

RESEARCH REPORT

July 30, 2009

Volume 13 • Number 7

Waiting for Warmth

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*You know the day destroys the night
Night divides the day
Tried to run
Tried to hide
Break on through to the other side
Break on through to the other side
-- The Doors Break on Through*



*The weight of this sad time we must obey;
Speak what we feel, not what we ought to say.
-- William Shakespeare King Lear*



*'Emergencies' have always been the pretext on which the safeguards
of individual liberty have been eroded.
-- Friedrich August von Hayek*



It is always tempting come late July to perpetrate the summer literary crime of referring to “dog days” or some such. We’ll refrain. Not because of some highbrow commitment to stamp out clichés. Rather, the reality for residents across much of the nation – people and cows – is weather that feels more like late-spring than mid-summer. For that reason, and myriad others, the dairy markets are still a little chilly. We continue to see the potential for a warm front to move through, a chance to shuck the windbreakers and sweat a little in the sun. But the chances for a heat wave still seem remote.

This month we provide an overview of the current scene – an admittedly brief look because things have not changed much over the past 30 days. That is followed by a lengthier discussion of macroeconomic forces and potential implications for the dairy markets. From there we go down a different path, examining in detail the concept of “supply management” and some of the ideas being bandied about in some segments of the producer com-

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munity. Finally, we revisit a conversation that began last October about the possibility that food prices have shifted to a new plane, much as was the case in the early 1970s.

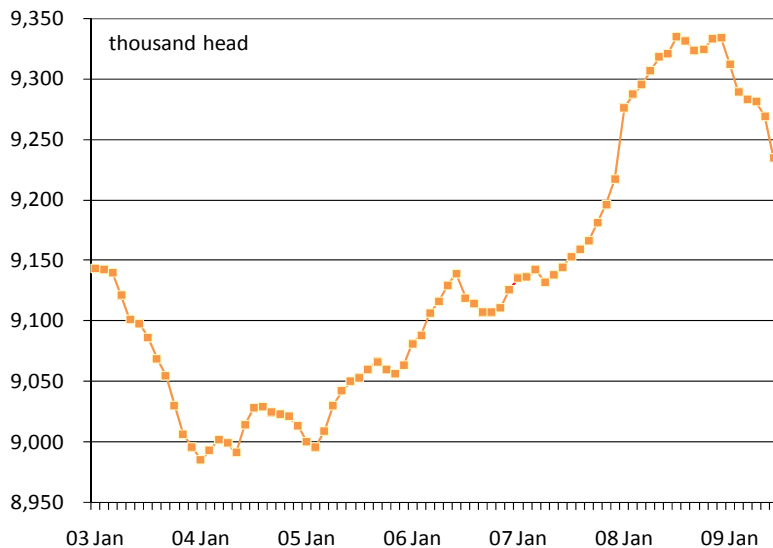


Dairy prices, with the continued exception of the whey market, remain depressed. While markets are not sitting hard by CCC support levels, rallies have been shallow and hard-fought. Block cheddar cheese has made it back above \$1.20/lb; while it still likely has room to move higher, the beating absorbed by the Class III futures market over the past two days serves as a reminder that the planets are not quite aligned for a major rally. **The issue with cheese is the issue everywhere else: stocks are at high levels, end-users are well bought and milk production remains decent enough overall even if down some in the beleaguered West.**

It is easy to get support for a rally when, for all practical purposes, “everyone” is long in one way or another. Rah, rah, go market, go! But at some point the pom-poms have to be put away as a

Cow numbers are coming down. The pace may be slower than expected (or hoped for), but it will matter before long.

US COW NUMBERS



harsh reality takes hold: in order to profit from higher prices, product actually has to move. It is difficult to build real momentum so long as end-users have what they need and so long as ongoing production remains adequate.

Which is not to say we are bearish from here on a spot market basis. **Though the pace of supply-side liquidation is still slow, we still believe it is underway.** The latest round of CWT herd retirements has taken more cows out of the system. A new round of retirements is set to begin soon. Economic performance continues to favor ex-its and every day that goes by without a real bounce in prices brings the industry a day closer to more herds leaving the system. It is ugly, to be sure. It always is. But it is the “cure” and we suspect that by late August and early September the ongoing supply-side losses will have reached enough critical mass to have an impact on the product markets.

Cheese remains the favored vehicle, in our estimation, because the CME market can come to appear tight quickly given the tight age specification for deliverable product. As noted in past reports, stocks matter, but in a less immediate way. We are maintaining expectations for prices to move up toward the mid-to-high 150s as the fourth quarter unfolds. Our faith in that assertion, it is fair to say, is waning some. But the mood in the cheese market can turn on a dime and we expect to see agitation for higher prices when the door to the possibilities opens a bit wider. We still believe the rally won’t last, with prices fading into and through the first quarter, as the market continues to work toward right-sizing supply.

Expectations for butter are unchanged, as well. Seasonal forces will create a push up to the low 140s as holiday preparations accelerate into the fourth quarter. It is also possible that deteriorating milk production in the West has changed the landscape some, maybe pushing some incremental buying into the spot market.

Nonfat dry milk prices should continue to loll about the low-to-mid 80s. Heat and DEIP activity might provide a little support, but upward thrust would likely be neutralized by global length and already sated demand.

Why prices have apparently met the resistance discussed for several weeks and contemplated by our previous forecast. We maintain that a modest slide is likely into year-end.

All of these unchanged expectations are subject to alteration as it appears likely that the US government will intervene in the coming weeks with announcement of higher support prices. There is little consensus around the magnitude of potential support price increases or about the duration of any changes. There is, however, near universal belief that something is coming – likely before Congress leaves town next week. We discuss the prospective efficacy of support price increases later. And here we will not even take a stab at guessing the magnitude. But with all the “supportable” products near the existing CCC purchase price, a government commitment to buy at higher levels would obviously skew the price picture higher, at least for the short-run.



On the other side of here lies...what, exactly? As we study prospects for the economy in general and the dairy markets in particular over the next 18 months one theme, one source of tension crops up repeatedly. It is this: a sense that once the current recession ends, things will somehow return to the way they were before the financial markets began to unravel late last summer. A sense that the other side of where we are looks something like where we were. Some of this is conveyed subtly. Some if it is conveyed explicitly via the equity markets and even in Class III milk

futures market valuations.

From our perspective, however, it is going to be quite difficult to get to a place tomorrow that looks much like yesterday. Forgive us for going back to this month after month, but we think consumer behavior has been radically altered – if not forever for at least the intermediate term. Without the consumer, a major recovery in the economy is not on the immediate horizon. And, without that, it is hard to imagine dairy commodity markets rocking like they did in 2007 and 2008.

Examining data we believe to be relevant to the dairy markets, report after report still shows the public pinching pennies and bankers balking at loosening credit.

The savings rate as calculated by the Bureau of Economic Analysis climbed to 6.9% in May, the highest level since November 1993. Consumers are also borrowing less (or have less access to credit). The Federal Reserve said consumer credit outstanding contracted by 1.9% on a year-over-year basis in May, the biggest decline since November 1991. And, a recent examination of financial results by *The Wall Street Journal* showed the total number of loans held by 15 large US banks shrank by 2.8% in the second quarter. Moreover, much of the

Class III milk futures values continue to slide as market participants recalibrate for lower possibilities month after month.



loan activity that did take place was of the refinancing variety. For example, Comerica's loan total was down 4.3%, with only \$1.6 billion of the \$10.2 billion in credit being extended representing new commitments. For all the banks reviewed, "more than half" of the loan volume in April and May "came from refinancing mortgages and renewing credit to businesses" instead of new loans.

Importantly, multiple reports show that restaurants are one area in which consumers have remained reluctant to spend. The latest "food and drinking place" sales figures from the US Department of Commerce showed 0.3% year-over-year growth in June, the worst showing since at least 1992. Sales declined 0.9% from May compared to an average May-to-June increase of 0.4% over the previous five years. The latest *Knapp Track* report showed customer counts in surveyed restaurants down by as much as 7% last month. Moreover, quarterly earnings reports released over the past two weeks still show a lot of slippage in same-store sales at major restaurant chains.

