

SITUATION AND OUTLOOK

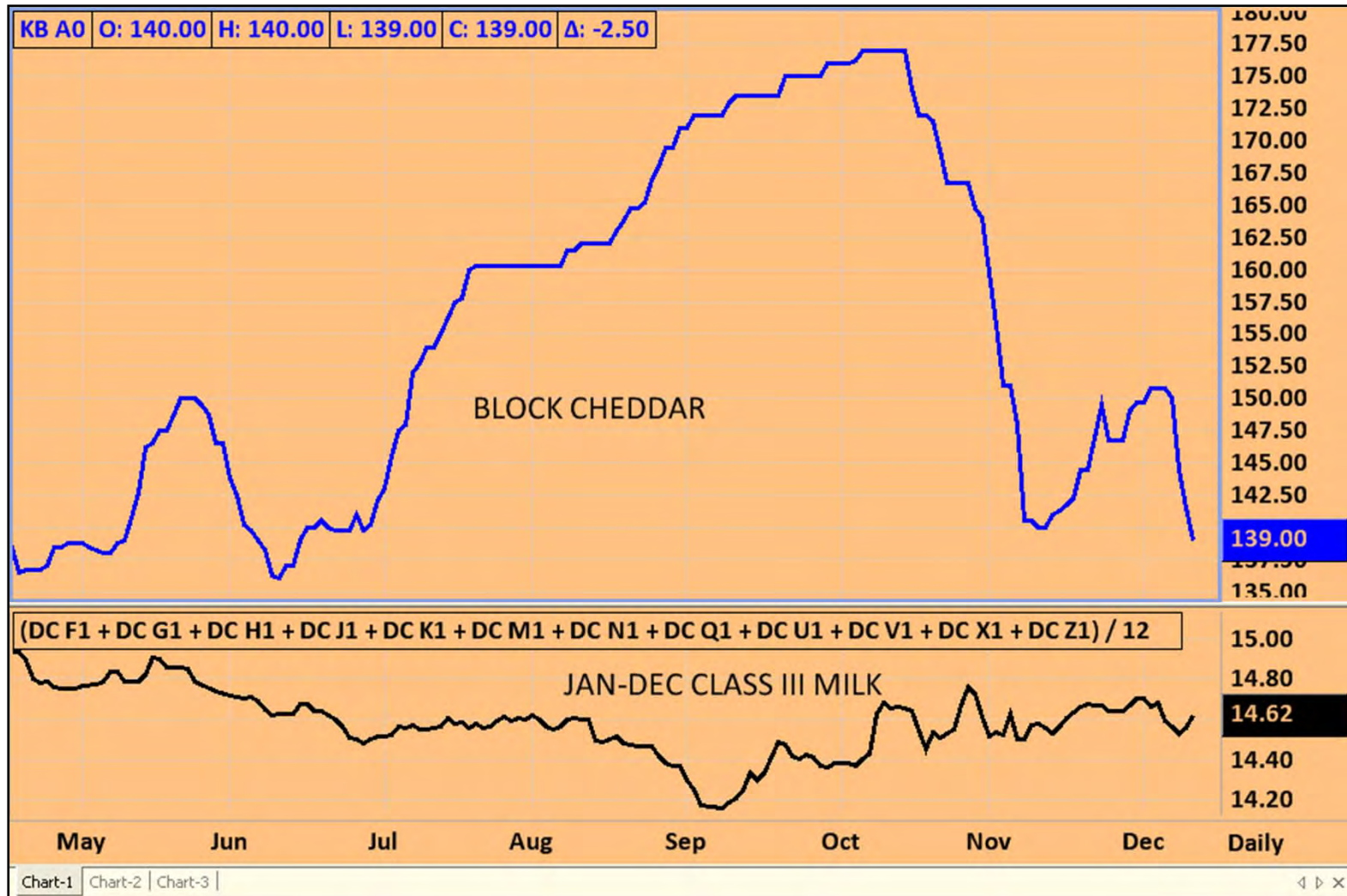
December 2010



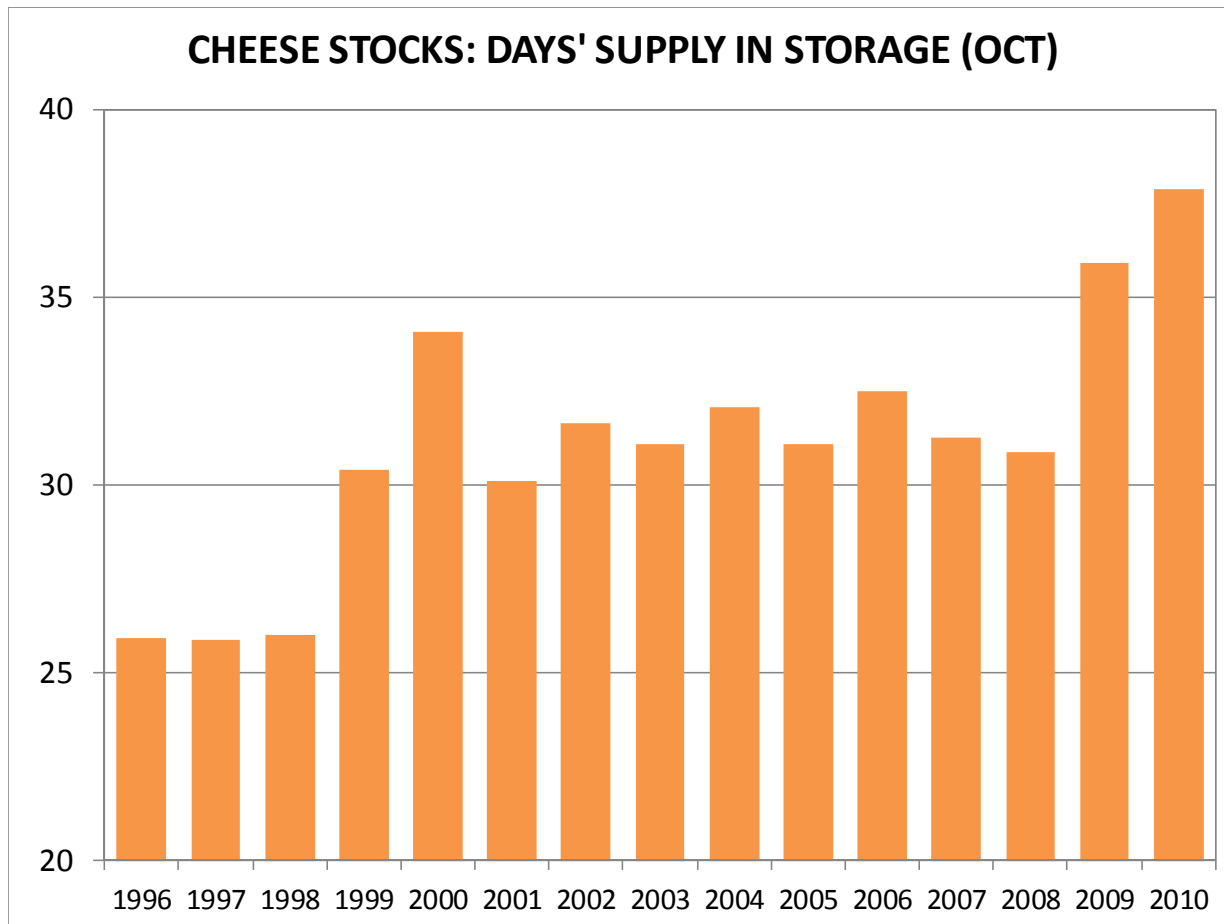
MAJOR MARKET THEMES

- Trade flow will be critical, especially pertaining to butter and powder. Talk of drought in New Zealand has the industry on edge, as performance there is critical (not a lot of margin for supply-side error in the world)
- But: cheese market still must contend with massive rolling supply overhang, decent near-term supply prospects and only fair domestic demand.
- Higher grain prices are going to put a squeeze on producer profitability, with likely consequences at some point in 2011.
- The “food inflation” story has legs and could give dairy a direct and indirect boost.
- Domestic economic conditions are moderate. Tensions between deflation and inflation persist.

