

NFI - Milk Market Letter

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Sun, Feb 7, 2010 at 12:55 PM

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MILK AND FEED USE MARKET LETTER

MEAL PURCHASE FILLS – If you are following our recommendations, you were filled on another 25% of your 2010 meal needs at \$2.95 Dec futures. I know most of you buy cash meal but you should now have bought 25% at \$275 and 25% at \$2.95 and 25% at \$280. We will look to secure the other 25% at lower prices at a later time.

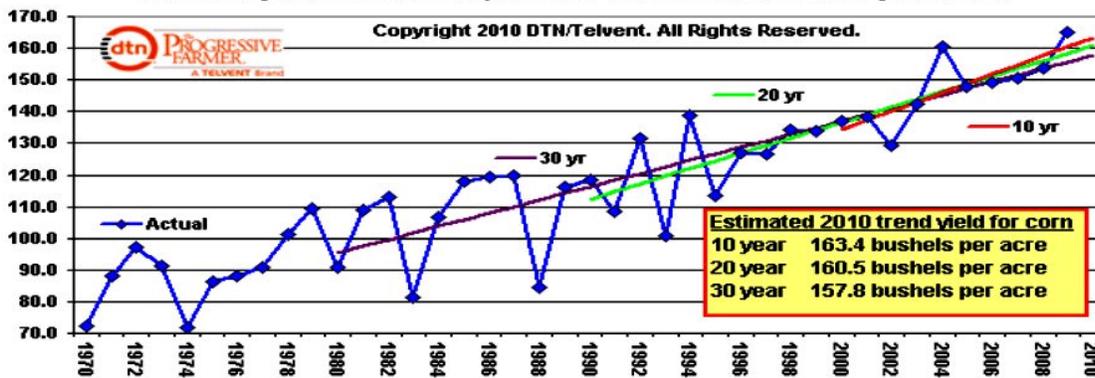
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CORN

For the week, corn lost 5 cents and while filling the gap that had been present on the weekly continuation chart since Nov 2009. Corn made new lows for the move off the top on Friday by trading below \$3.49 but end of the day buying brought the market back above \$3.50. As the corn market was closing last Friday, the Dow Jones was trading down some 170 points but rallied back to close 12 points higher. This should lend some support in the Sunday night market. Funds have now reduced their long positions from 160,000 4 weeks ago to just 34,000 as of Friday. We should expect that they will attempt to reduce their longs in an attempt to turn their position to a short in the weeks ahead. The reason being is that we are trading corn below all 6 major MA's and funds are tend following entities.

The USDA will release their February supply/demand report on the 9th at 7:30 AM. It is logical that they will reduce exports by 50-100 million over time and maybe 50 million in Tuesday's report. There are other areas that the USDA could touch but they will probably leave the rest unchanged. That would mean a slight increase in carryout that could bring us to 1.800 billion bushels. Nothing overly negative. They could increase ethanol and feed use as the reduction in the cattle herd is nothing close to what was thought 3 months ago. We have about the same number of cattle on feed and placed as we did a year ago. We have an increase in hog and poultry numbers so we could see that feed number increase.

U.S. corn yields in bushels per acre; actual, 10, 20, and 30 year trend



There is still a lot of debate within the trade as to how the U.S. could have produced both a record 2009 corn crop and record yields given very late plantings and harvesting. The fact is that this is what the market will have to trade until updated data is released with the March supply-demand report. Though corn prices have plunged over the past month in response to this and other bearish inputs, talk is that at least another three million acres of additional land will be needed for corn plantings this spring to accommodate higher forecasted demand. Note that the need for additional corn acreage may be tempered if trend yields in corn are higher than commonly thought. The above graphic charts actual corn yields over the past 40 years and then adds in the 10, 20, and 30 year trends. Corn yields appear to have improved in recent years as the ten year line pegs 2010 trend yields in corn at 163.4 bushels per acre while the 20 year line has trend at 160.5 and the 30 year trend comes in at 157.8. There has been a lot of talk about why corn yields have turned higher in recent years with some noting the generally cool Midwest summers, the new triple stack varieties, increased plant populations, better tiling of ground, and the new GPS technology that helps maximize seed dispersal and input applications. - Joel Karlin, Western Milling

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From a technical perspective, NFI's timing bottom of \$3.31 by the middle to the end of March still looks to be right on. This would allow the funds to get net short and fulfill the bear's beliefs of a lower market. It would send both weekly stochs below 9% and bring the monthly stochs below 35%. It would more than likely give us bullish divergence on all the studies except the monthly. If NFI is correct in price and timing, from Friday's low of \$3.48 we would have 17 cents to the down side. We would not press the market with new short positions or cash sales.