From a dairy market perspective, it is true that some of the volume lost in the food service arena is being recovered in

the retail space. Indeed, retail volumes have been quite good. Persons familiar with the latest scanner data say that volume sales of cheese in grocery stores were up by about 5% from mid-June to mid-July. Butter sales were said to be up by more than that. **But holding serve is one thing; solid growth is another. We maintain that the demand side is not going to be of much – if any – help at all in getting the market back to balance.**

Zooming out some, we saw some commentary this week from well-regarded analyst David Rosenberg of wealth management firm Gluskin Sheff that summed up the situation neatly (emphasis is ours):

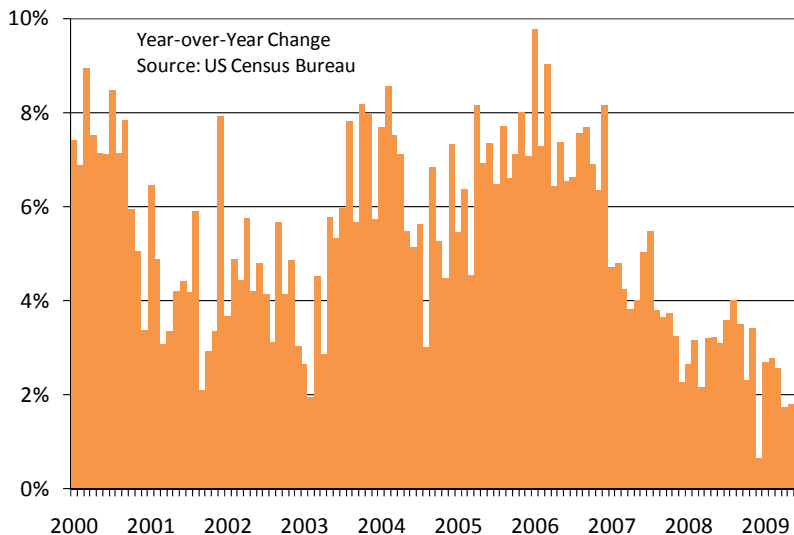
*Any student of the 2000-2003 cycle knows that in the year after that downturn, the consumer offered little help – contributing barely more than one percentage point to GDP growth, which was unprecedented and the cyclically sensitive spending segments exerted not one iota of positive contribution. **The difference is that this 2007-2009 cycle was double the asset deflation and triple the job loss and coupled with a credit collapse, which means that it is going to take even longer for the consumer to come back this time around... the risk that the end of the recession only manages to bring on a prolonged period of stagnation is non-trivial and is not priced into the stock market at current valuation levels.***

Another nugget from the same report puts things in tangible terms. Referring to the government sponsored "cash-for-clunkers" program, Rosenberg writes:

*The chatter is that we are going to see motor vehicle sales improve to 10 million units (annualized in July). Whoopee. The program is going to keep sales near 25-year lows. **What is important to focus on here is the 'new normal'.** The 'new normal' nearly a decade ago was that 0% financing would bring in 20 million in*

Food service continues to be a drag on dairy demand. That might not change anytime soon with consumers in a cautious mood.

"FOOD AND DRINKING PLACE" SALES



sales... Today's 'new normal' is doing everything Washington can do to get to 10 million units. Has it dawned on them, or anyone else, that since 2000, the number of vehicles sold (net of replacements) rose nearly 30 million, doubling the 15 million increases in the number of licensed drivers? The over saturation of the auto market is unwinding, and this process will very likely take years.

We continue to see signs that things have stopped getting worse. Some of the numbers released in the past week even hint at modest improvement – housing data (existing sales, Case-Shiller Price Index, etc). But victories of the “house values are down 17% year-over-year compared to 18% last month” variety are hollow and suggest the road back is still long. **Assumptions about consumptive demand should be calibrated accordingly.**



As a for-profit enterprise with a diverse customer base, we are not in the habit of offering printed commentary on specific dairy policy issues or proposals. Typically, the battle lines are clearly drawn based on long-held positions, the debate can be emotionally charged and, quite honestly, the subject matter quickly becomes arcane or boring.

Today's environment, however, compels a cautious exception to our normal operating mode. Quite simply, this latest bout of low prices has spawned what appears to be a greater number of proposed “solutions” than has been evident during previous depressed periods. Moreover, some of the proposals tend to be more far-reaching than what we have seen in the past. Or, at least, the sweeping solutions are getting more prominent play in government and media circles. As such, they deserve some reasoned economic analysis and commentary.

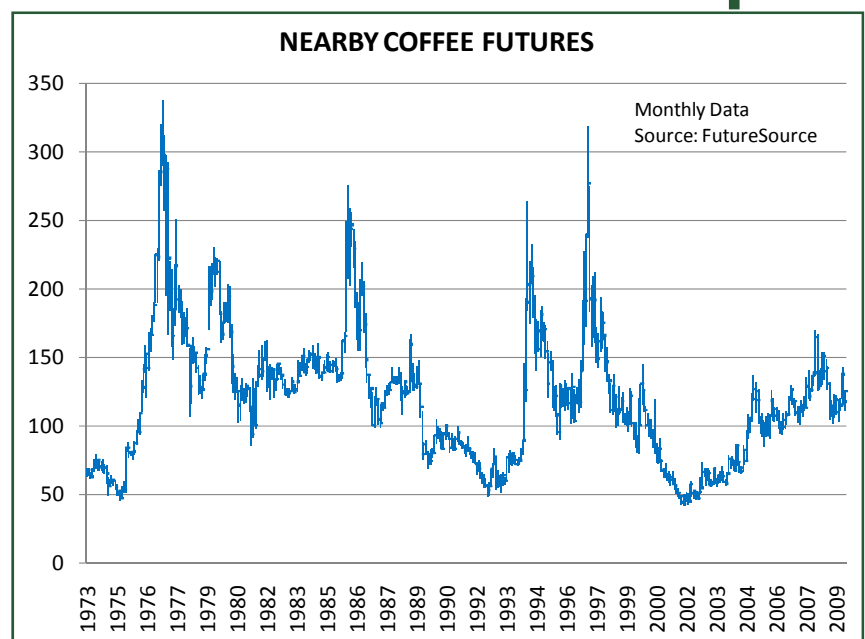
Most notably, there has been a lot of

discussion about “supply management” as a way to reduce “price volatility” in the dairy marketplace. The movement is somewhat loose – and, for now, appears to lack the universal support from producer organizations. But there is a concept circulating; it has traction in certain quarters.

Before diving into the specifics, two things should be stated up front. First, our economic leanings tend toward the libertarian. Our general views on market intervention are framed by the wisdom of free market economists in the Friedrich Hayek/Milton Friedman tradition. Hayek asserted that, “we must face the fact that the preservation of individual freedom is incompatible with a full satisfaction of our views of distributive justice.” Friedman once noted that, “the only way that has ever been discovered to have a lot of people cooperate together voluntarily is through the free market.” Neither, it is safe to say, would look favorably on any scheme to collectively manage supply. So it should not surprise that such proposals also run counter to our inclinations.

Second, economic history is hardly replete with examples of successful efforts to manage commodity supply. We note, for example, that the International Coffee

Numerous “coffee agreements” inked over the years have done little to either raise prices or lower market volatility.



Agreement of 2007 was the seventh such agreement inked since 1962. Coffee prices were at less than \$0.60/lb in 1973, 1975, 1992 and again in 2001. Since 2000, nearby New York coffee futures have traded in a range between \$0.48/lb and \$1.69/lb. The average monthly settlement since 1973 is \$1.19; today's settlement was \$1.23/lb. It seems appropriate to wonder whether the agreements have raised prices or limited volatility. Similarly, OPEC could not prevent crude oil from falling to \$10.35/bbl in 1999 or halt the slide from \$147 to \$32 in 2008 on into earlier this year. Cynically, we would be inclined to suggest that supply management is often viewed as something someone's neighbor should practice.

With those two points in mind, let's consider the elements of US dairy supply management plans presently under discussion. There is no real single plan on the table, but the various proposals are similar in that they do not explicitly call for "quotas" to be imposed on milk production. **Rather, the plan that seems to be getting the most attention would call for the system to be governed by a board (made up primarily of dairy producers) that would determine allowable growth rates.** If a producer wishes to grow beyond the "allowable level" a penalty would have to be paid on all of that dairy's milk production. The penalty would be established at \$2.00-3.00/cwt and would apply to all volume for a year. That fee would be due after the first quarter in the expansion year; If a producer does not end up violating the cap over the course of the entire year, the assessment would be refunded. The resulting new, higher, production level would become the producer's base going forward.