CHEESE MARKETS

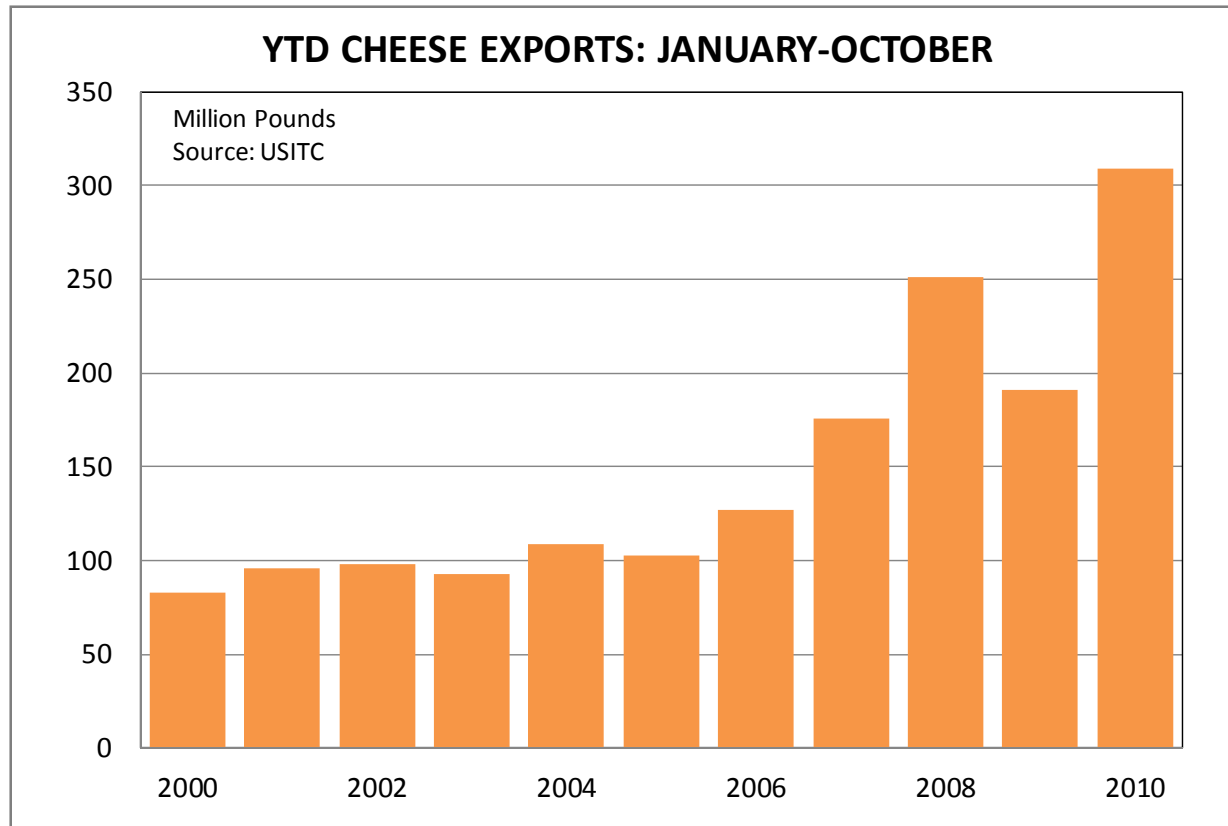


LOTS TO LUG AROUND



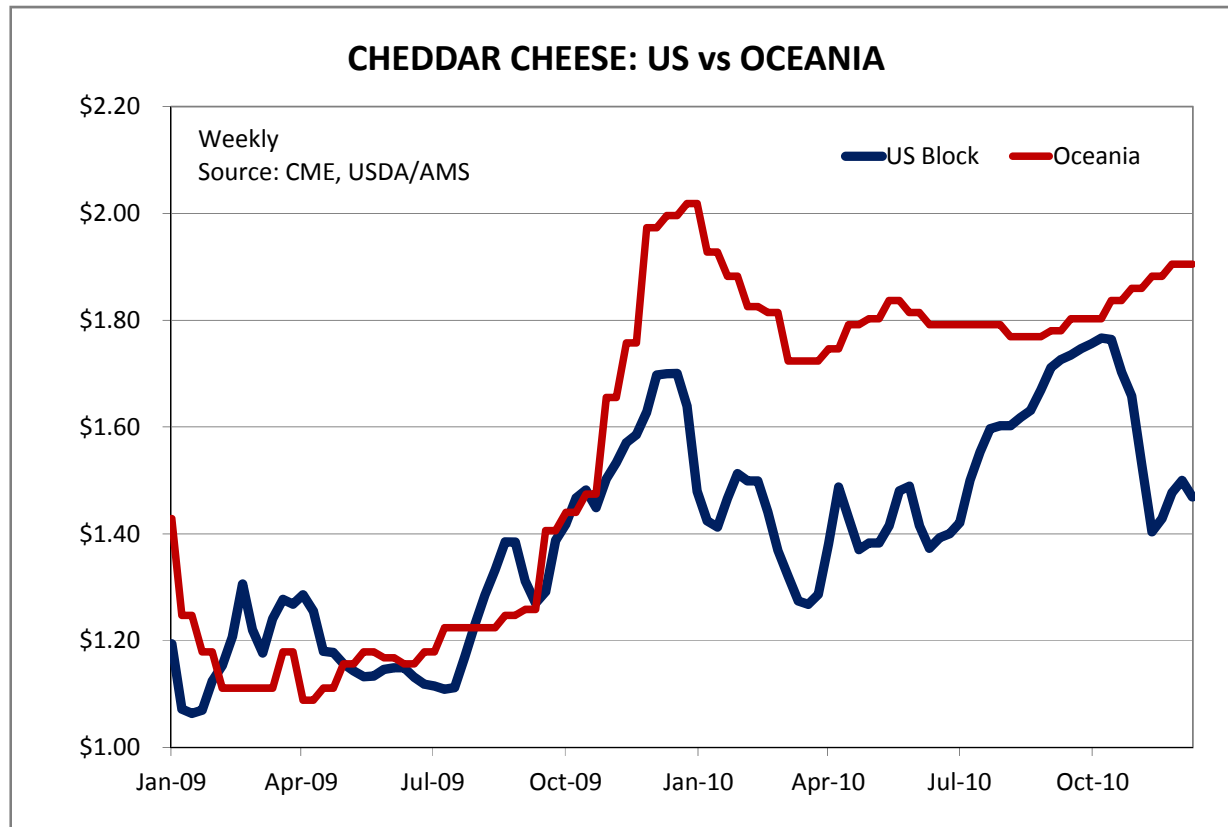
The cheese market is confronting an issue that has lingered all year: heavy stocks.

CHEESE EXPORTS



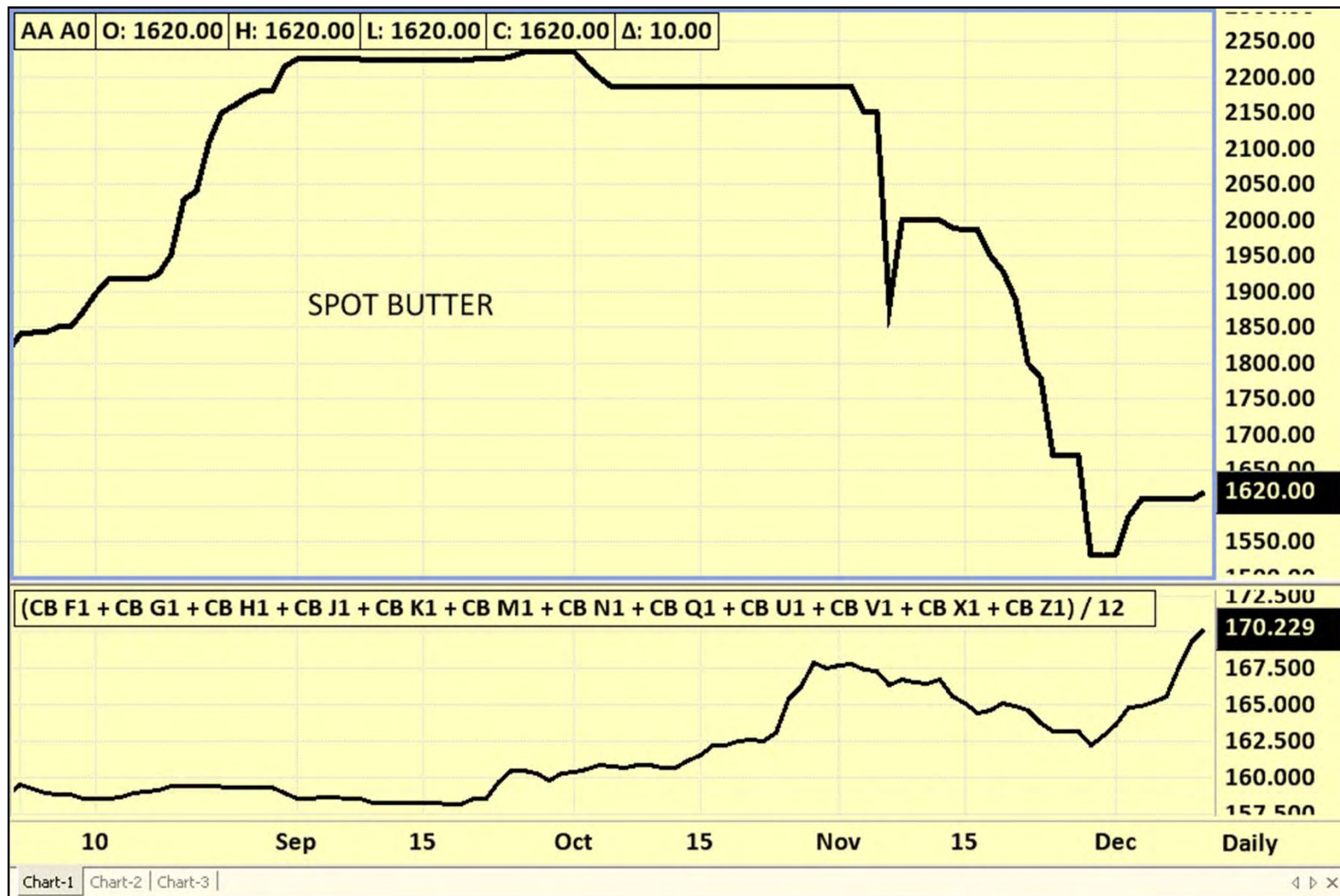
Exports have already been solid in 2010... how much more can we do in 2011?

BIG ENOUGH GAP?



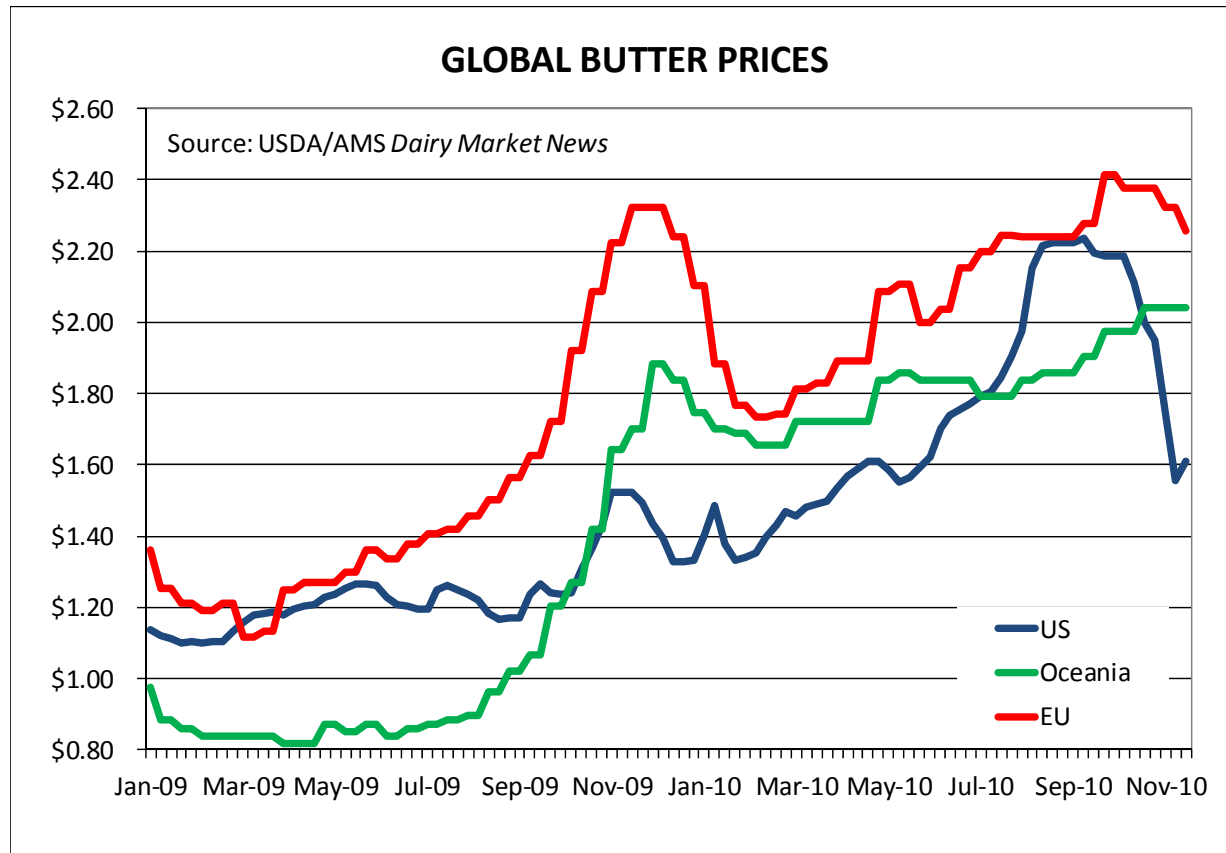
It would appear that US cheese prices are at a level that would accommodate export activity.

CME BUTTER MARKETS

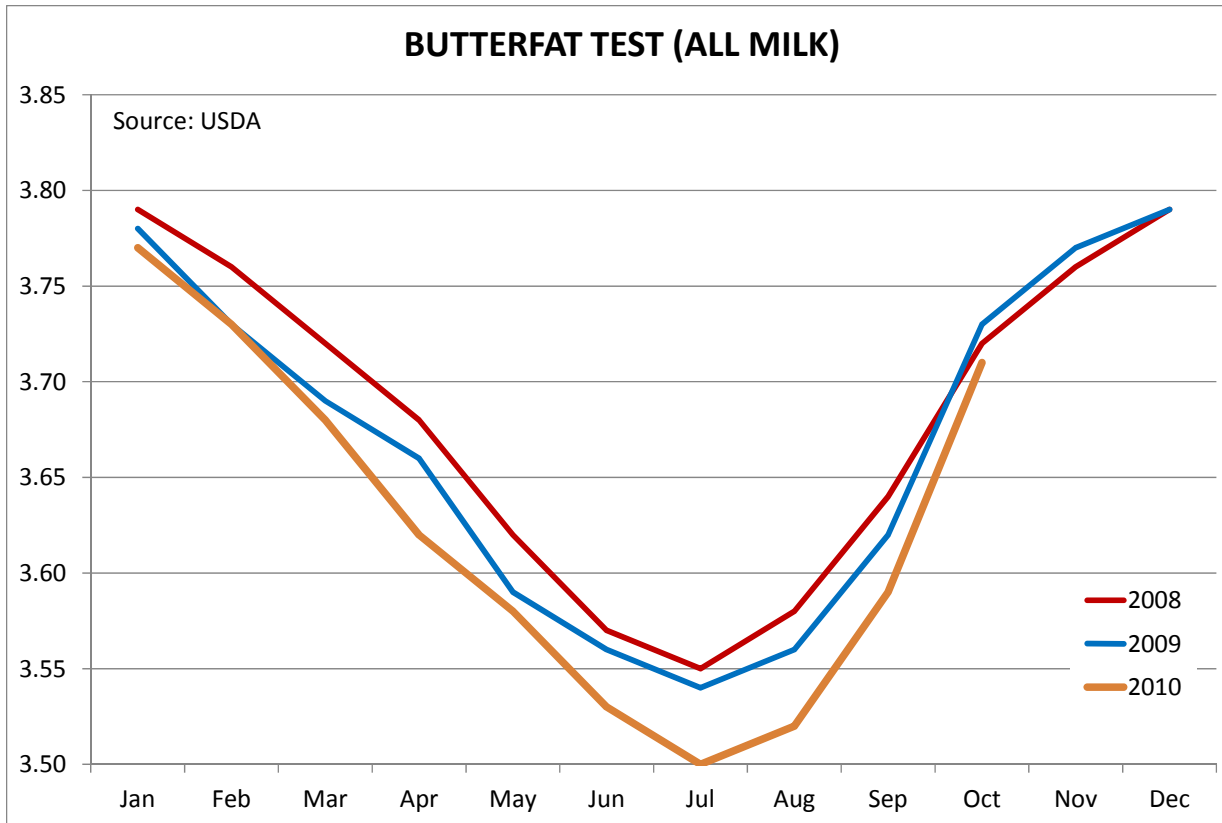


GLOBAL PRICES

US butter is seemingly competitive again in the world market.

