September 30, 2009

MCTCOMPASS

A complimentary service of MCT Dairies, Inc.• www.mctdairies.com

The Latest to Digest

USDA's latest Milk Production, Cold Storage, and Livestock Slaughter reports provide ample fodder for market participants to digest.

The **Milk Production** report provides the basis for those who believe "the worm has turned" and that a period of less milk and tighter dairy product markets lies ahead. In the Sept. 18 report following several months of consistent upward revisions in estimated milk production, NASS revised July 2009 production downward by 13 million pounds, or 0.1% from the previous month's preliminary estimate. Furthermore, USDA's preliminary estimate of August 2009 milk production was 0.3% less than last year. Barring any significant upward revision, this would mark the first back-to-back monthly declines in U.S. milk production vs. the prior year since May 2004.

The **Livestock Slaughter** report illustrates the impact of the multiple herd reductions implemented by the Cooperatives Working Together (CWT) program. From January through August 2009, 1.9 million cows have been sent to slaughter. This year's slaughter is on pace to surpass 2003's slaughter of 2.9 million head.

A closer look at the slaughter report over the past decade reveals that during the first half of the decade a greater percentage of the U.S. dairy cow slaughter came from region 5, which consists of mostly Upper Midwest and mid-Eastern states. By 2005, regions 9 and 10, which include key Western states, surpassed region 5 as a percent of the U.S. dairy cull. Even during the high milk prices of 2007 and 2008, the Western states' cull rate exceeded region 5's (see chart, page 2). This could indicate that while 2007 and 2008 were years of high milk prices, the higher feed and energy costs in the West reduced margins vs. those in the Midwest and mid-Eastern regions.

In 2009, the West's dairy cull likely will approach 40% of the U.S. total. In other words, it appears that more happy cows are becoming happy meals. As more cows are culled in the West, a decline in milk production and dairy product output—most notably butter and powder—will result.

Continued on page 2

KEN'S CORNER

by Ken Meyers
President
MCT Dairies Inc.

As our industry continues to sort through the limited and eternally questionable data we receive, one must also contend with the uncertainty of government intervention. Producers, marketers, and ingredient buyers alike are all awaiting the outcome of the pending Sanders' provision, which could provide another $350 million for dairy. There is tremendous speculation how and when the money will be spent. Some even wonder if it will be spent.

Whether it is used to extend the current temporary higher support prices, raise the support prices further, expand the use of dairy products in current feeding programs, or used to outright buy products for domestic feeding programs, the uncertainty continues unabated. Uncertainty is the medium for volatility.

Right now, the industry, like the economy, is on unsteady ground. It is said that consumerism is what will pull us out of our recession. Congress and industry leaders must be mindful of our customers' needs and concerns as well as the needs of producers. I don't envy their position. MCT

MCTCOMPASS

Peak or pre-peak?

More often than not during the past decade, the cheese market has peaked in September, only to flounder by December. Could 2009 be one of those years? Or does the outlook for continued lack of growth in the milk supply bode well for continued incremental increases in dairy product prices. If the current stock positions are more a function of physical hedges than excess supply, prices can be expected to continue to modestly increase. MCT

MCT Forecast

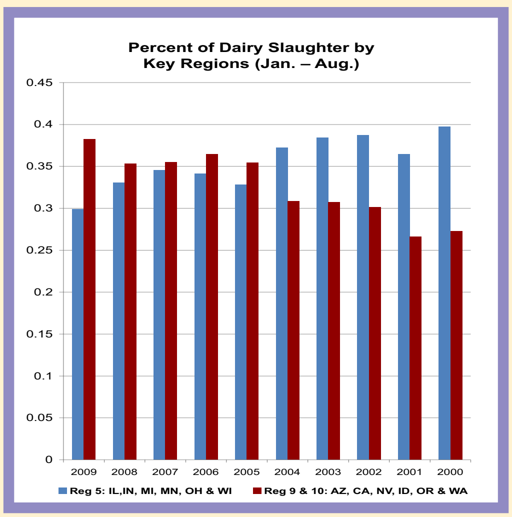
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Sep	1.3300	1.3000	1.2200	0.2990	0.970	12.10	11.20
Oct	1.4250	1.4000	1.2900	0.3125	1.000	12.70	11.85
Nov	1.4600	1.4350	1.3350	0.3100	1.010	13.20	12.10
Dec	1.5200	1.4950	1.3450	0.3000	1.000	13.70	12.00
Jan	1.5400	1.5150	1.3600	0.2950	0.975	14.05	11.90
Feb	1.5500	1.5250	1.3750	0.2900	0.945	14.20	11.70

** Block, barrel and butter are monthly averages of CME prices.*
***Whey and NFDM are monthly averages of NASS prices.*

Reasons for building...

Continued from page 1

Against the backdrop of these reports, which show a decline (albeit slowly) in milk production, is the **Cold Storage** report. American cheese stocks as of Aug. 31, 2009, totaled 621.5 million pounds of commercial stocks, a historically high level. The last time stocks were near this level was in August 2000 and the CME block market averaged $1.2460/lb. In August 2000, American cheese stocks totaled 609.3 million pounds and represented 27.7% of the total January through July 2000 American cheese production. In August 2009, American cheese stocks represented 25.3% of January through July 2009 American cheese production. So while today's stock level appears large as a percent of total American cheese production, it is not outside the normal range.



The market implications from a stocks report can be difficult to gauge. For example, there could be several explanations for rising stocks. Stocks can increase because there is simply too much cheese that is not clearing the marketplace. Stocks might also rise in anticipation of less cheese production in upcoming months. And stocks can rise as people take advantage of buying opportunities for aging programs. The latter two likely contributed to the current inventory level.

Exceptionally low milk prices, especially after the extraordinary price levels of 2007 and 2009, have resulted in a contraction in the growth of milk production. As a result, inventory building is likely to have occurred ahead of the anticipated decline.

Furthermore, the inventory value on the balance sheet might not have changed much, but total volume could be up significantly. In other words, the financial outlay for cheese as a physical hedge is significantly less at a $1.30/lb. than $1.90. The CME block price averaged less than $1.20/lb. through August 2009, providing aging programs the lowest prices in 2.5 years.

All said, it appears change could be coming. The rate of U.S. milk production growth has definitely slowed. Western producers are culling cows and cutting back at a faster rate than their counterparts and that likely will translate into lower butter and nonfat dry milk production. Furthermore, the government is working off its inventories rather quickly. Together, this adds up to only one thing—greater price volatility. MCT

 MCT Dairies, Inc., 15 Bleeker St., Millburn, NJ 07041 (973) 258-9600 fax: (973) 258-9222 www.mctdairies.com. For more information, email **info@mctdairies.com.**