The stated objective of the program is to stabilize price at an "acceptable" level. Most statements from proponents key on presumed reductions in volatility that would result from implementation.

That, of course, can be tricky. **Any program seeking to reduce price volatility would need to either be able to anticipate**

and counteract shocks or, on a systematic basis, allow the market to better align supply and demand on a day to day basis.

By definition, anticipating shocks is not likely. Milk market dynamics are complicated by the fact that supply and demand growth are somewhat steady but are generally somewhat out of sequence. Demand tends to react more quickly than supply due to cow biology and the fact that true supply-side contraction has historically tended to be more about the absence of expansion than about increased exits. So contraction can only really take place in the "dark period" after all in-progress expansions are completed and few new projects are set in motion. There is also the counter-intuitive impact of cash-flow demands to deal with. That is, when milk prices get low, many producers initially respond by increasing volume to keep revenues up even if margins are down.

Consequently, any program designed to minimize volatility (that means reducing peaks as well as valleys) must be designed to accelerate expansion when demand advances and accelerate contraction when demand declines. Given the obvious and unavoidable lags in supply-side adjustment we can only wonder about how supply growth could be truly accelerated. Moreover, it seems certain that the proposed program would not help and would in fact probably hinder any efforts to expand production when needed. That said, need for expanded supply might not be as acute considering that the higher prices wrought by a supply management program would reduce prospects for demand growth. We doubt that such stagnation is an objective.

It is also fair to wonder whether a \$2 or \$3 levy is really sufficient disincentive. Essentially, those payments would be folded into decision making surrounding expansion and would be included in any pro-forma calculations as inflating production costs in year one. But that cost could ultimately be spread over a financing term

Minimizing volatility requires the ability to speed growth when demand advances and accelerate contraction when demand declines.

for dairies that have access to capital. Accordingly, the expansion fee could be as little as, say, \$.20/cwt annually over a loan of 15 years (excluding interest expense). Is that enough to alter decisions?

Taking that thought a step further, since the fee is fixed and known in advance and could likely be amortized it seems likely that it will encourage large-scale expansion more than small-scale expansion. The bigger the expansion, the bigger bang for the buck because the fixed expansion fee tied to legacy milk production can be spread out over a larger expansion volume. We also doubt this would be a program goal.

There is also potential that this dynamic would actually increase volatility. Supply management as envisioned could erode the long-term base of expansion that is gradual and smooth – such as the internal growth of small- and medium-sized dairies that expand by managing cull rates – and replace it with a much choppier pattern of large, discrete expansions.

Indeed – and quite ironically – such a turn of events would seem to be penal to small producers and could quicken the pace of current consolidation. And, even smaller producers that are positioned and inclined to expand will be forced to do so in larger increments than in the past.

Volatility would also inevitably be the byproduct of any inability by a governing board to foresee demand changes before they materialize. Decisions would almost have to be reactionary. Accordingly, if the governing board reduces fees (to encourage growth) we will see sizable production increases after conditions are ripest (demand would likely adjust lower in the face of higher prices while expansion in reaction to demand growth was unfolding).

There are additional considerations concerning cow valuation. Current internal growth/expansion that happens day-to-day, month-to-month is the result of growing replacement heifer numbers. In an envi-

ronment in which growth is choked off, heifer prices would decline as a significant percentage of buyers in that market would no longer be interested in acquiring cows. As a result, the small number of large dairies with cash costs low enough to justify expansion even under the worst conditions and most onerous fees would have access to cheaper heifers to fill their new barns. Thus a perverse situation could develop: producers might have strong returns from higher prices but reduced asset values (tied to cows) and, consequently, lower net worth.

Finally, one can only imagine that there would be potential for various high jinks involved, as tends to be the case with any such program. The Cooperatives Working Together program, for example, has been wrestling with how to prevent producers from going through a revolving door – exiting the business and re-entering in short order. In addition, there is always potential for the waters to be muddied by various political agendas that play out as an idea becomes legislation.

In sum, the list of unintended consequences potentially emanating from currently discussed proposals is long – probably longer than we imagine. Inevitably, such a program would likely just take a more complicated route to achieving what is already the reality today: rewards would tend to accrue to the most efficient producers...producers that have lower costs and, on balance, tend to be larger.

Supply management is not the only relief measure being kicked around. There is talk about temporarily increasing the support price, for example. We get how that might work from a political angle – “we hear you and we are helping” – but hasten to point out that raising prices is not going to make the underlying problem (too much supply/too little demand) go away. In fact, rudimentary economics would say that paying more for supply is going to result in...more supply (and less demand).

The list of potential unintended consequences emanating from currently discussed proposals is long,

There is no disputing that things are rough on the farm – rougher than ever for larger producers in the West and plenty lousy for producers elsewhere.

It should be noted, however, that all of these proposals are coming in response to the 2008-2009 crash as though it was somehow normal – in some way a function of a poorly designed or maintained system. But the reality is far more complicated than that. **In our estimation, the industry collectively misread market conditions that prevailed in 2007 and early in 2008.** The issue may not be that demand simply crashed; rather, it may be that there was considerable investment in infrastructure – on both the producer and plant level – predicated on faulty assumptions about that demand. As noted frequently here over the past year, what was assumed in many quarters to be a blossoming global demand story was really more of an Oceania supply story. **And, at too many junctures, classical, common-sense concerns about price impact on demand were either discounted or ignored altogether.** What are the odds that a governing board overseeing supply growth would have gotten that right considering that essentially the same participants in the same industry got it wrong? What are the

It is interesting to see food prices bounce off a low that is near the highs of the range that prevailed from 1973 to 2006.

CRB FOODSTUFFS INDEX



odds considering that participants in many other industries – think shipping, think autos – missed it, too?

We are in no way unsympathetic to what is going on at the farm level. Some of us grew up on dairy farms and still own cows. Some of us have relatives still doing the yeoman work of stepping into the parlor early every morning. We care. **And because we care, we think that it would be best to take a deep breath and see that newfangled government-type, centrally-planned solutions won't likely produce any better results than the government and voluntary programs already in place today and centrally-planned initiatives that have failed in other industries.** Moreover, decisions made to address a short-term situation on an emergency basis are rarely good decisions for the long run. As Milton Friedman also once said, "the government solution to a problem is usually as bad as the problem."



Just about a year ago, the Organization for Economic Cooperation and Development/Food and Agricultural Organization of the United Nations (OECD/FAO) published its annual 10-year forecast of agricultural prices. Eagerly anticipated and widely quoted, the report asserted that while prices were likely to fall from then-prevailing highs, there would be, "strong reason to believe that there are now also permanent factors underpinning prices that will work to keep them both at higher average levels than in the past and reduce the long-term decline in real terms..."

The latest edition of the OECD/FAO *Agricultural Outlook*, published a month ago, does not really back off those assertions, global economic calamity notwithstanding. According to an OECD/FAO press release:

Food prices have come down from the record peak of early 2008 but they remain high in many poor countries. Over the coming decade prices for all

farm commodities except beef and pigmeat - even when adjusted for inflation - are unlikely to fall back to their average levels before the 2007-08 peaks. Average crop prices are projected to be 10 - 20 percent higher in real terms (adjusted for inflation) for the next 10 years compared with the average for the period 1997-2006. Prices for vegetable oils are expected to be more than 30 percent higher. An expected economic recovery, renewed food demand growth from developing countries and the emerging biofuel markets are the key drivers underpinning agricultural commodity prices and markets over the medium term.

This, naturally enough, got us to thinking about (a) whether the assertions are plausible and (b) where might dairy fit into the picture?

At a glance, there is some evidence to support the OECD conclusions. Just look at the grain markets. Last week, nearby corn futures fell to a new year-to-date low of \$3.04/bu. For more than three decades prior to 2007 three-dollar corn was the function of major rallies. From 1970 through 2006 the monthly high for corn topped \$3.00/bu on 89 occasions – or 20% of the time. The average price for that period was about \$2.45/bu. Corn has been below \$3.00/bu during only two sessions since January 2007 (December 5 and 8 of 2008). Moreover, the market saw a new all-time high of \$7.62/bu along the way – a 37% jump from the previous record established in July 1996.