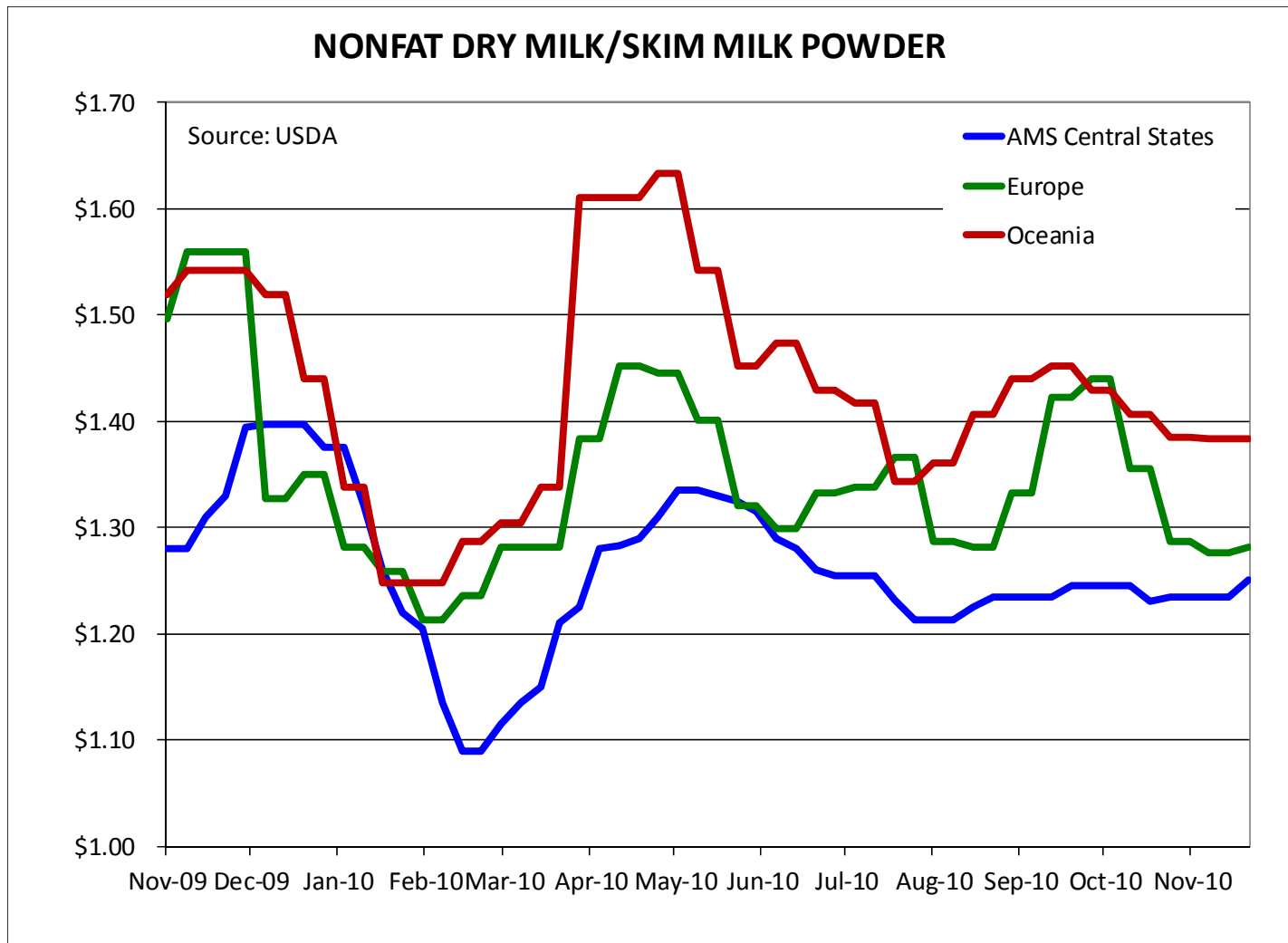


COMPONENTS

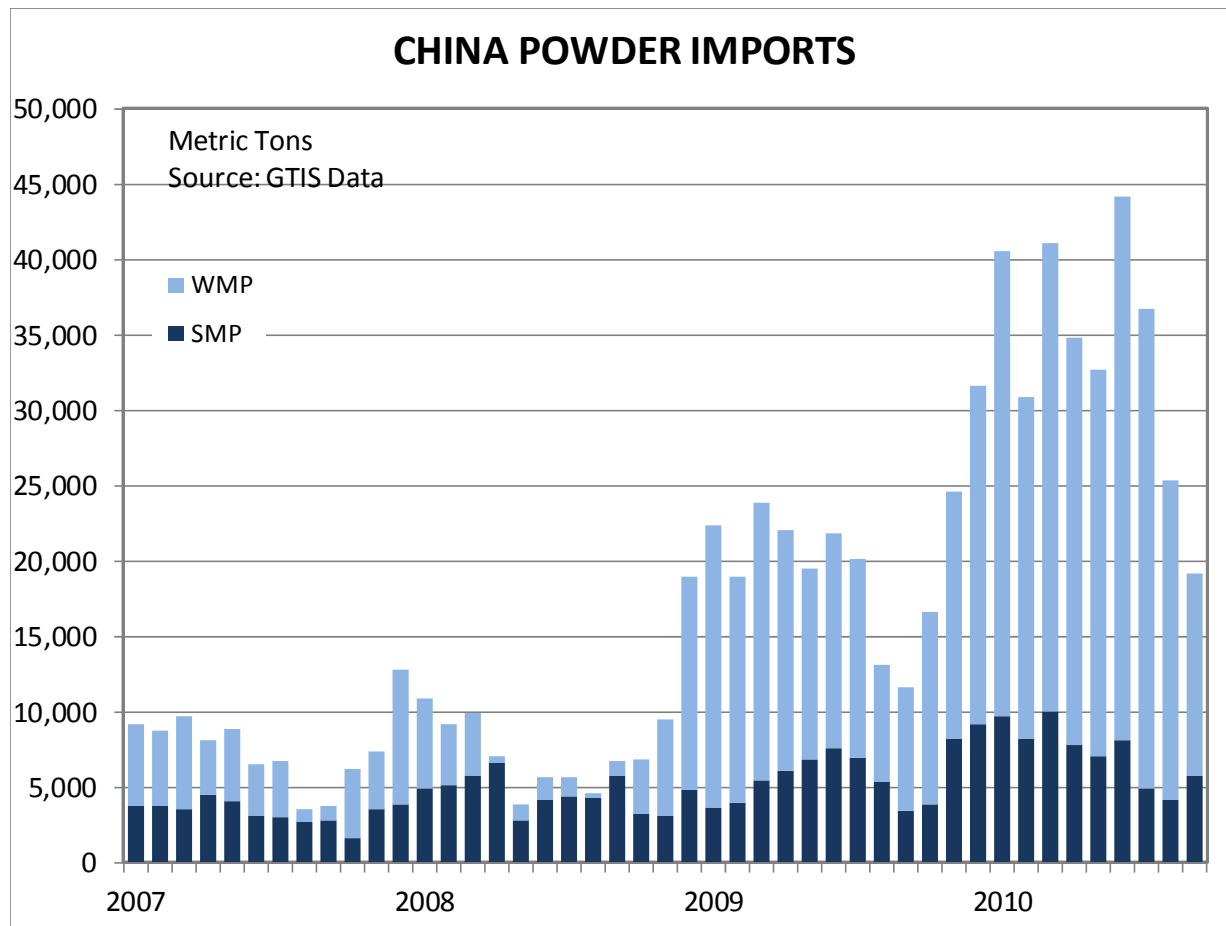


On-farm fat test has averaged 3.62% so far this year compared to 3.65% for the same period in 2009. So: fat output is up by only about half of the overall milk production gain.

