

**The KDM Dairy Report – May 25<sup>th</sup>, 2012**

**What's Bullish:**

- Spot Market: Blocks settled at \$1.57/lb, gaining 7¢ on the week, with 6¼¢ of that coming on Friday. Just 4 trades exchanged hands as sellers have become quiet. Barrels picked up a penny to settle at \$1.47/lb with no trades at all. Butter increased 3¼¢ to close at \$1.38¼/lb on 2 trades. Finally, Grade A nonfat dry milk, which rarely trades on the spot market, gained 3¢ on 15 trades to settle at \$1.15¼/lb.
- Livestock Slaughter Report: 239,800 head exited the milking herd in April, up 2,000 head from a year ago.
- Cold Storage Report: Total cheese stocks in April were down 1% vs. last year, while American cheese stocks were up just 1%. However, butter stocks jumped 79%.

Futures Month	Class III 05/25	Class III 05/18	Change	Dry Whey 05/25	Dry Whey 05/18	Change	Cheese 05/25	Cheese 05/18	Change
May-12	\$15.27	\$15.17	\$0.10	54.75¢	53.50¢	1.25¢	\$1.517	\$1.513	\$0.004
Jun-12	\$15.80	\$15.39	\$0.41	51.00¢	50.13¢	0.88¢	\$1.584	\$1.551	\$0.033
Jul-12	\$16.35	\$15.26	\$1.09	50.50¢	47.98¢	2.53¢	\$1.645	\$1.556	\$0.089
Aug-12	\$16.23	\$15.45	\$0.78	47.60¢	46.00¢	1.60¢	\$1.660	\$1.579	\$0.081
Sep-12	\$16.20	\$15.85	\$0.35	46.00¢	46.00¢	0.00¢	\$1.660	\$1.620	\$0.040
Oct-12	\$16.12	\$15.90	\$0.22	45.00¢	45.00¢	0.00¢	\$1.665	\$1.643	\$0.022
Nov-12	\$15.97	\$15.89	\$0.08	45.50¢	43.00¢	2.50¢	\$1.645	\$1.655	(\$0.010)
Dec-12	\$15.90	\$15.79	\$0.11	44.00¢	43.50¢	0.50¢	\$1.655	\$1.652	\$0.003
Jan-13	\$15.90	\$15.59	\$0.31	41.00¢	41.00¢	0.00¢	\$1.655	\$1.650	\$0.005
Feb-13	\$15.59	\$15.45	\$0.14	40.50¢	40.50¢	0.00¢	\$1.645	\$1.645	\$0.000
Mar-13	\$15.64	\$15.55	\$0.09	39.50¢	39.50¢	0.00¢	\$1.660	\$1.660	\$0.000
Apr-13	\$15.65	\$15.51	\$0.14	38.50¢	38.50¢	0.00¢	\$1.680	\$1.680	\$0.000
<b>12 Mo Avg</b>	<b>\$15.89</b>	<b>\$15.57</b>	<b>\$0.32</b>	<b>45.32¢</b>	<b>44.55¢</b>	<b>0.77¢</b>	<b>\$1.639</b>	<b>\$1.617</b>	<b>\$0.022</b>

- Dry whey made a reversal and picked up 1.6¢ to average 54.4¢/lb, in this week's National Dairy Products Sales Report. Cheese was steady, with 40-lb blocks unchanged at \$1.53/lb and 500-lb barrels down ¼¢ to \$1.49/lb.
- For the first 21 days in May, cheese stocks at USDA selected storage centers are unchanged; typically holdings build during this period. Butter stocks, however, are up 12%.
- Dairy cow slaughter for the week ended 05/12 totaled 57,300 head, up 5,200 head from the same period a year ago.
- A private cheese plant we work with says sales are good and orders are getting pushed to 3 weeks out.
- Fluid Milk Central: Farm milk intakes and component contents are gradually receding from seasonal highs in the Central region. Various marketing representatives and dairy cooperative managers indicate the competition for farm milk is increasing steadily in some areas of the Central region where cheese and butter/powder plants are numerous. Lures of higher premiums on volumes or component content are reportedly being offered as incentives to large scale dairy farms considering changes to farm milk destinations. Marketers now indicate premiums to Class price range from \$.50 to \$1.50 for spot loads of milk. Various cheese plant operators report they are bringing in fewer loads of spot milk because of the increase in price does not pencil out for commodity cheese end products.
- Fluid Milk West: Arizona milk production is trending lower on a week-to-week basis. Hotter temperatures are a main cause, along with time in milk and feeding changes made because of high feed costs. No issues are expected at processing plants over the upcoming holiday weekend. Western cream markets are firming. The timing is interesting when observed from the perspective of being the week ahead of a three day, holiday weekend. Demand has improved from both ice cream and fresh products. With school milk needs slowing as more schools recess for the summer, there is less cream coming off the standardization process for fluid milk.
- Butter: Beginning late last week, spot cream in the Northeast has become very challenging to locate. A manufacturer commented that it is a "big deal" to have "no cheap cream" during a week leading into the Memorial Day holiday weekend. Another comment was that "cream is much tighter than at any time this year so far". Multiples began moving up late last week and that continued into this week, increasing daily to Wednesday. Sellers are already anticipating multiples to be even higher next week. This is attributed to a combination of a drop in cream supply and a "big jump" in demand, as butter manufacturers react to increasing butter prices by wanting to manufacture more, now.
- Dry Whey: Export competition moved some manufacturers to lower prices this week to maintain export sales. However, while exports are being pressured lower, domestic offerings are tightening. More of the whey stream from cheese plants is currently going towards production of higher concentrated whey protein products. This shift is reducing dry whey production and tightening stocks. Spot offerings are available, but buyers are finding firmer pricing in some cases.
- Cheese Northeast: Some regional cheddar manufacturers, report inventory levels as "full but not burdensome". There is beginning to be consideration of the pros and cons of increasing production now to accumulate an inventory cushion for meeting fall demand, due to concern over the volume of late summer milk supply in the event of adverse summer weather. No resolution has yet been reached. Manufacturers of Italian varieties have somewhat tight inventories, particularly those focused on manufacturing for retail sales. This has led to plants operating seven days a week. Milk supplies have been ample and plant capacity is the limiting factor.
- Cheese Midwest: Some Midwest cheddar plants are presently selling cheddar with high suitability for aging at a premium. Some manufacturers to expect some sales slowdown moving ahead, but plan to move cheese into export through CWT to remove it from domestic markets. CWT has accepted requests for export assistance to sell a total of 3.578 million pounds of Cheddar and Monterey Jack cheese. The product will be delivered May through November 2012. Bulk Mozzarella production is in good balance with demand in the region. While there is no widespread change in days per week of overall cheese manufacturing this week, some plants have reduced vat numbers each day. Some other plants anticipate reducing days of production after the holiday weekend.
- Cheese West: Production levels are heavy with many plants running at near capacity, but manufacturers are comfortable with inventory levels in most cases. Demand is moderate with buyers content to purchase at current prices.
- International: A recent earthquake in Italy is reported to have damaged over 300,000 wheels of aged cheese worth hundreds of millions of dollars.