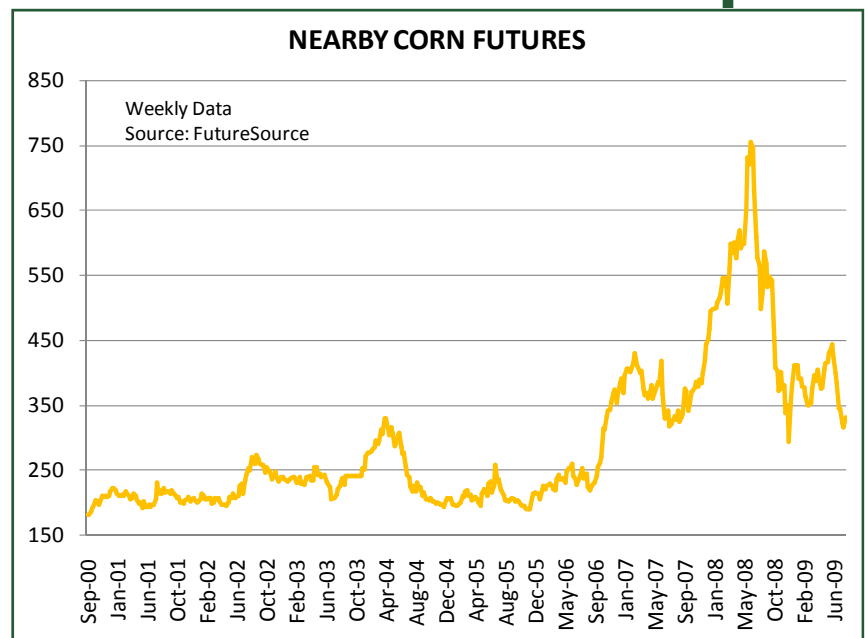
Last October (Research Report October 1, 2008) we discussed the possibility that food commodity prices were making a step change higher for the long run. We used the CRB Foodstuffs Index as a measuring stick. That index includes hogs, steers, lard, butter, soybean oil, cocoa, corn, Kansas City wheat, Minneapolis wheat and sugar. Looking back at history, food prices as measured by the CRB Index stayed within a

well defined range from the 1940s to the 1970s; once prices moved out to the upside, they never fell back into the old area. Indeed, a new range with clear boundaries was carved out and prevailed until 2007. The 1947-1972 highs became the 1973-2007 lows. **So, the basic question boiled down to: will the 1973-2006 highs become the lows going forward?**

For starters, there are some interesting parallels between the early 70s and today. The original spike in prices to new highs in both 1973 and 2007 took place in an environment with:

- ◆ Strong economic growth around the world, with global GDP in the +5% area
- ◆ Unpopular Republican presidents engaged in a controversial war financed by increased deficits and foreign borrowing (for what it is worth, political economist Jeffrey Sachs points out that Dick Cheney was on the scene in both cases, too)
- ◆ Expansionist monetary policy devaluing the US Dollar
- ◆ Turmoil in the Middle East inflaming energy markets
- ◆ Weather issues in key agricultural production regions around the world

Corn futures have found support in the \$3.00-\$3.50 area that was once on the high side of the historical range.



- ◆ A sense that global supply resources for food and energy were constrained
- ◆ A subsequent collapse in commodity prices from the highs, deep recession in the US and slower growth globally.

The last time around, while food commodity prices moved off their highs they never collectively got back to pre-1973 levels. The first part makes sense – demand was unsustainable at the highs. The second part is curious – something we will study in the months ahead. Intuitively, though, it seems possible that sustained strength in the energy sector put a floor under everything else. Energy costs are like a finger on every scale – affecting cost of food production (fertilizer, diesel for tractors, etc) and transportation.

This time around we have seen the CRB Foodstuffs Index fall from its highs, find support and bounce off a level that is in fact approximate to the 1973-2006 highs. The CRB Foodstuffs cash index dropped to 280 in February; the 1973-2007 high reading was 292 in April 2004. The Index jumped right back to 296 in March 2009, so the journey into the previously prevailing range was neither deep nor extended.

It is also interesting to note that the top end of the “new range” was pretty

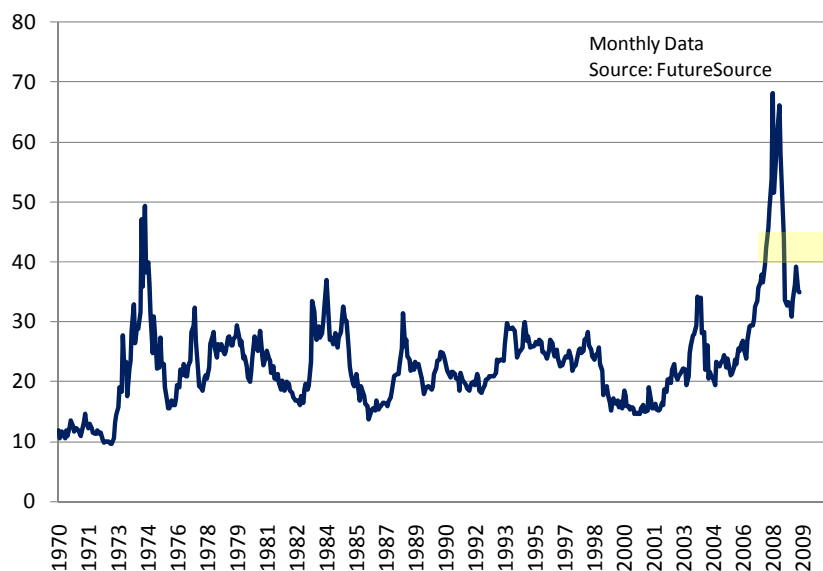
well established on the first wave up in the early 1970s. In November 1974 the CRB Foodstuffs Index reached 282; from that point through 2006 that number was topped only 10 times. Wouldn't it be something if the highs in food commodities achieved in 2008 (CRB Foodstuffs Index at 442 in June) stand as the highs for two decades?

It is way too early to make definitive conclusions about whether history is repeating itself. There are some important questions to consider that might argue for things being different today. For example, if mandated use of bio-fuels is underpinning energy today will we see things fall apart if and when mandates are either met or repealed? Put differently, is presumed underpinning of energy via bio-fuels as strong as the early 70s girding provided by upheaval in the Middle East and the associated evolution of petro-politics? And can industries competing with energy for foodstuffs possibly pay the price? Here's another one: is the resilience of the commodity complex in recent months (and the bounce of the CRB Foodstuffs lows) largely a function of investment flows – people piling into commodities ahead of a presumed recovery? If so, does money move out of commodities once recovery materializes, putting the old lows in renewed jeopardy? Asked differently: has the massive influx of speculative/investment capital into the commodity space distorted the picture in some way?

For a moment, though, assume the range shift is true, is for real. What would that mean for, say, soybean oil? Roughly speaking, the 30 cent mark that served as a top for decades until 2007 – with only a few exceptions -- becomes the floor. And, oddly enough, that has been basically true so far, with the market finding its February/March bottom in the mid-to-high 29s. The new ceiling on the range would be 70 cents. We doubt the “average” will fall in the midpoint of the range – at 50 cents – but it might resemble something close to

It is too early to know if things have really shifted. In case they have, it may be useful to scope out possible long-term averages going forward.

NEARBY SOYBEAN OIL FUTURES



the average from January 2007 to the present: between 41 and 42 cents. Turning back to the CRB Foodstuffs Index, the average from 1974-2006 was equal to 136% of the low reading. Applying that math to soybean oil yields 41 cents.

Going a step further, if a new range is in effect, manufacturers, marketers and end-users should note that there is still a lot of real estate between high and low. **Volatility is not likely to go away.** That makes sense considering the periodic distortions made possible by bio-fuel policy and investment manias. It also could be a function of increased global linkages and homogenization of diets placing more emphasis on a fewer number of base materials. If there really is a movement toward more Western diets the stakes become higher (crop failure, disease, etc) for some foodstuffs.

Global dairy markets would seem to be at least indirectly affected if the step-change theory turns out to be accurate. If corn is not regularly going to be below \$3/bu or soybeans won't spend much time below \$7/bu there are certainly implications for milk production costs. It lends credence to notions that the "Western model" of dairying will not be as competitive as it was five or ten years ago. It would also suggest

that average prices will have to move higher if it is true that long-run prices reflect cost of production plus some return.

Obviously, though, any movement to a new price range for foodstuffs in general has not prevented a specific collapse of dairy prices to lows seen during the "previous era" (if there is such a thing). **The old highs have most certainly not become the new lows.** This could be a "dairy is different" thing – products are perishable; markets tend to be discrete, more local than global; regulation tends to run high. **It could actually be in some small way a function of poorly developed central markets and the associated absence of much speculator/investor participation.** Yet we would be surprised to not see dairy lumped in with and riding the coattails of some sort of global growth story over the next 18-to-24 months.

