \$15's. Dairy prices rising slightly in this week's Global Dairy Trade auction should provide some support, and we would expect buyers to get more aggressive the lower cheese prices go, but we wouldn't rule out a quick dip to these levels for a few weeks. We would sell Feb and Mar on rallies; target 16.75 for Feb and 16.95 for Mar. For Apr-Jun, offer to buy the 16.00 PUT and sell the 18.00 CALL for up to 10¢/month. Get started on the second half of 2012. Offer to buy the 16.00 PUT and sell the 18.50 CALL for up to 10¢/month. In summary, we continue to believe we're headed for a soft patch in the near term, after which prices will recover. Hay is tight.



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