- International: An agribusiness company that exports dairy heifers to China says it can't get enough to supply demand this year. For the second consecutive year, a record shipment of 100,000 cattle will sail from dairies in Australia, New Zealand and Uruguay. They're going to modern intensive dairies in China, where dairy consumption is expected to double in less than ten years.
- International: In Western Europe, there is increasing demand for fresh milk and cream based products, which is alleviating the stress on plants making cheese, butter, and powders. Milk supplies are being handled well and processors are able to make the product mix needed for current and future sales. The results of the recently completed export tender indicate there are heavy volumes of SMP and WMP being sourced from Europe. The sales are welcomed to move or rebalance stocks that have been built during the production season. Current pricing for SMP and WMP are unchanged, but there are indications pricing levels are trying to firm.

#### What's Bearish:

- Fluid Milk East: Northeast milk production is widely believed to have reached a plateau a "couple" of weeks ago. Nevertheless, production remains heavy and drying at some plants remains at full capacity. That is now projected to be scaled back next week. Milk production in the Southeast is declining overall except in the mid-Atlantic region. This has kept manufacturing capacity in the Southeast at about 60%-70% of capacity but that is expected to increase over the weekend. While there is some hope for production overall to decline, some processors expect that there will be a surplus for a couple of weeks as the effects of schools ending and the holiday weekend are absorbed by the system. Florida remains hot and humid, with day temperature highs in the 90's and nights in the 70's, reducing cow comfort, leading to farm milk production declining. Schools are in the process of ending classes and "it's barbecue season", both of which will reduce demand for milk.
- Fluid Milk West: California milk output is mostly steady and remains at or near the seasonal peak. Weather conditions have been warm during the daytime, but are cooler at night. The impact on cows has been limited to none. New feed is being consumed and giving milk output a boost. Class I needs are trending lower with schools and colleges breaking for the summer or taking a break from full year terms. The holiday weekend will see smaller plants taking extra days off and more milk moving to the larger plants. Milk production in the Pacific Northwest has slowed from the heavy levels a few weeks ago, but remains heavy across the region. Milk handlers are expecting some additional loads to move to manufacturing plants during the holiday weekend as some Class I and II plants are closed for the long weekend. Some excess supplies are being moved out of the region to find processing capacity. Butter/powder and cheese plants in Utah and Idaho will be busy over the holiday weekend with local supplies and some outside milk from the Northwest. Favorable weather for milk production is helping to keep milk supplies above year ago levels.

#### Recommendation:

Wow! What a way to finish the week! The spot market finally came alive with blocks jumping 6¾¢ today, and no offers in sight. Word on the street was that barrels were a touch more snug than blocks, so the blocks leading the way came as a surprise. With a 10¢ spread now between the two, one would expect barrels to rise to close the gap, vs. the other way around. Futures exploded to the upside, with 840 contracts trading in July alone. July was also the big gainer for the week,



picking up an impressive \$1.09 from last Friday, with August making a 78¢ climb. To be honest, while we have been calling for a bottom, we're scratching our heads a little as to the potential upside from here. Current spot prices for cheese work out to about \$15.15 Class III. With July settling at \$16.35 today, it's pricing at about \$1.65/lb. We're not saying cheese can't trade another dime higher, but with the U.S. dollar continuing to strengthen (the euro put in new multi-year lows this week), we wonder how competitive our exports will be. Expect further strength in Class III next week, unless the spot market suddenly reverses. But as you can see in the chart above of the July-Dec avg, the long-term trend is still down, unless we can break through and stay above the \$16.30 level. Perhaps you might want to lightly sell here to get some coverage. That would be locking in over \$1.60 cheese avg for the last half of the year. Next week will be very interesting. If we do break higher, the next stop would be \$16.70, where we made a double-top in Mar and April. With nearly all other commodities from energy to grains to precious metals on downward trends, it's hard to think that the dairy complex will be able to break free and ride north over the long run, but it has run to its own drum before.

**Note:** We will be closed on Monday in observance of Memorial Day. Have a great weekend!

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