Pondering longer-term trends is admittedly speculative and may not be immediately actionable. Moreover, as noted on the front end of this discussion, there is not enough data on hand to make definitive judgments. We cannot shake a sense, however, that as overplayed and overhyped as the global growth story may have been a year ago it may today be receiving less than the attention it deserves.

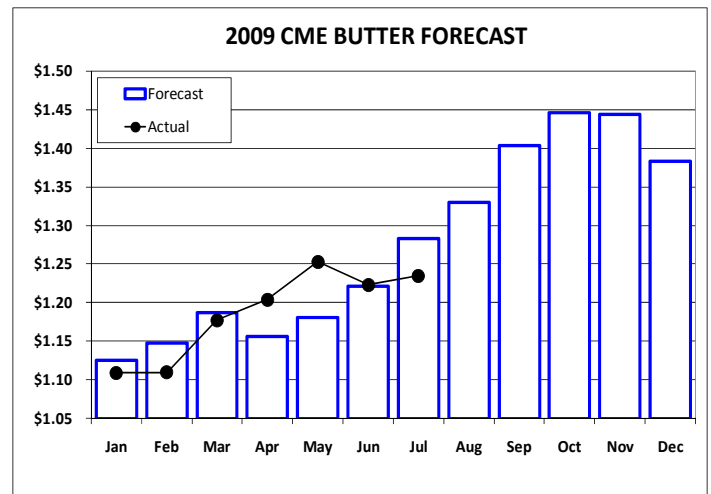
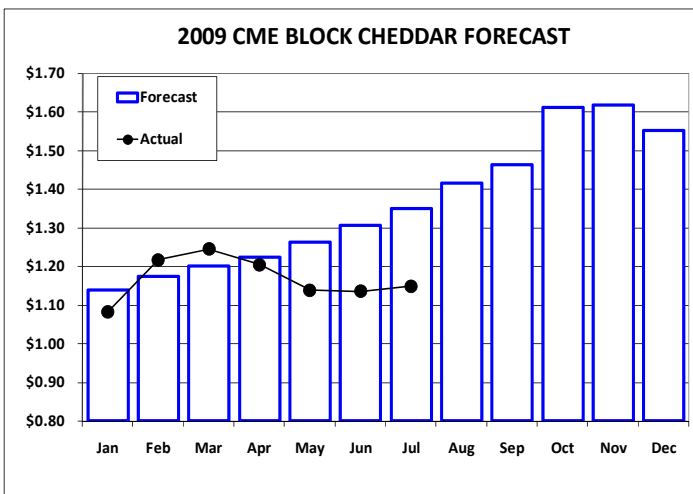
Any movement to a new price range for foodstuffs in general has not prevented a specific collapse of dairy prices.

2008 "FINAL" PRICE FORECASTS

"FINAL" 2009 PRICE FORECAST (as of December 31, 2008)

BLOCK CHEDDAR			GRADE AA BUTTER			NDM (NASS)			WHEY (NASS)		
Month	Forecast	Actual	Month	Forecast	Actual	Month	Forecast	Actual	Month	Forecast	Actual
Jan	\$1.14	\$1.08	Jan	\$1.13	\$1.11	Jan	\$0.83	\$0.83	Jan	\$0.17	\$0.17
Feb	\$1.18	\$1.22	Feb	\$1.15	\$1.11	Feb	\$0.83	\$0.82	Feb	\$0.17	\$0.16
Mar	\$1.20	\$1.25	Mar	\$1.19	\$1.18	Mar	\$0.83	\$0.82	Mar	\$0.18	\$0.17
Apr	\$1.22	\$1.20	Apr	\$1.16	\$1.20	Apr	\$0.84	\$0.82	Apr	\$0.19	\$0.19
May	\$1.26	\$1.14	May	\$1.18	\$1.25	May	\$0.84	\$0.83	May	\$0.19	\$0.23
Jun	\$1.31	\$1.14	Jun	\$1.22	\$1.22	Jun	\$0.85	\$0.85	Jun	\$0.20	\$0.27
Jul	\$1.35	\$1.15	Jul	\$1.28	\$1.23	Jul	\$0.86	\$0.84	Jul	\$0.21	\$0.29
Aug	\$1.42		Aug	\$1.33		Aug	\$0.87		Aug	\$0.24	
Sep	\$1.46		Sep	\$1.40		Sep	\$0.89		Sep	\$0.25	
Oct	\$1.61		Oct	\$1.45		Oct	\$0.92		Oct	\$0.26	
Nov	\$1.62		Nov	\$1.44		Nov	\$0.94		Nov	\$0.27	
Dec	\$1.55		Dec	\$1.38		Dec	\$0.97		Dec	\$0.28	
Avg	\$ 1.36	\$ 1.17	Avg	\$ 1.28	\$ 1.19	Avg	\$ 0.87	\$ 0.83	Avg	\$ 0.22	\$ 0.21

CLASS I MOVER			CLASS II MILK			CLASS III MILK			CLASS IV MILK		
Month	Forecast	Actual	Month	Forecast	Actual	Month	Forecast	Actual	Month	Forecast	Actual
Jan	\$15.74	\$15.74	Jan	\$10.46	\$10.41	Jan	\$10.56	\$10.78	Jan	\$9.64	\$9.59
Feb	\$10.32	\$10.72	Feb	\$10.44	\$10.25	Feb	\$9.43	\$9.30	Feb	\$9.70	\$9.45
Mar	\$9.62	\$9.42	Mar	\$10.66	\$10.35	Mar	\$9.80	\$10.44	Mar	\$10.00	\$9.64
Apr	\$9.87	\$10.36	Apr	\$10.54	\$10.49	Apr	\$10.08	\$10.78	Apr	\$9.86	\$9.82
May	\$10.03	\$10.97	May	\$10.52	\$10.71	May	\$10.43	\$9.84	May	\$9.89	\$10.14
Jun	\$10.38	\$10.08	Jun	\$10.83	\$10.79	Jun	\$10.93	\$9.97	Jun	\$10.19	\$10.22
Jul	\$10.82	\$10.26	Jul	\$11.03	\$10.85	Jul	\$11.35	\$9.93	Jul	\$10.42	\$10.10
Aug	\$11.24	\$10.04	Aug	\$11.31		Aug	\$12.14		Aug	\$10.77	
Sep	\$12.05		Sep	\$11.78		Sep	\$12.72		Sep	\$11.26	
Oct	\$12.60		Oct	\$12.13		Oct	\$13.77		Oct	\$11.72	
Nov	\$13.76		Nov	\$12.47		Nov	\$14.74		Nov	\$11.96	
Dec	\$14.76		Dec	\$12.45		Dec	\$14.49		Dec	\$12.01	
Avg	\$ 11.77	\$ 10.95	Avg	\$ 11.22	\$ 10.55	Avg	\$ 11.70	\$ 10.15	Avg	\$ 10.62	\$ 9.85