NDM/SMP



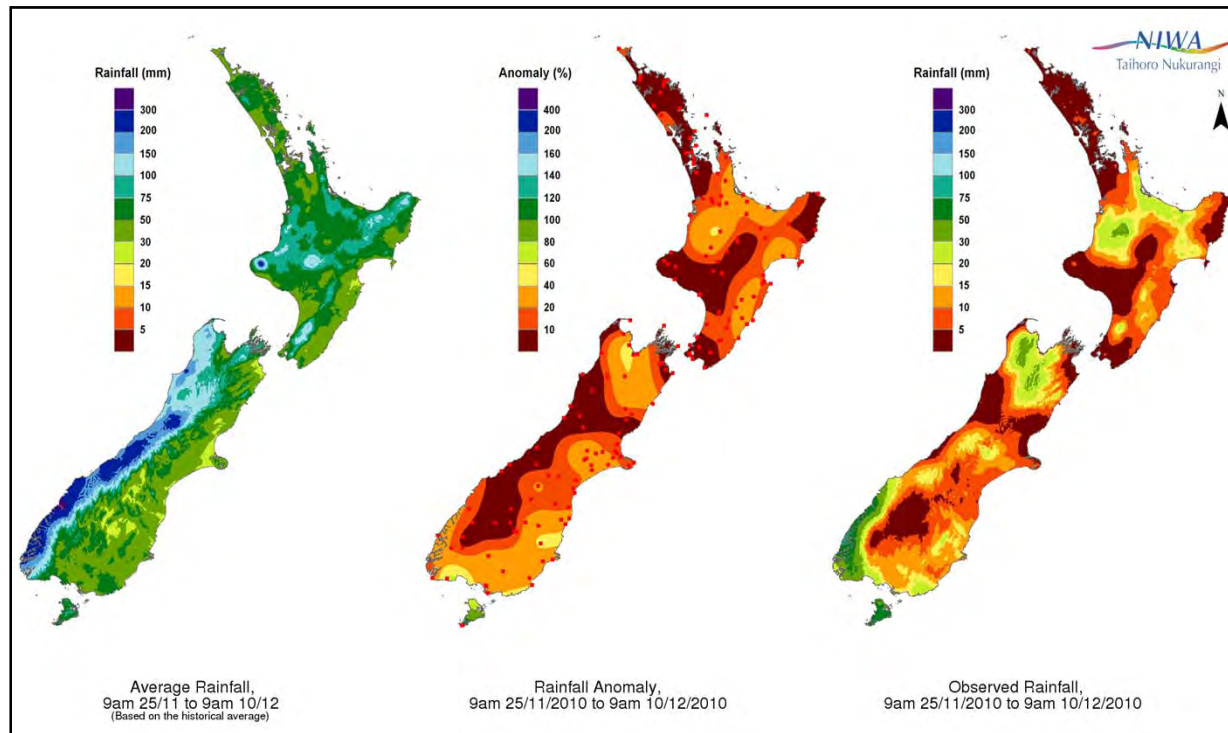
CHINA APPETITE



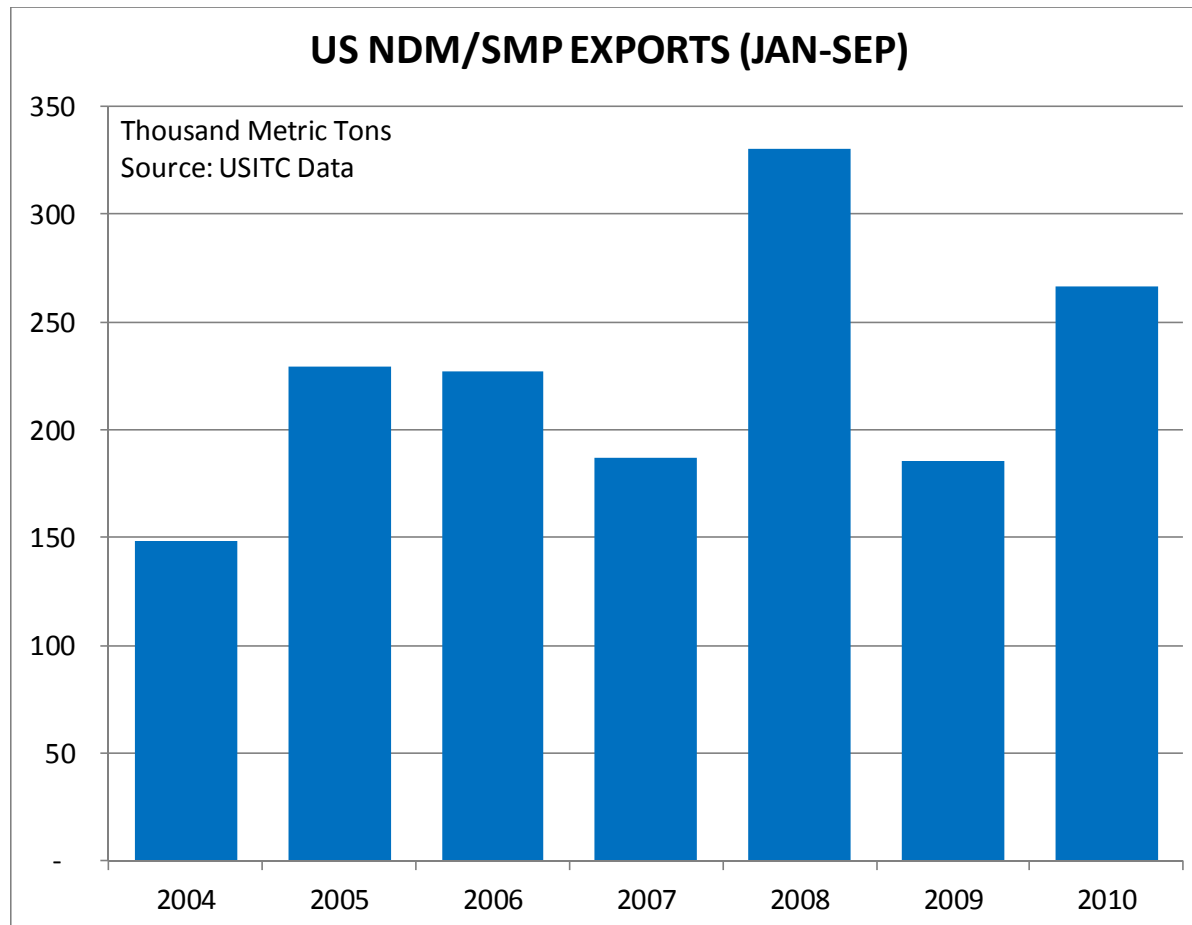
China's demand for milk powders has seemed insatiable. Some questions about nature and sustainability of buying linger... but the numbers don't lie.

ON THE DRY SIDE

Rainfall in New Zealand over the past few weeks has been well below normal, spurring concerns about drought and (another) early end to the milk season.

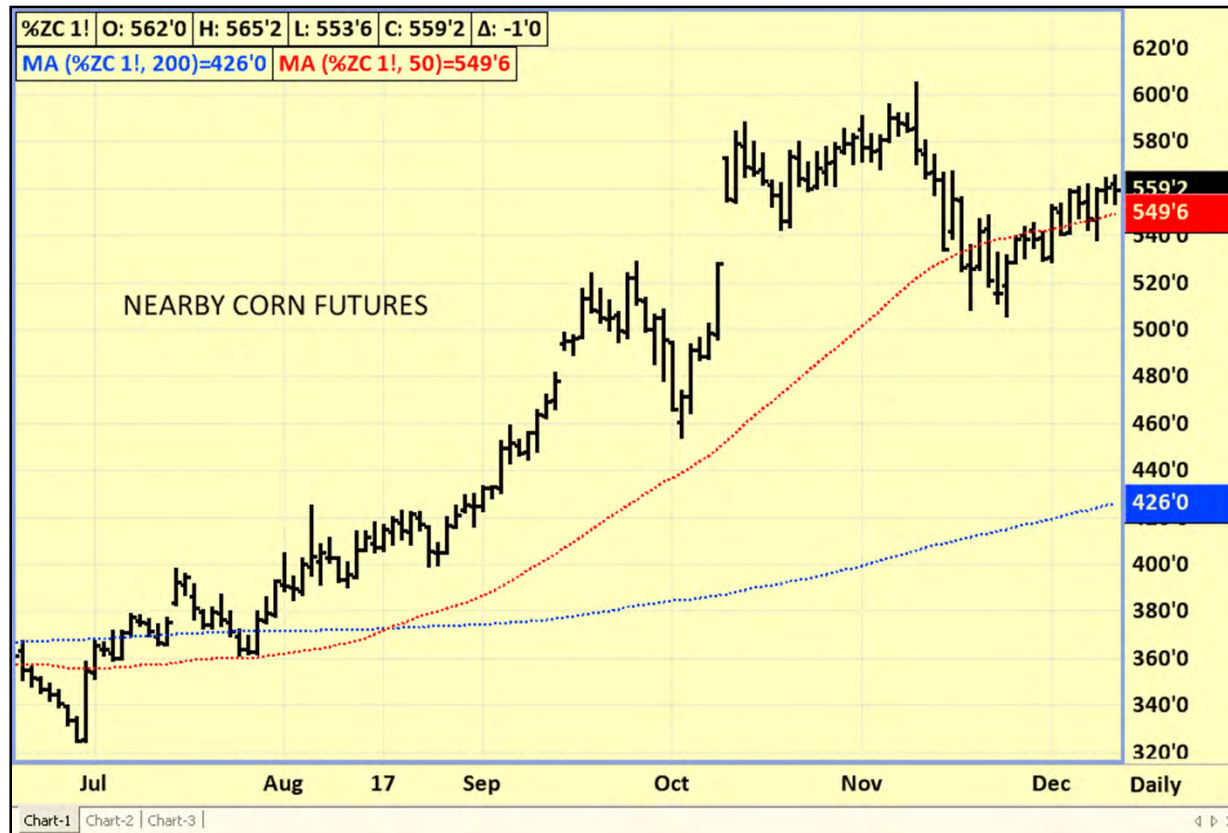


NEW ZEALAND IN, US OUT



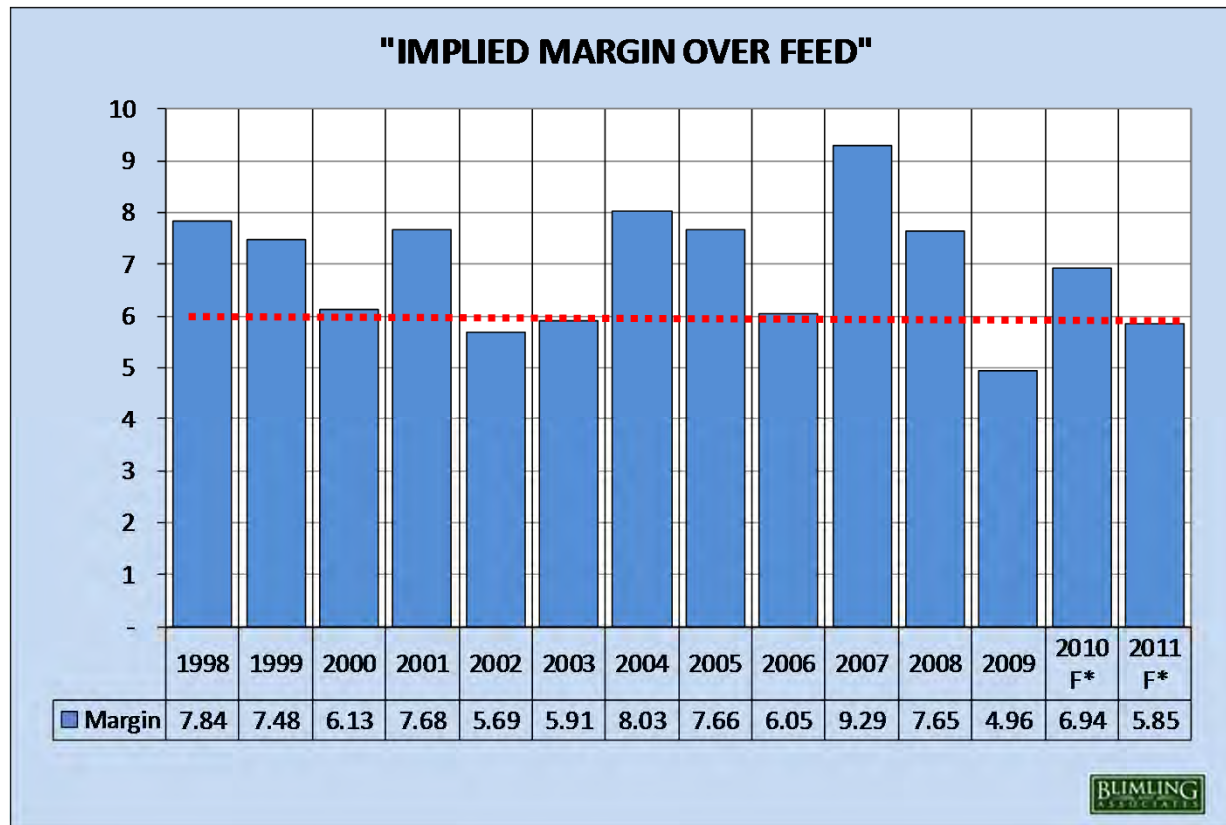
If New Zealand milk production hangs on, there will be less room for the US in world markets. If it doesn't, we can ship a lot of powder...