Let's assume that the US farmer will plant 4 million more acres this year to corn and put a large yield on it of 163 bpa. Demand looks solid with the reduction to exports used above so demand in 2010 should be around 13.10 billion bushels. Harvested production would be around 13.646 billion or an increase of 5.5 billion bushels to current carryout or about 2.300 billion. This would lead to a Dec corn futures price of \$2.50-\$2.70. Our study shows that the year's following a record yield like the one the USDA wants to give us from last year, we should expect yield drop on average of 4-7 bushels per acre or a yield of around 159 with good weather and a production number of 13.197 with a carryout and market that goes nowhere from what we saw in 2009. This overview is in sharp contrast to all the major analytical firms' projections for 2010 as they have yields over 161 and carryout over 2.150 bbu. We have a long time to debate yields going forward.

MEAL

Last week's announcement from the EPA that we sent out to everyone points out the fact that we will have to crush a lot more beans to accommodate the new "advanced bio fuel" program the EPA outlined for the years to come. You don't have to over analyze the report to know that more crush is only going to increase the amount of meal stocks we will be facing in the future. Stocks should increase by some 8-9% so simple math would tell us that meal prices could drop a like amount or a drop in price of \$22-\$30. The feed industry has to be elated about the announcement as do most of the analytical companies putting out their corn price outlooks for 2010. It all makes the livestock industries look a lot more profitable for 2010 but we also know that these types of price outlooks make for larger inventories from the price drop from those that use it and that's livestock users.

From our weekly analysis of the meal continuation chart below we see that meal is trading on the bottom weekly BB. This usually leads to a strong rally in prices and could last for several weeks. The weekly stochs of 9% and 15% are within 10 points of each other and we are nearing the point where both stochs are below 10%. Even though we've outlined a negative fundamental view above, technicals play a much more important part of price movement than does fundamental analysis most of the time. A move in stocks this week below \$265 should result in a strong rally back to the \$285-\$2.92 levels. There is now base built on the market so this is just a trade from a severely oversold market.





For now we view rallies as being very hard to hold and build on with the new outlook from the EPA and a move as low as \$236-\$258 could be seen in meal by April. If we do see such a move a much more aggressive stance should be taken by endusers and purchases to finish out 2010 needs along with 100% purchase of 2011 needs would be in order. There is a much greater chance to see massive reductions in world bean numbers by the end of 2010 through the first quarter of 2011.

MILK

The front end of the milk market held in well but the back end was sold hard last week. The July milk futures lost 44 cents last week and milk has dropped \$1.35 in the past month. Part of the problem was a release last week from the USDA on the size of the cattle herd and its direct impact on the milk market. In what we thought would be a reduction in total cattle here in the US turned out to be just the opposite. The report did confirm that total cow numbers had dropped 252,000 head, which was the largest drop in milk cow head since the drought of 1988 and was the third smallest dairy herd since 1868. Unfortunately, producers simultaneously increased the number of replacement heifers by 106,000 head. The net result was only a minor decrease in the US milk herd and that doesn't work if you want better milk prices.



The problem with US dairy prices is not just a supply story. The US and world economic recession has reduced demand for both fluid milk and other dairy products both domestically and in the export market, pressuring domestic prices lower. Total commercial milk disappearance, while still above average, trended below 2008 for much of the year. Domestic fluid milk consumption in 2009 increased slightly from the prior year, while commercial cheese disappearance was also larger. However, exports of fluid milk and dairy products have fallen while total imports during the year have been well ahead of both 2008 and longer term averages. The net result has been a decline in total disappearance. With a grim outlook, US gaining world dairy market share can only be achieved by lower prices with a much supply as we currently carry.

Cheese production is the single largest use for milk and also the only way to store milk for an extended period of time. With an oversupply of milk in 2009, US cheese production increased as processors were able to purchase class III milk near 10 year low prices. US cheese stocks subsequently end the year at a record large level of 967 Mil Lbs. US dairy producers have seen modest profits at the end of 2009/early 2010 as milk prices increased during the month of December, but those small profits do not begin to make up for the extreme loss of industry wide capital in the previous 2 years. The increasing number of heifers suggests that productivity in 2010 will again reach a record level. The industry needs to (still) focus on reducing herd size and increasing demand in the export market.

It's not the rosiest outlook we've ever written but the fact of the matter is many in the industry thought we'd see fewer producers in the industry and thought they could capture a raising price outlook from this and wound up laying in more cows only to wind up hurting themselves.

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Mark Prudhomme is commodity licensed as an IB and is a certified CTA. Mark was securities licensed for 15 years but surrendered his license in 2001.