

The KDM Dairy Report – Mar 16th, 2012

What's Bullish:

- Cash Market: Blocks gained 9¢ while barrels picked p 8¢ on the week, with both settling at \$1.58¼/lb. In neither case were there any sales, as sellers disappeared. Butter increased 6½¢ to settle at \$1.51½, with 26 loads exchanging hands.
- Most Class III components in this week's NASS survey were up for the first time in over a month. 40-lb cheddar blocks increased 0.5¢ to average \$1.49/lb while 500-lb barrels inched 0.8¢ higher to \$1.51/lb. Dry whey was up 1.3¢ to average 61.9¢/lb, but nonfat dry milk decreased 2.3¢ to \$1.34/lb and butter lost 0.8¢ to \$1.42/lb.
- Dry Whey East: Dry whey remained readily available again this week, but recent multiple load sales have significantly reduced inventory levels at plants with burdensome supplies. The uncertainty in the dry whey market remains, but more and more members of the industry are coming to the understanding/opinion that the recent market declines were an adjustment in prices, rather than a continuing decline in prices. There were fewer resale offers this week compared to last, an indication that owners of dry whey are more comfortable with their current inventories. Domestic demand is improved from last week as prospective buyers believe they have a clearer picture of the market.
- Dry Whey West: Prices were mostly steady this week as some of the unsettledness in the market noted over the past few weeks has dissipated. Some buyers and sellers are becoming more comfortable with the present market and trading activity is improving for some manufacturers.
- Cheese East: Increases in milk production continue to prompt increases in cheese output; however, an uptick in holiday cheese orders has helped limit the rate of inventory expansion. Some cheddar plants have increased the volumes going into aging programs. Export interest remains fairly good when assistance is provided.
- International: The Foreign Ag Service this week reported cheddar cheese exports to Mexico in January were up 560% vs. last year. Total cheddar cheese exports increased 27% and totaled 10.8 million lbs.

Futures Month	Class III 03/16	Class III 03/09	Change	Dry Whey 03/16	Dry Whey 03/09	Change	Cheese 03/16	Cheese 03/09	Change
Mar-12	\$15.61	\$15.42	\$0.19	60.75¢	58.28¢	2.48¢	\$1.525	\$1.505	\$0.020
Apr-12	\$15.82	\$15.24	\$0.58	57.75¢	51.50¢	6.25¢	\$1.553	\$1.538	\$0.015
May-12	\$15.50	\$15.21	\$0.29	52.50¢	48.00¢	4.50¢	\$1.555	\$1.566	(\$0.011)
Jun-12	\$15.88	\$15.64	\$0.24	50.75¢	46.50¢	4.25¢	\$1.606	\$1.605	\$0.001
Jul-12	\$16.46	\$16.17	\$0.29	50.00¢	43.50¢	6.50¢	\$1.691	\$1.670	\$0.021
Aug-12	\$16.78	\$16.42	\$0.36	46.75¢	43.00¢	3.75¢	\$1.718	\$1.705	\$0.013
Sep-12	\$16.79	\$16.50	\$0.29	45.00¢	44.98¢	0.02¢	\$1.735	\$1.710	\$0.025
Oct-12	\$16.74	\$16.47	\$0.27	45.00¢	44.68¢	0.33¢	\$1.727	\$1.718	\$0.009
Nov-12	\$16.44	\$16.28	\$0.16	45.00¢	42.95¢	2.05¢	\$1.697	\$1.694	\$0.003
Dec-12	\$16.42	\$16.25	\$0.17	45.00¢	42.50¢	2.50¢	\$1.700	\$1.694	\$0.006
Jan-13	\$16.18	\$16.06	\$0.12	40.00¢	40.00¢	0.00¢	\$1.683	\$1.692	(\$0.009)
Feb-13	\$16.05	\$16.10	(\$0.05)	38.50¢	38.50¢	0.00¢	\$1.754	\$1.754	\$0.000
12 Mo Avg	\$16.22	\$15.98	\$0.24	48.08¢	45.36¢	2.72¢	\$1.662	\$1.654	\$0.008

What's Bearish:

- Weekly cold storage numbers are showing increases in both butter and cheese stocks over the first 12 days of March. Butter holdings at USDA selected storages centers are up 499,000 lbs, while cheese stocks are up 346,000 lbs.
- Fluid Milk East: Mild weather continues to prompt increases in milk production and, when combined with the continued sluggishness in Class I demand, have resulted in heavier milk volumes going into manufacturing plants in the Northeast and Mid-Atlantic regions. Manufacturers have noted the heavy supply of milk has caused increased production of Class III and Class IV dairy products, expanding inventories to undesired levels. Florida's milk production is quickly increasing to its seasonal peak. Class I demand has declined as some schools have begun their spring break periods, causing exported spot milk to increase to 190 loads, up from 110 last week. Milk production in the Southeast has increased to flush levels with the peak of the flush still a few weeks out. The resulting heavy manufacturing milk supplies are causing all auxiliary manufacturing facilities to be heavily utilized. Some schools and universities have begun their spring breaks, lowering already sluggish, Class I demand.
- Fluid Milk Central: The surge in milk supplies for the Central region continued this week. Milk handlers at times are scrambling to find manufacturing homes for the increased milk supplies. Class I needs are less than expected with the unusual weather and adding to supplies. Cheese plants are pushing some loads back.
- Fluid Milk West: California milk output continues to increase on a week-to-week basis and remains at levels well above a year ago. The upward trend is helped by favorable weather conditions and adequate feed supplies. New crop alfalfa is available from the Imperial Valley. Processing plants are running on heavy schedules to process the milk supplies. Arizona milk output and volumes remain heavy. Plant capacity is being taxed to handle the milk supplies. Farm level conditions are very favorable for the milk cows and they are still responding by making more milk. New Mexico milk production trends are increasing. Conditions are good for making milk across the state with weather seasonally favorable. Plants are running on longer schedules this week as some Class I milk needs are lower with schools and colleges taking spring breaks.
- Cheese Midwest: Disappointing retail cheese sales are mentioned across the spectrum of the cheese industry as an area of some concern. Retail pizza sales have been unexpectedly slow in recent weeks altering schedules of some pizza manufacturing lines by shutting down some previously planned production for the next several weeks. This will reduce the need for Mozzarella. Cheese manufacturers now face the quandary of how to handle the milk which they had expected to require for manufacturing the

canceled Mozzarella orders. With milk supplies already higher than had been expected, this presents an additional challenge. With sluggish retail sales and continuing heavy cheese manufacturing, inventories reportedly continue to build. Some manufacturers who have exported cheese routinely for a number of years, express their perspective that cheese export sales this year seem "slow".

- Cheese West: Cheese production in the region remains heavier than projections due to milk supplies coming on faster than anticipated. Plant stocks are heavier than desired at some locations, but others indicate that they think they have things under control for the time being.
- Butter: Many are questioning the strength at this time with most speculating that upcoming Easter/Passover needs is the main impetus to the strength. Although the cash price is firm, many traders and handlers are speculating that this price will ease following the upcoming holiday. Production levels remain heavy as processors handle the seasonally building milk and cream supplies.
- Dry Whey Central: Prices are slightly lower on a weaker market. The market is unsettled as buyers and sellers adjust to lower reported prices from across the United States. Increased production of whey has added to price uncertainties.
- Nonfat Dry Milk: Prices are lower this week. Demand is soft. The perception of increased supplies is weighing on the market. Heavy milk supplies are in fact adding to inventories. Spot buyers are willing to wait for anticipated lower prices.
- January fluid milk sales were 2.7% lower than a year ago, according to Dairy Market News.
- International: Fonterra has cut their forecast payout to dairy farmers due to a higher global milk supply and uncertainty in the markets.
- International: Weather conditions in Western Europe are more spring like and producers and handlers are stating that noticeable production increases are occurring ahead of typical trends. Manufacturers and handlers of dairy products are indicating that overall demand is limited to domestic or internal markets. International buyer interest is slow. The European whey powder market and prices are weak. Cheese production is building seasonally as milk volumes increase, thus whey volumes are also on the increase.
- International: Milk production trends in both New Zealand and Australia continue to run positive when compared to last year at this time. Weather patterns in both countries have been favorable, and milk producers and handlers continue to project a strong 3% annual increase with 4% plus possible.

Recommendation:

Last week we warned of an uptick in the dairy complex and suggested lifting some hedges. That turned out to be good advice, as on the face of it, we finished the week with solid gains in Class III and dry whey futures. We hate to flip-flop from one week to the next, but we are back in the bear camp. Supply fundamentals just appear to be too overwhelming to us. From coast to coast, milk production is heavy and manufacturing plants are running hard. Inventories are building. Some of the tightness causing prices to go up can be explained by Easter/Passover demand and perhaps an early start to the grilling season with all the warm weather, but it now appears orders are slowing down again. Cream demand is picking up with some early increases in ice cream production, but supplies have easily matched needs. Lastly, while spot cheese prices are up for the week, in the last two sessions we've seen no attempt to move prices higher. In fact, there has been no activity at all, bids or offers. Ominous, perhaps. The markets sensed this today, as Class III futures finished lower, and well off their early highs. For example, April traded as high as \$16.14 but settled at \$15.82, while May hit a high of \$15.83 but settled at \$15.50. If you lifted your hedges, we would resell at current prices. In fact, we would sell milk through August. Navigating through an increasingly volatile milk market is difficult, and we may be wrong here. On the other hand, the move higher this week has given those that need to get more coverage an additional opportunity to do so.

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