MARGIN SQUEEZE



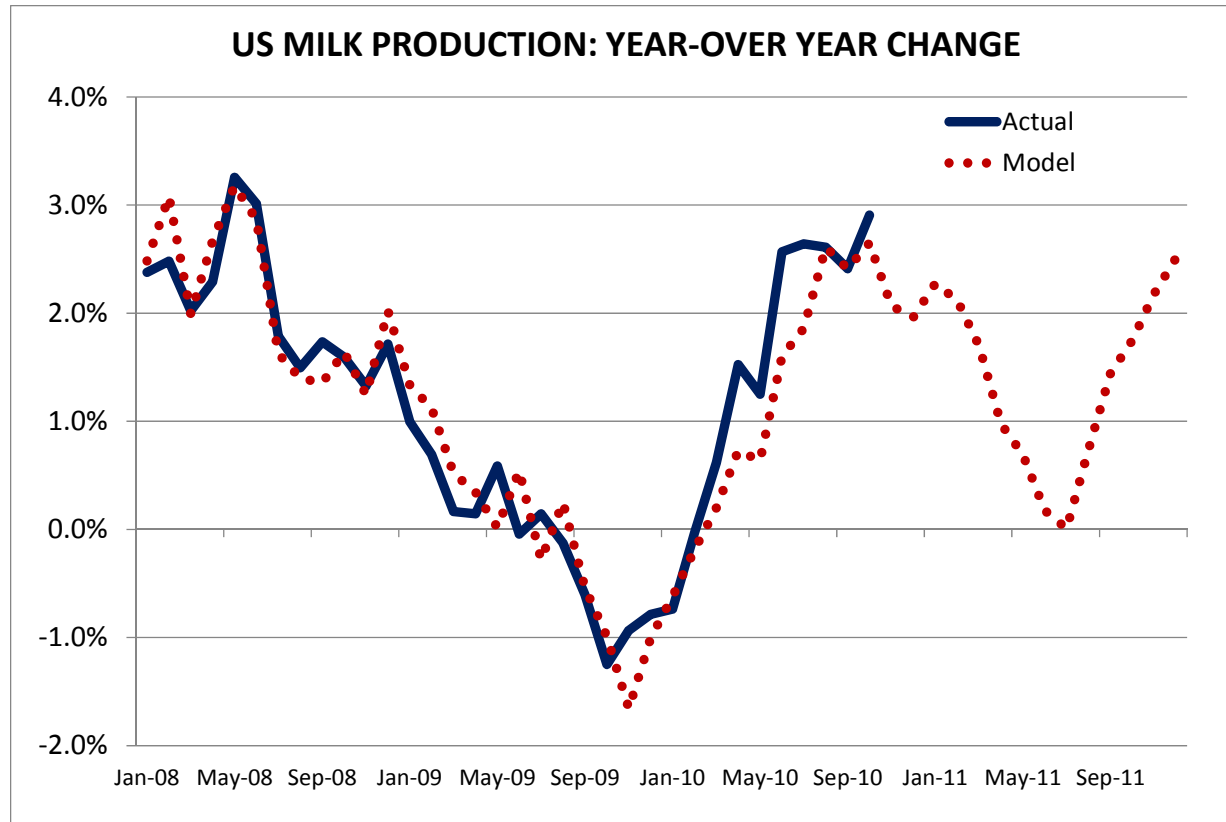
Were grain prices to remain high, the margin pressure on dairy producers could mean more liquidation at \$13-\$14 milk than was previously likely.

GETTING TIGHTER



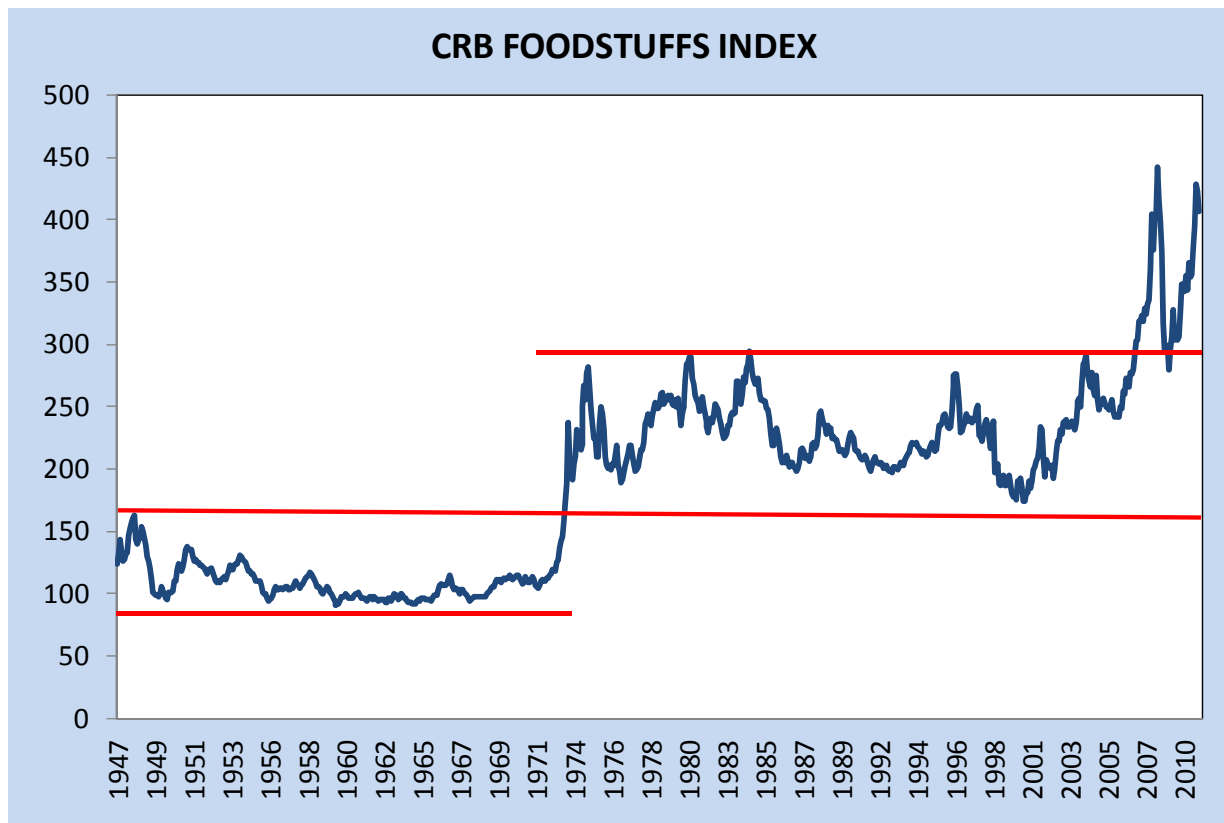
With grain prices up and dairy prices down, implied margins are below the line that has historically separated expansion and contraction.

MILK PRODUCTION



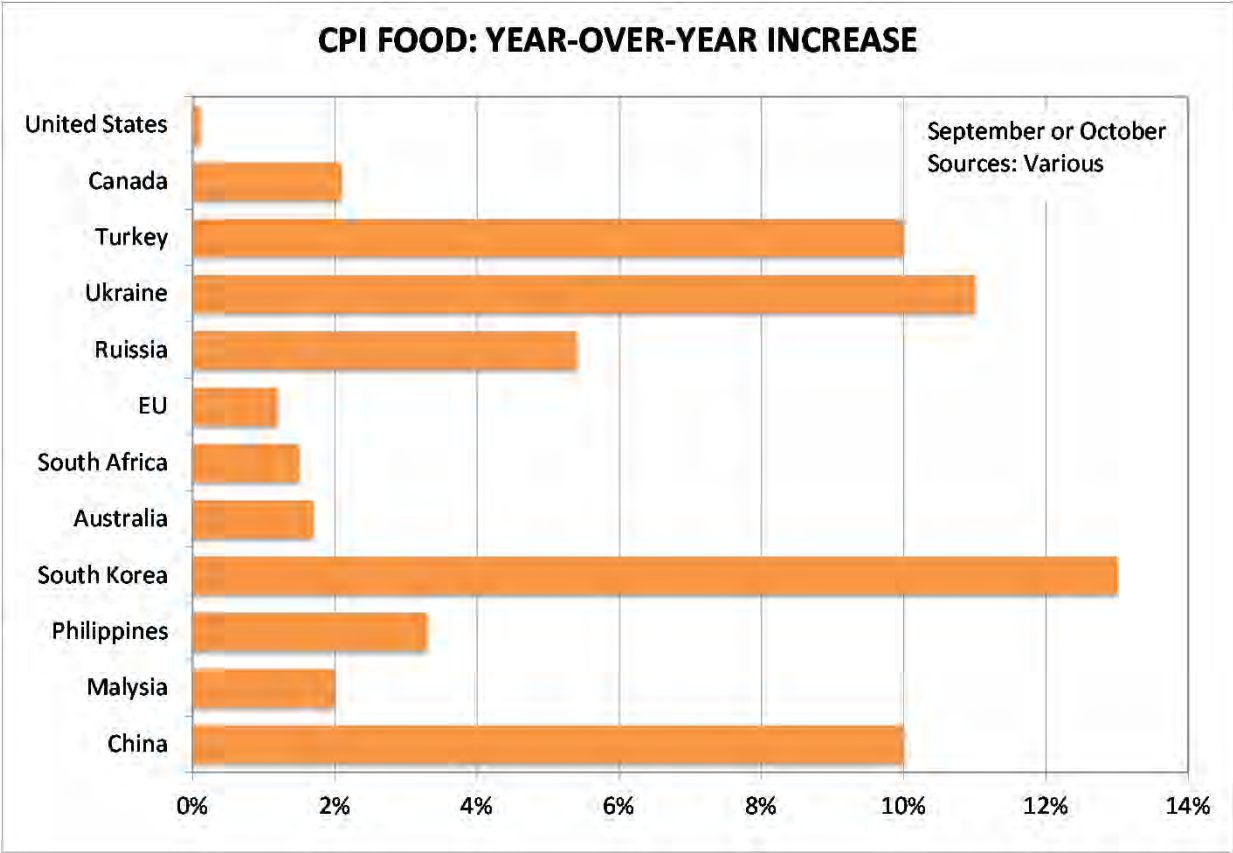
Our milk production model shows +1.7% for 2010 and +1.3% for 2011.

FOOD INFLATION



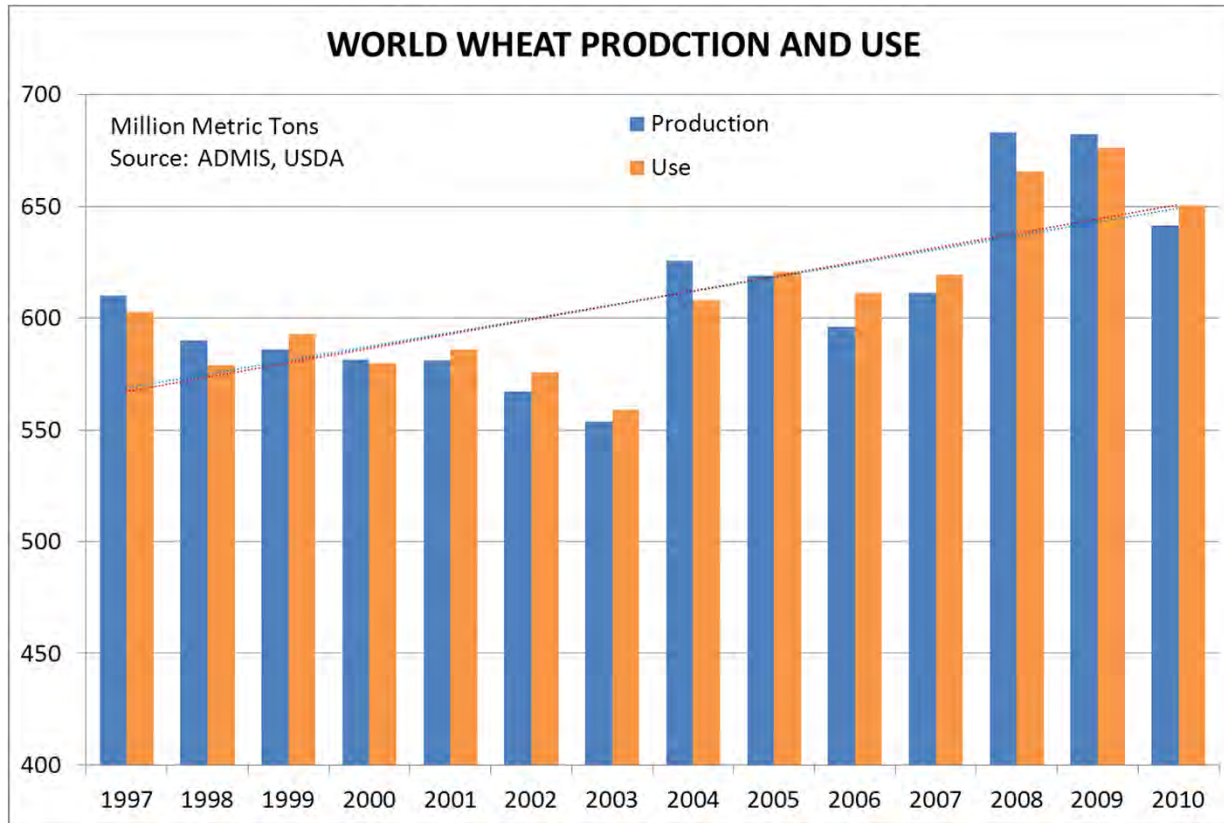
“Resource realignment from developed economies to emerging economies has the potential to slow economic growth in the developed economies, as the emerging markets are willing to pay more for natural resources given the greater value they add to their economies.”
-- Goldman Sachs
December 2009

CPI-FOOD WORLDWIDE



Food price inflation is hardly homogenous in the current environment...