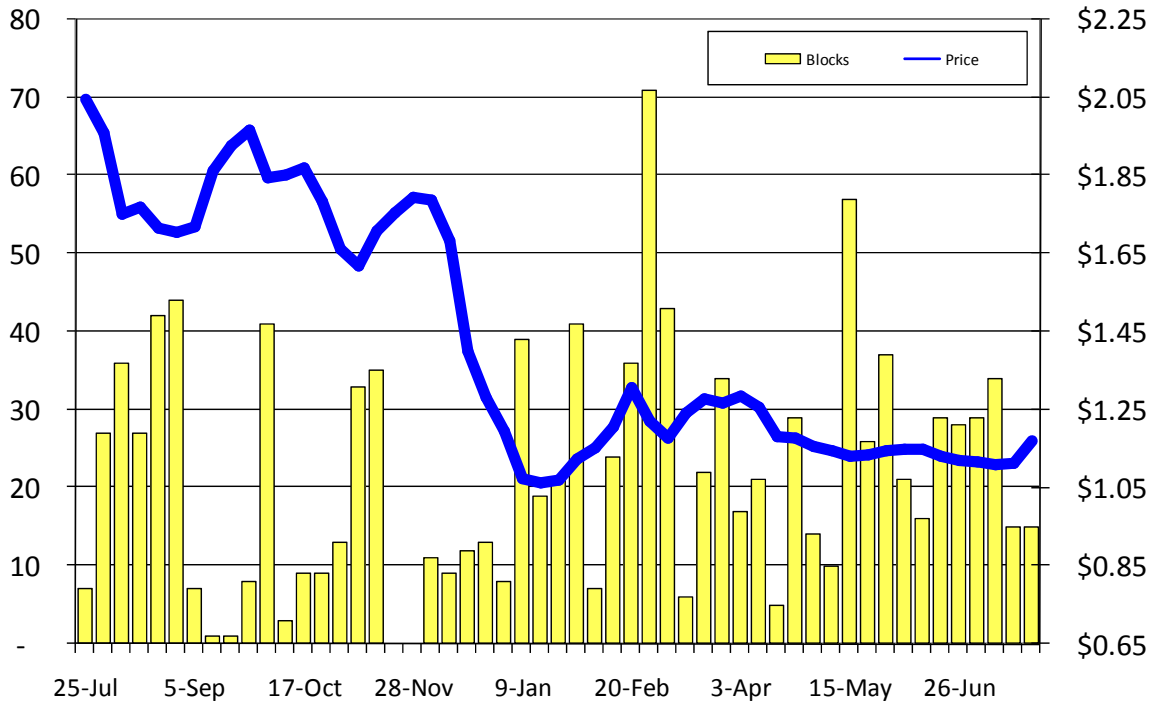


STATISTICALLY SPEAKING

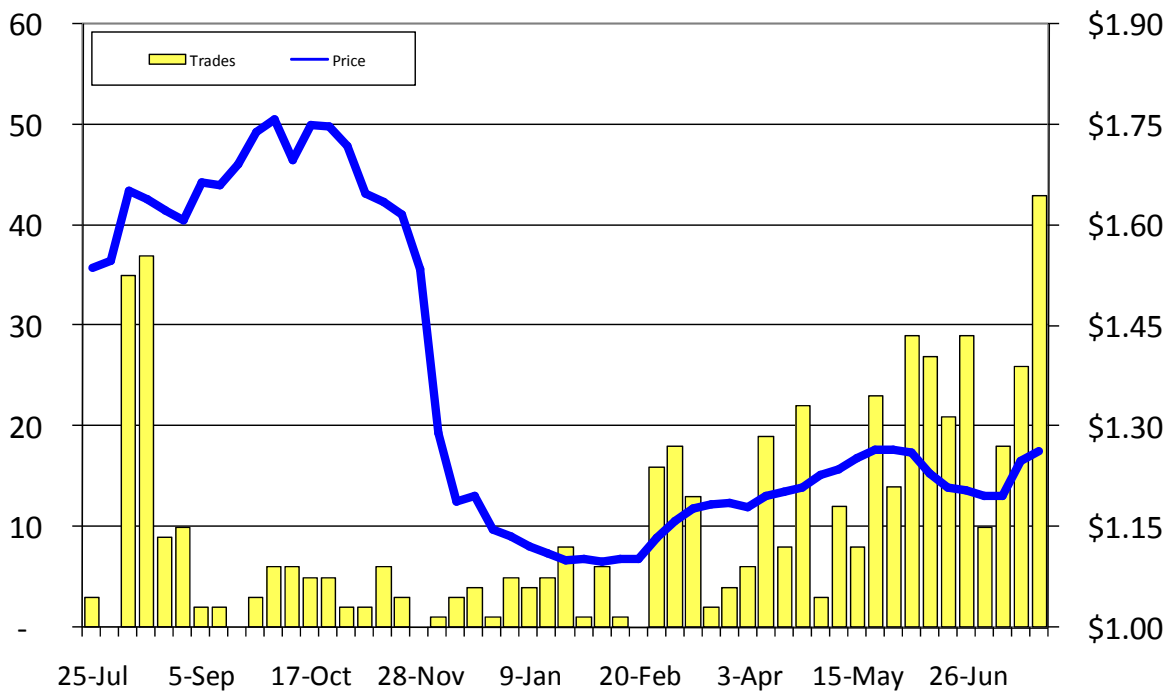
CME CASH MARKETS										
	Block Cheddar				Barrel Cheddar		Grade AA Butter			
	Settle	Volume	U/F Bids	U/C Offers	bbl settle	bbl vol	Settle	Volume	U/F Bids	U/C Offers
18-May-09	\$ 1.1325	0	1	0	\$ 1.0800	0	\$ 1.2650	0	1	1
19-May-09	\$ 1.1325	2	1	0	\$ 1.0800	0	\$ 1.2650	0	2	1
20-May-09	\$ 1.1325	13	1	0	\$ 1.0800	8	\$ 1.2650	0	2	1
21-May-09	\$ 1.1325	1	1	0	\$ 1.0800	1	\$ 1.2650	19	1	1
22-May-09	\$ 1.1400	10	0	0	\$ 1.0800	7	\$ 1.2650	4	1	1
25-May-09										
26-May-09	\$ 1.1400	4	1	0	\$ 1.0850	7	\$ 1.2650	6	1	0
27-May-09	\$ 1.1425	11	1	0	\$ 1.0875	6	\$ 1.2650	0	1	2
28-May-09	\$ 1.1500	21	2	0	\$ 1.1000	10	\$ 1.2650	0	2	0
29-May-09	\$ 1.1525	1	1	0	\$ 1.1000	0	\$ 1.2650	8	1	1
1-Jun-09	\$ 1.1525	6	2	0	\$ 1.1025	4	\$ 1.2650	6	1	2
2-Jun-09	\$ 1.1525	0	1	0	\$ 1.1025	0	\$ 1.2650	4	1	1
3-Jun-09	\$ 1.1475	13	1	0	\$ 1.1000	1	\$ 1.2650	6	1	2
4-Jun-09	\$ 1.1475	0	0	0	\$ 1.1000	0	\$ 1.2600	0	1	2
5-Jun-09	\$ 1.1475	2	1	0	\$ 1.1000	0	\$ 1.2525	13	2	1
8-Jun-09	\$ 1.1475	0	1	0	\$ 1.1000	0	\$ 1.2300	9	1	1
9-Jun-09	\$ 1.1500	6	0	1	\$ 1.0975	2	\$ 1.2300	5	1	0
10-Jun-09	\$ 1.1500	2	0	0	\$ 1.0975	1	\$ 1.2325	2	1	1
11-Jun-09	\$ 1.1500	5	0	0	\$ 1.0975	4	\$ 1.2275	9	2	0
12-Jun-09	\$ 1.1500	3	1	0	\$ 1.0925	2	\$ 1.2275	2	0	1
15-Jun-09	\$ 1.1500	0	0	1	\$ 1.0925	0	\$ 1.2200	3	0	0
16-Jun-09	\$ 1.1350	4	1	1	\$ 1.0775	3	\$ 1.2050	3	1	0
17-Jun-09	\$ 1.1300	5	0	1	\$ 1.0700	4	\$ 1.2050	2	1	1
18-Jun-09	\$ 1.1275	6	1	1	\$ 1.0700	1	\$ 1.2050	0	2	1
19-Jun-09	\$ 1.1175	14	1	0	\$ 1.0700	4	\$ 1.2050	13	0	1
22-Jun-09	\$ 1.1175	4	1	1	\$ 1.0700	2	\$ 1.2050	0	1	0
23-Jun-09	\$ 1.1175	0	0	0	\$ 1.0700	0	\$ 1.2050	6	1	0
24-Jun-09	\$ 1.1175	15	1	0	\$ 1.0700	4	\$ 1.2050	6	2	0
25-Jun-09	\$ 1.1200	3	2	0	\$ 1.0800	0	\$ 1.2050	3	0	1
26-Jun-09	\$ 1.1200	6	1	0	\$ 1.0900	3	\$ 1.2050	14	0	0
29-Jun-09	\$ 1.1150	3	0	0	\$ 1.0950	3	\$ 1.2050	0	1	1
30-Jun-09	\$ 1.1150	11	1	0	\$ 1.1000	3	\$ 1.1925	6	1	0
1-Jul-09	\$ 1.1150	8	0	1	\$ 1.1000	3	\$ 1.1925	0	1	1
2-Jul-09	\$ 1.1150	7	1	0	\$ 1.1000	2	\$ 1.1925	4	1	0
3-Jul-09										
6-Jul-09	\$ 1.1150	2	0	0	\$ 1.1000	4	\$ 1.1850	4	1	0
7-Jul-09	\$ 1.1150	12	1	0	\$ 1.1000	4	\$ 1.1850	0	1	1
8-Jul-09	\$ 1.1150	0	1	0	\$ 1.1000	0	\$ 1.1850	2	1	1
9-Jul-09	\$ 1.1100	10	0	1	\$ 1.0900	3	\$ 1.2000	5	0	0
10-Jul-09	\$ 1.0900	10	0	1	\$ 1.0900	3	\$ 1.2225	7	0	0
13-Jul-09	\$ 1.0900	0	0	0	\$ 1.0900	0	\$ 1.2250	4	0	0
14-Jul-09	\$ 1.0875	3	1	0	\$ 1.0800	1	\$ 1.2400	6	1	1
15-Jul-09	\$ 1.0950	9	1	1	\$ 1.0750	2	\$ 1.2600	7	1	1
16-Jul-09	\$ 1.1425	2	1	0	\$ 1.1425	0	\$ 1.2700	5	1	1
17-Jul-09	\$ 1.1450	1	1	1	\$ 1.1400	0	\$ 1.2500	4	0	1
20-Jul-09	\$ 1.1600	3	1	0	\$ 1.1500	1	\$ 1.2600	7	1	0
21-Jul-09	\$ 1.1600	2	0	1	\$ 1.1500	0	\$ 1.2650	8	2	0
22-Jul-09	\$ 1.1600	3	1	0	\$ 1.1500	0	\$ 1.2700	11	1	1
23-Jul-09	\$ 1.1700	3	1	0	\$ 1.1500	5	\$ 1.2600	7	1	1
24-Jul-09	\$ 1.2000	4	2	0	\$ 1.1700	2	\$ 1.2600	10	2	0

STATISTICALLY SPEAKING

CME Block Cheddar Weekly Volume & Price

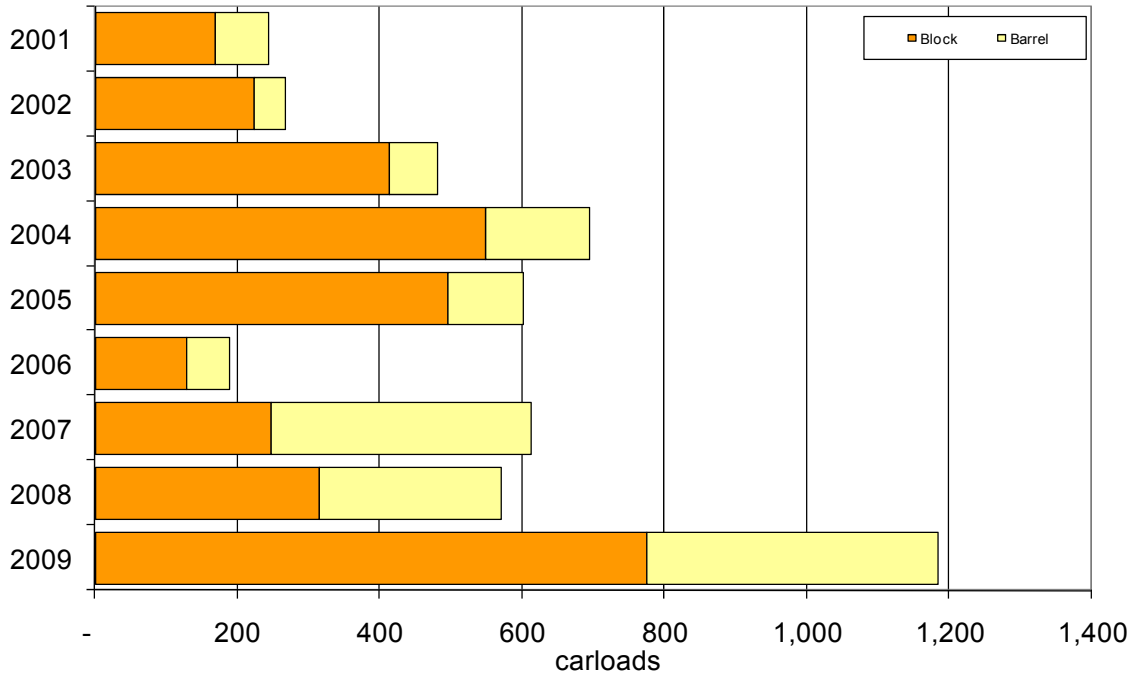


CME Butter: Weekly Volume and Price

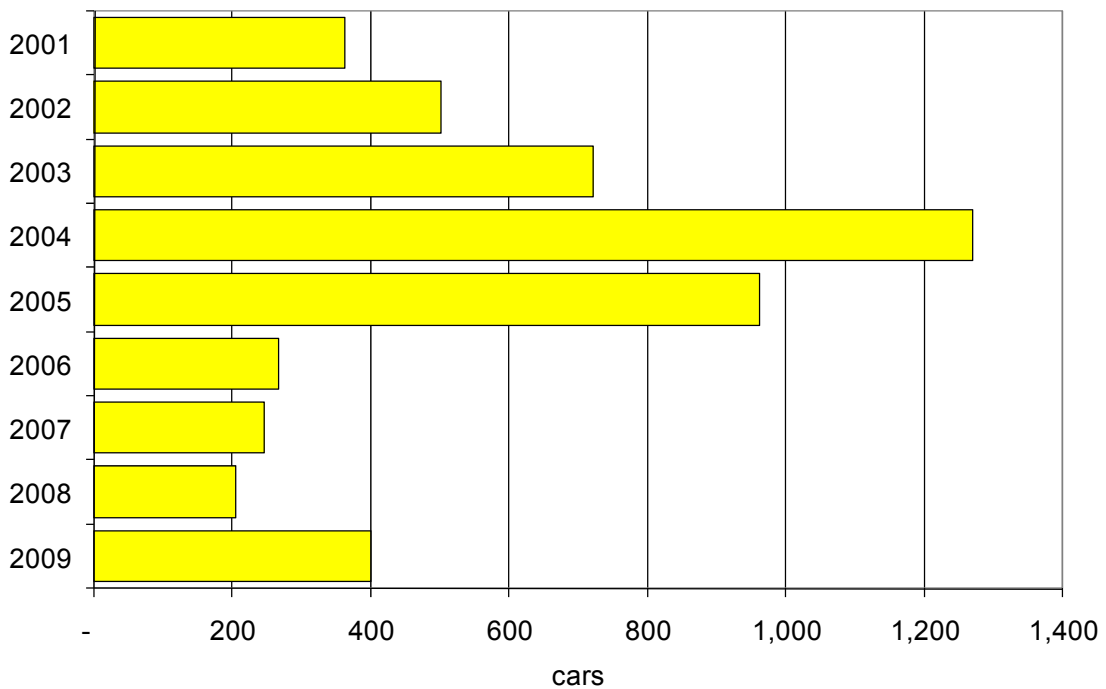


STATISTICALLY SPEAKING

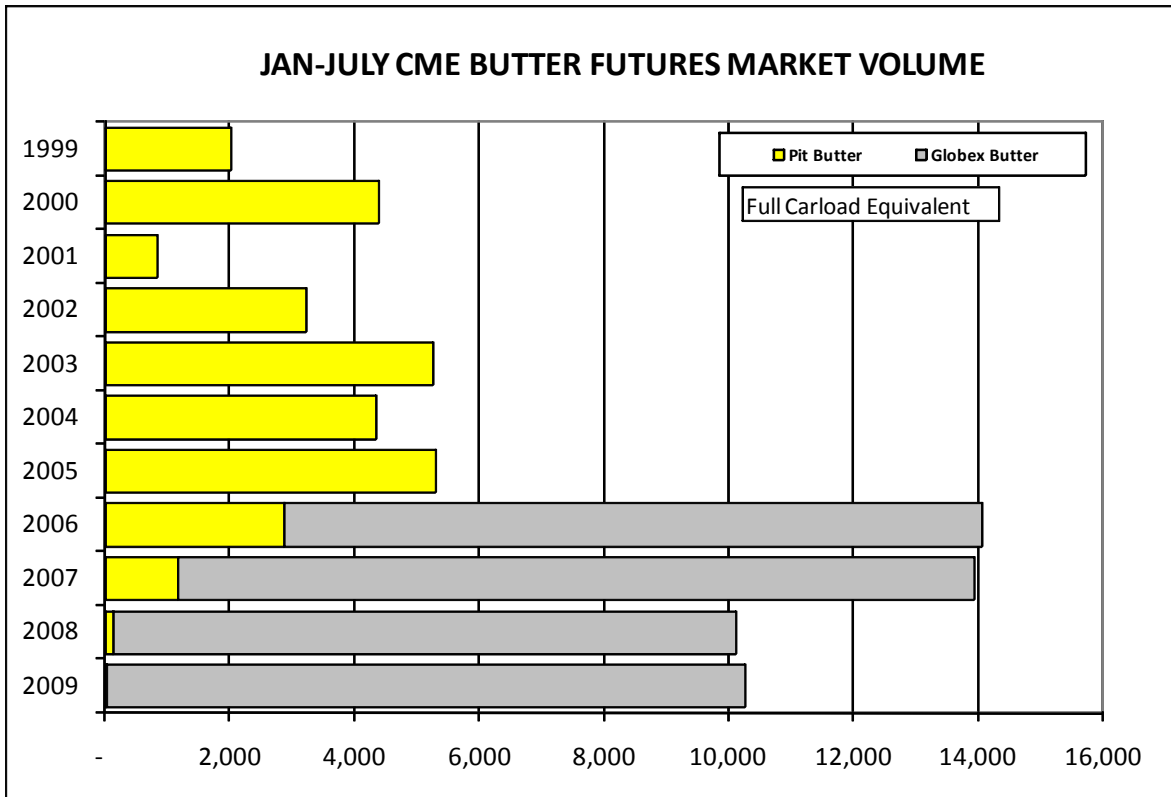
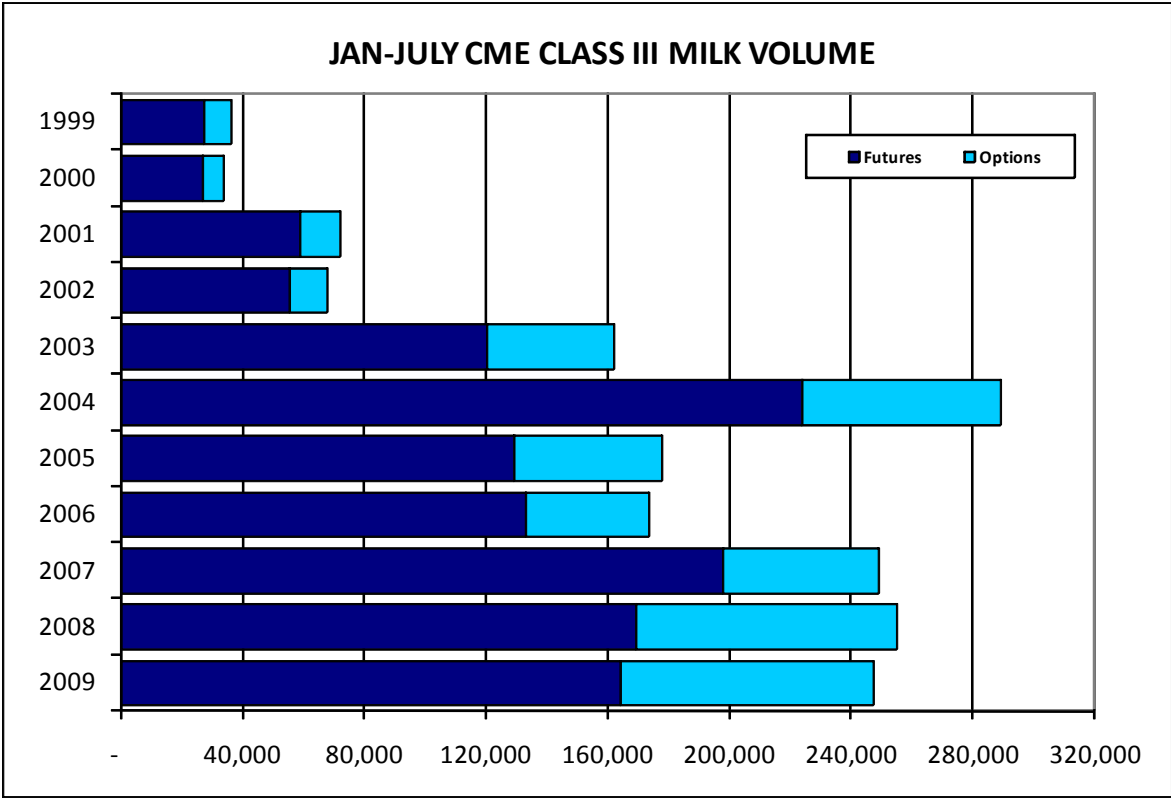
CME Cash Cheddar Volume (30 Weeks)



CME Cash Butter Volume (30 Weeks)



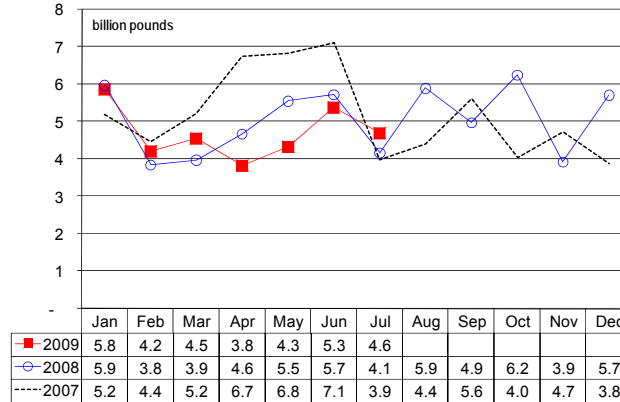
STATISTICALLY SPEAKING



STATISTICALLY SPEAKING

CME FUTURES/OPTIONS VOLUME AND OPEN INTEREST										
Month-->	CLASS III		CLASS III OPTIONS		CASH BUTTER		DRY WHEY		NONFAT DRY MILK	
	Volume	Open Interest	Volume	Open Interest	Volume	Open Interest	Volume	Open Interest	Volume	Open Interest
22-Jun-09	1,130	28,929	1,258	47,454	8	4,844	23	1,538	5	790
23-Jun-09	1,004	29,167	1,494	48,243	44	4,848	36	1,567	-	790
24-Jun-09	907	29,384	835	48,781	31	4,849	19	1,582	-	790
25-Jun-09	1,818	29,956	395	48,894	7	4,855	15	1,595	-	790
26-Jun-09	1,315	30,303	513	49,060	9	4,861	59	1,632	-	790
29-Jun-09	582	30,357	768	49,285	125	4,835	8	1,639	-	790
30-Jun-09	1,089	30,494	551	49,138	28	4,833	31	1,669	-	790