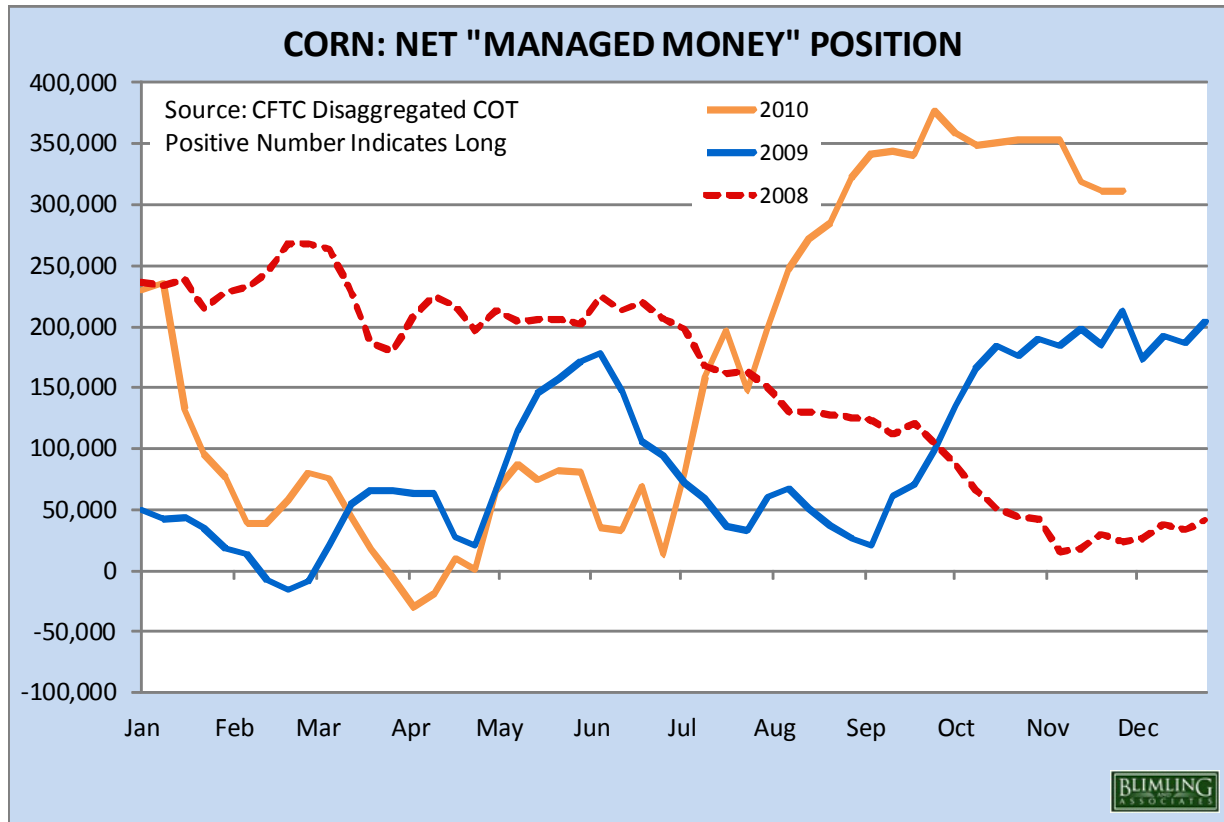
SUPPLY OR DEMAND?



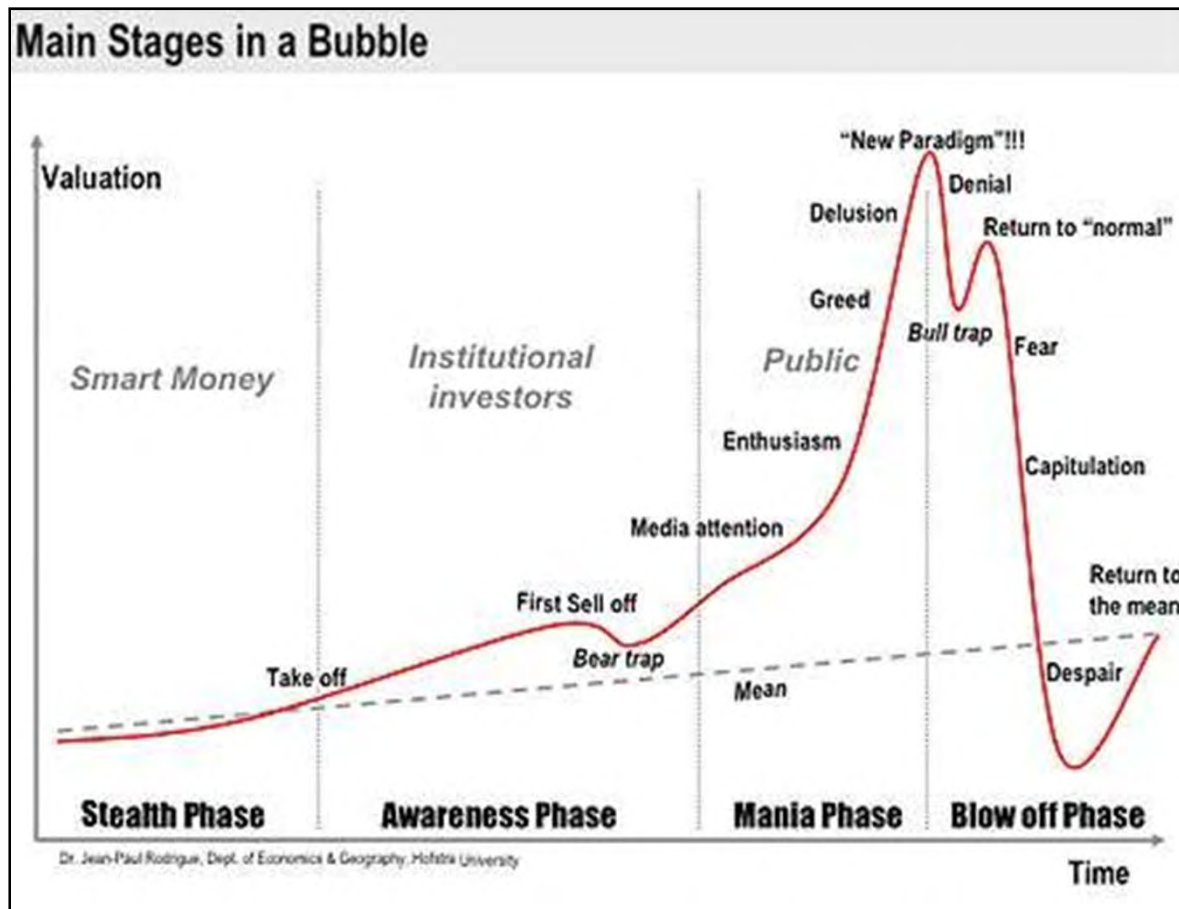
It seems to us that it is possible that we are prone to interpret supply issues as demand issues... and underestimate productive capacity.

GOOD STORY FOR SPECS

Spec money has moved back into agricultural commodity markets in a big way. In corn, the long position is bigger than it was in 2008.

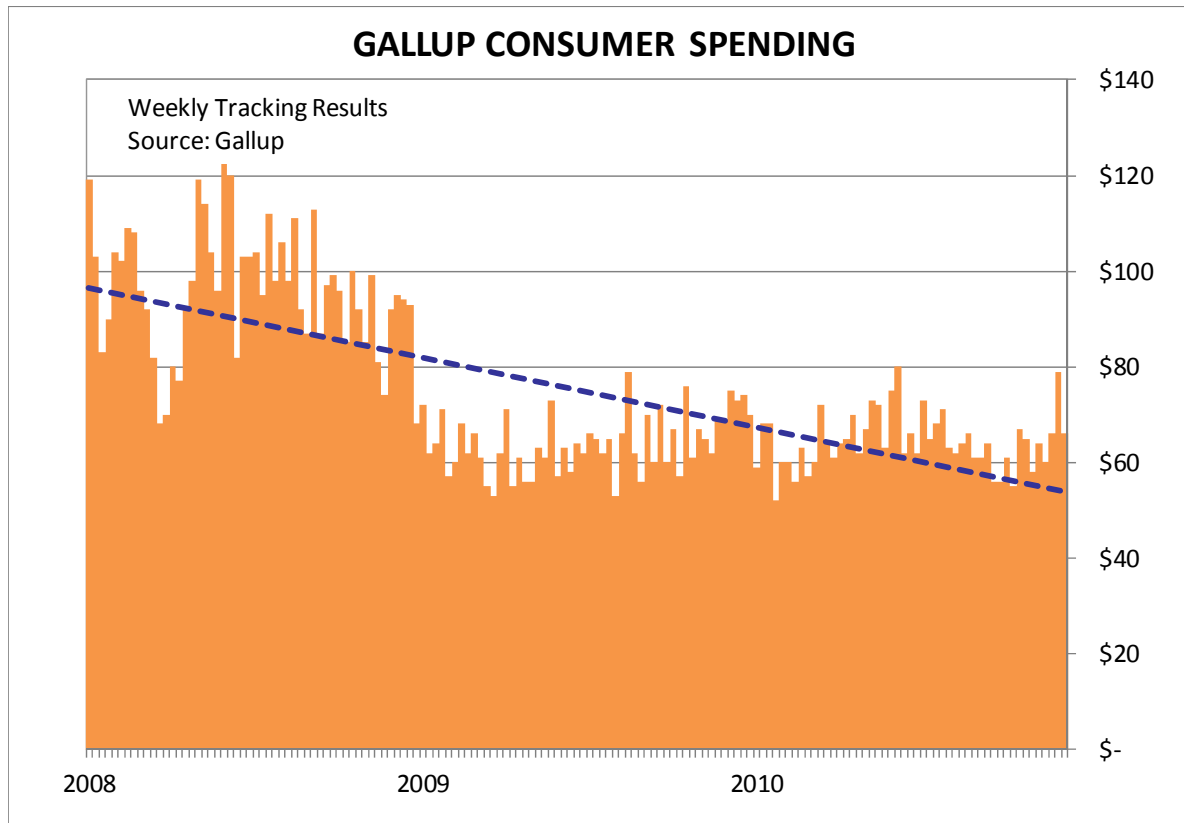


STAGES OF A BUBBLE



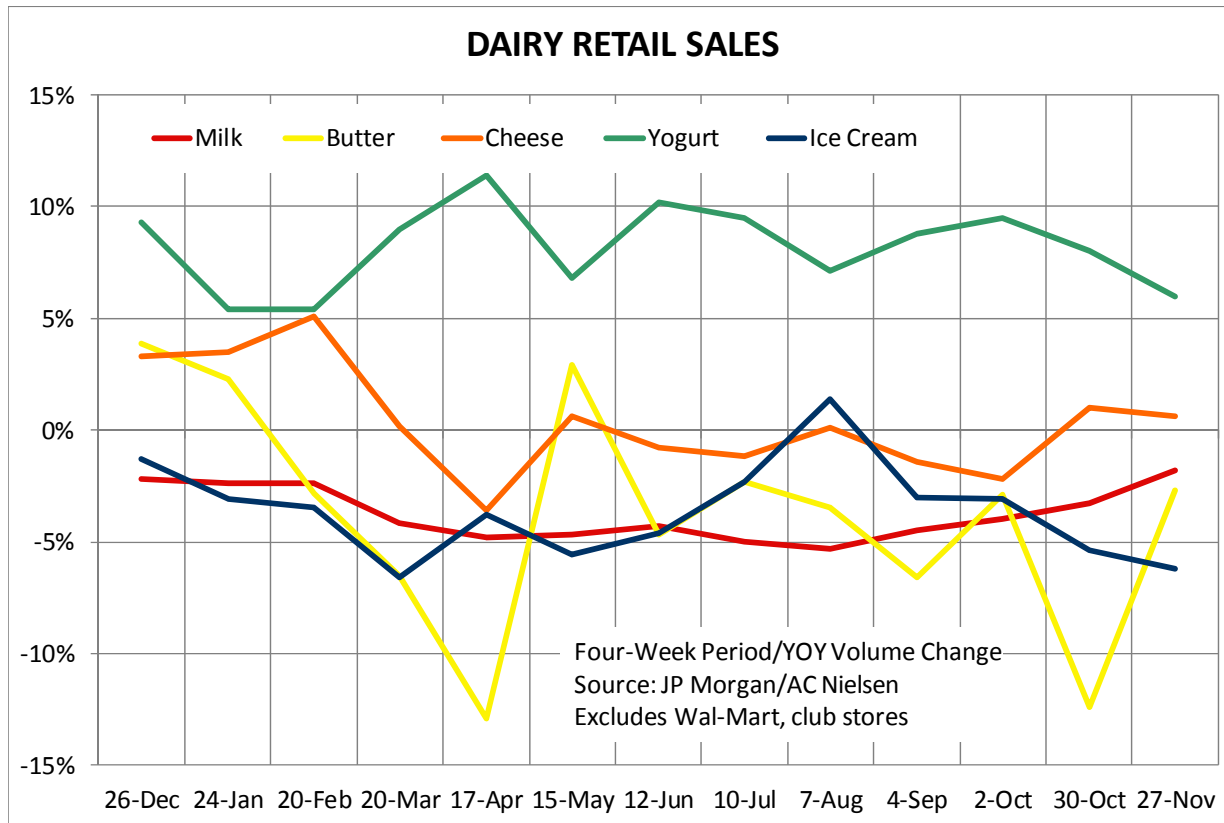
It is difficult to tell where the “food inflation” story falls in the life cycle of a bubble market. Perhaps early in the mania phase?

RELUCTANT CONSUMER



Gallup polling data shows consumers spending an average of \$64/week so far in 2010. That's flat versus 2009 and down 33% versus 2008.

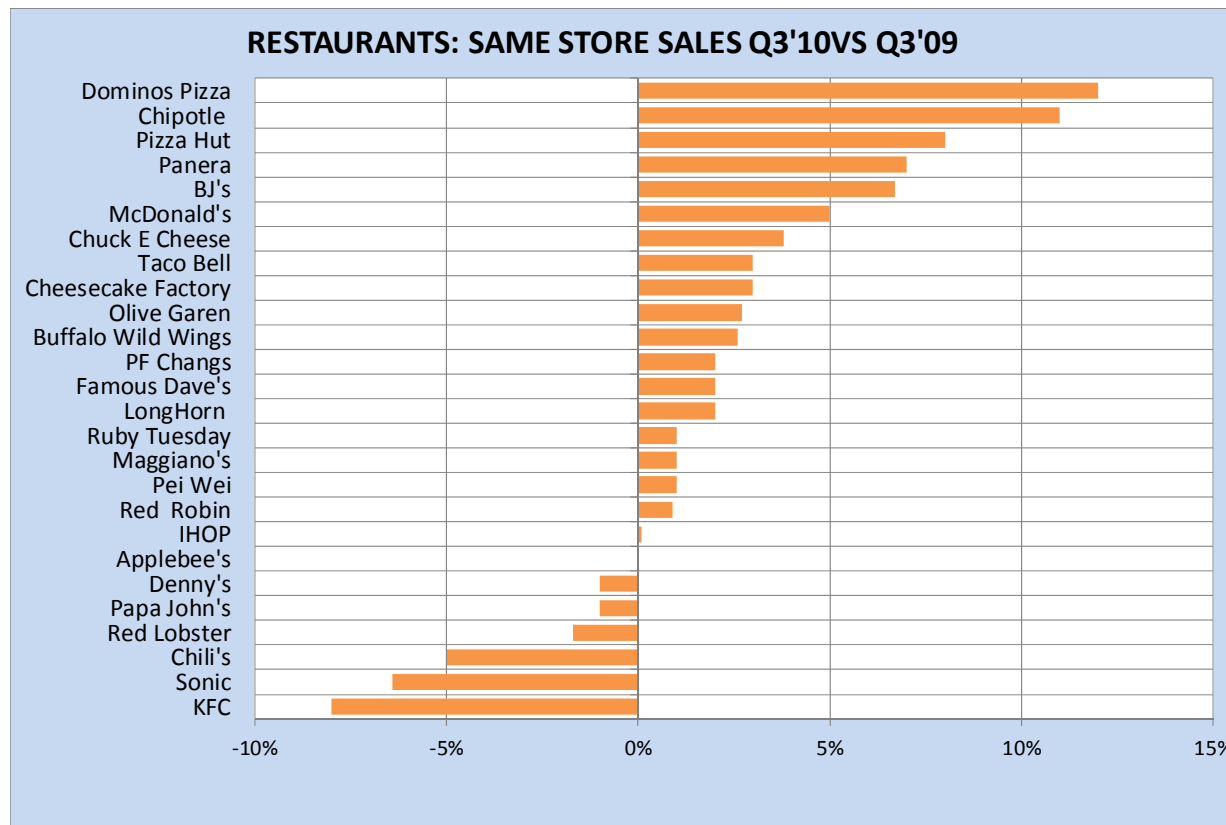
MEDIOCRE SALES



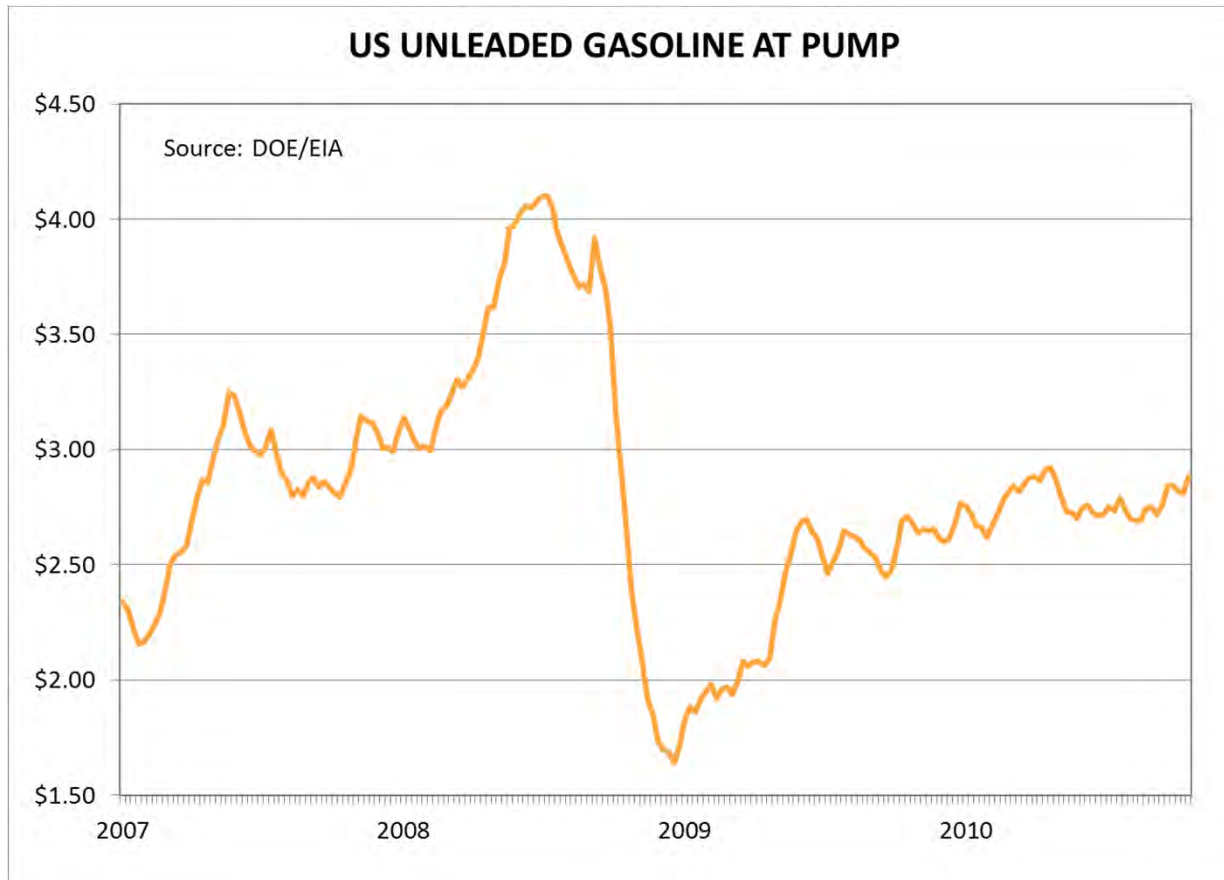
Going into 2010 we thought resistance to higher prices would be formidable. So far, we have been largely right – and believe the same holds into 2011.

FOOD SERVICE: BETTER

Restaurant performance in Q3 showed continued improvement in both quarter-to-quarter and year-over-year terms.