1-Jul-09	1,469	30,465	420	43,062	163	4,876	6	1,669	7	791
2-Jul-09	851	30,636	277	43,233	162	4,889	16	1,667	-	791
3-Jul-09	-	-	-	-	-	-	-	-	-	-
6-Jul-09	1,114	26,169	726	43,340	201	4,482	5	1,437	-	688
7-Jul-09	839	26,350	395	43,498	95	4,489	5	1,438	-	688
8-Jul-09	661	26,486	223	43,500	132	4,566	20	1,458	-	688
9-Jul-09	601	26,516	496	43,465	54	4,592	11	1,468	1	689
10-Jul-09	612	26,625	469	43,774	54	4,624	14	1,478	-	689
13-Jul-09	426	26,696	252	43,847	39	4,630	-	1,478	1	690
14-Jul-09	964	26,710	323	43,785	45	4,630	1	1,479	-	690
15-Jul-09	1,672	27,022	1,125	44,351	29	4,646	-	1,479	10	695
16-Jul-09	2,168	27,826	985	45,020	34	4,670	4	1,483	-	695
17-Jul-09	1,481	27,989	385	45,132	42	4,678	8	1,491	15	709
20-Jul-09	2,699	28,642	750	45,548	30	4,702	68	1,513	14	709
21-Jul-09	1,988	28,671	1,862	46,021	23	4,722	32	1,536	2	709
22-Jul-09	1,373	28,626	858	46,159	12	4,722	7	1,541	-	709
23-Jul-09	1,143	28,647	920	46,520	150	4,735	4	1,545	-	709
24-Jul-09	1,122	29,164	258	46,711	52	4,744	10	1,547	1	708

Class III Futures Volume (Milk Equivalent)



Butter Futures Volume