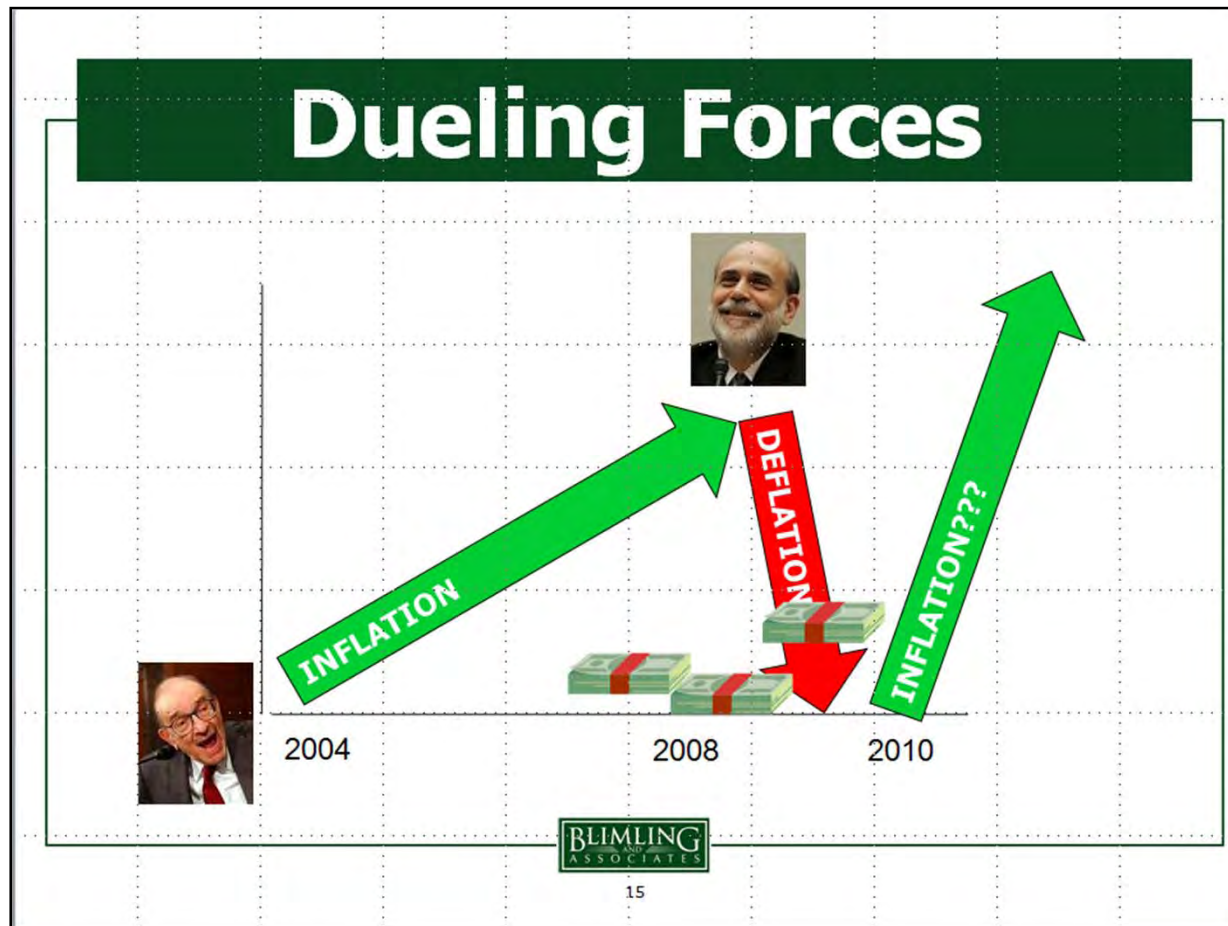


LESS TAXING



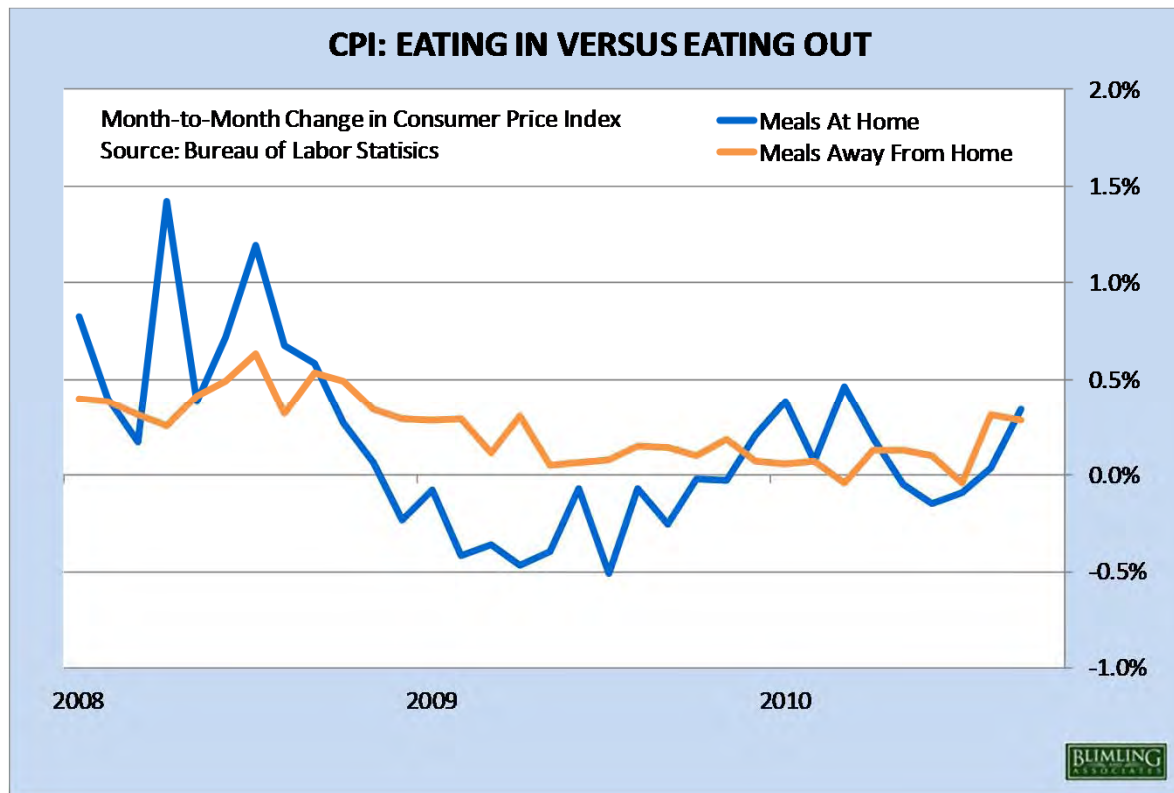
So far, consumers have not been pinched too hard at the pump. A crude oil run to the 2008 highs would obviously change that (and have consequences).

INEVITABLE...



Two years ago, we noted that that inflation would surely follow deflation and that the Fed was going to be involved. What we don't know: how far along is the process?

WHERE'S THE INFLATION?



Competition for the consumer dollar is keen – and few are especially eager to “take price” and risk losing precious market share.

CURRENCY CLASHES

Currency remains a hot area... the medium-term fundamentals for the US Dollar are not especially...



CRUDE EVALUATION



The crude oil market remains something worth watching most days – it is going to provide a lot of clues about global economic conditions and/or inflation.

DAIRY FORECASTS

	CME Blocks	CME Barrels	CME Butter	NDM (NASS)	Whey (NASS)	Class 3	Class 4	Class 1	Class 2	NDM West	NDM Central	Central Whey	West Whey	WPC
Jan-10	\$1.45	\$1.47	\$1.39	\$1.19	\$0.39	\$14.50	\$13.85	\$15.03	\$15.22	\$ 1.31	\$ 1.37	\$ 0.38	\$ 0.41	\$ 0.92
Feb-10	\$1.45	\$1.42	\$1.36	\$1.08	\$0.39	\$14.28	\$12.90	\$14.84	\$15.65	\$ 1.07	\$ 1.21	\$ 0.38	\$ 0.41	\$ 0.93
Mar-10	\$1.30	\$1.28	\$1.46	\$1.05	\$0.38	\$12.78	\$12.92	\$14.34	\$14.46	\$ 1.06	\$ 1.11	\$ 0.37	\$ 0.40	\$ 0.91
Apr-10	\$1.42	\$1.39	\$1.55	\$1.12	\$0.36	\$12.92	\$13.73	\$13.22	\$13.78	\$ 1.17	\$ 1.23	\$ 0.35	\$ 0.40	\$ 0.91
May-10	\$1.44	\$1.42	\$1.59	\$1.25	\$0.36	\$13.38	\$15.29	\$13.80	\$14.90	\$ 1.28	\$ 1.32	\$ 0.35	\$ 0.40	\$ 0.92
Jun-10	\$1.40	\$1.36	\$1.64	\$1.26	\$0.37	\$13.62	\$15.45	\$15.28	\$16.01	\$ 1.30	\$ 1.32	\$ 0.35	\$ 0.39	\$ 0.94
Jul-10	\$1.55	\$1.52	\$1.78	\$1.23	\$0.36	\$13.74	\$15.75	\$15.66	\$17.10	\$ 1.21	\$ 1.26	\$ 0.34	\$ 0.38	\$ 0.94
Aug-10	\$1.64	\$1.60	\$1.99	\$1.16	\$0.36	\$15.18	\$15.61	\$15.77	\$16.98	\$ 1.12	\$ 1.22	\$ 0.35	\$ 0.38	\$ 0.96
Sep-10	\$1.74	\$1.71	\$2.23	\$1.14	\$0.36	\$16.26	\$16.76	\$15.50	\$17.60	\$ 1.17	\$ 1.23	\$ 0.34	\$ 0.37	\$ 0.96
Oct-10	\$1.72	\$1.71	\$2.19	\$1.17	\$0.37	\$16.94	\$17.15	\$16.58	\$17.57	\$ 1.19	\$ 1.24	\$ 0.35	\$ 0.38	\$ 0.98
Nov-10	\$1.46	\$1.45	\$1.93	\$1.20	\$0.37	\$15.44	\$16.68	\$17.24	\$17.21	\$ 1.19	\$ 1.23	\$ 0.36	\$ 0.39	\$ 1.00
Dec-10	\$1.50	\$1.46	\$1.53	\$1.20	\$0.38	\$14.05	\$14.94	\$16.96	\$15.56	\$ 1.19	\$ 1.23	\$ 0.36	\$ 0.39	\$ 0.99
2010 Avg	\$1.51	\$1.48	\$1.72	\$1.17	\$0.37	\$14.42	\$15.09	\$15.35	\$16.00	\$ 1.19	\$ 1.25	\$ 0.36	\$ 0.39	\$ 0.95
	CME Blocks	CME Barrels	CME Butter	NDM (NASS)	Whey (NASS)	Class 3	Class 4	Class 1	Class 2	NDM West	NDM Central	Central Whey	West Whey	WPC
Jan-11	\$1.43	\$1.41	\$1.50	\$1.14	\$0.37	\$14.01	\$13.99	\$14.94	\$15.22	\$ 1.13	\$ 1.18	\$ 0.35	\$ 0.38	\$ 0.94
Feb-11	\$1.42	\$1.39	\$1.51	\$1.08	\$0.36	\$13.42	\$13.45	\$14.19	\$14.78	\$ 1.08	\$ 1.13	\$ 0.34	\$ 0.37	\$ 0.89
Mar-11	\$1.41	\$1.38	\$1.55	\$1.03	\$0.35	\$13.32	\$13.25	\$13.53	\$14.45	\$ 1.04	\$ 1.09	\$ 0.33	\$ 0.36	\$ 0.83
Apr-11	\$1.41	\$1.38	\$1.53	\$1.01	\$0.34	\$13.24	\$13.05	\$13.37	\$13.95	\$ 1.03	\$ 1.08	\$ 0.33	\$ 0.36	\$ 0.80
May-11	\$1.40	\$1.37	\$1.50	\$1.03	\$0.35	\$13.23	\$13.03	\$13.23	\$13.58	\$ 1.06	\$ 1.11	\$ 0.34	\$ 0.37	\$ 0.81
Jun-11	\$1.42	\$1.39	\$1.53	\$1.04	\$0.35	\$13.28	\$13.23	\$13.25	\$13.75	\$ 1.07	\$ 1.12	\$ 0.34	\$ 0.37	\$ 0.82
Jul-11	\$1.44	\$1.41	\$1.54	\$1.07	\$0.36	\$13.48	\$13.54	\$13.22	\$13.98	\$ 1.12	\$ 1.17	\$ 0.35	\$ 0.38	\$ 0.84
Aug-11	\$1.51	\$1.48	\$1.57	\$1.12	\$0.37	\$13.91	\$14.04	\$13.54	\$14.28	\$ 1.18	\$ 1.23	\$ 0.37	\$ 0.40	\$ 0.89
Sep-11	\$1.61	\$1.58	\$1.72	\$1.18	\$0.38	\$14.79	\$15.00	\$13.95	\$15.17	\$ 1.25	\$ 1.30	\$ 0.37	\$ 0.40	\$ 0.92
Oct-11	\$1.79	\$1.76	\$1.74	\$1.22	\$0.38	\$16.18	\$15.75	\$15.01	\$16.08	\$ 1.27	\$ 1.32	\$ 0.37	\$ 0.40	\$ 0.93
Nov-11	\$1.81	\$1.78	\$1.64	\$1.18	\$0.39	\$17.60	\$15.17	\$15.95	\$16.21	\$ 1.20	\$ 1.25	\$ 0.38	\$ 0.41	\$ 0.91
Dec-11	\$1.64	\$1.61	\$1.47	\$1.11	\$0.38	\$16.76	\$13.86	\$17.53	\$15.30	\$ 1.10	\$ 1.15	\$ 0.36	\$ 0.39	\$ 0.85
2011 Avg	\$1.52	\$1.49	\$1.57	\$1.10	\$0.37	\$14.44	\$13.95	\$14.31	\$14.73	\$ 1.13	\$ 1.18	\$ 0.35	\$ 0.38	\$ 0.87

THE FINE PRINT

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