



# The KDM Dairy Report

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## On the bright side:

- In the USDA Dairy Products Report, released yesterday, January '04 Total Cheese output was 2.4% above a year ago, but 2.5% below the prior month. How is that bullish? With current inventory known to be tight, the higher output looks to be more an indicator of strong demand for product.
- In the same report, butter production was 6.8% below year ago levels, but 15.3% above the prior month. Same demand argument here - people are looking for product due to substantiated fears of availability later this year.
- The average price for 500 lb barrels increased 6.9¢ from the previous week, to \$1.39/lb, according to this week's Dairy Products Prices report, leapfrogging over blocks which finished up 1.5¢ to \$1.34/lb.
- February official close of \$11.89 is only a penny of it's historical top-third price, and the highest since 1998.
- Strong gains in the cash markets with butter rocketing up 12.75¢ today to finish at \$2.11/lb on 18 trades and 25 bids left unfilled. Butter's gain for the week is an impressive 25.75¢. Cash blocks gained 7.5¢ for the week to finish at \$1.54 today, while barrels were up 2.5¢, settling at \$1.5150 today. Probably more impressive was the double-egg in trade volume - no sales.
- In today's annual Livestock Slaughter 2003 Summary report, the dairy cull for the year was 2,860,000 head, up 2.8% over the prior year cull of 2,607,000.
- Butter futures traded limit up in all contract months today.
- All-time record volume in Class III futures today - an estimated 2,661 contracts. Five months over \$15 and an April through December average of \$14.72/cwt.
- Monsanto acknowledges customers have been lost, according to a report in Agri-View.

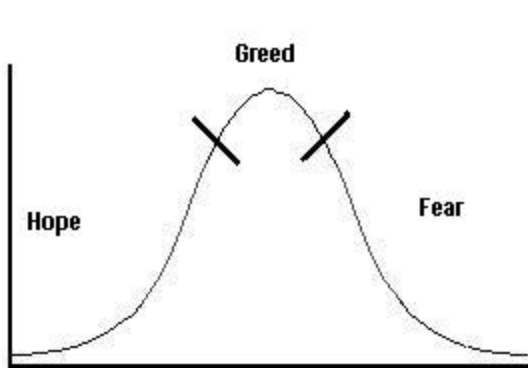
Futures Month	Friday 03/05	Friday 02/27	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Feb-04	\$11.89	\$11.85	\$0.04	\$11.34	\$11.90	\$12.45
Mar-04	\$13.64	\$13.47	\$0.17	\$11.35	\$11.91	\$12.47
Apr-04	\$14.67	\$14.10	\$0.57	\$11.24	\$11.76	\$12.27
May-04	\$15.23	\$14.40	\$0.83	\$11.27	\$11.94	\$12.59
Jun-04	\$15.27	\$14.51	\$0.76	\$11.65	\$12.48	\$13.30
Jul-04	\$15.44	\$14.64	\$0.80	\$12.46	\$13.38	\$14.28
Aug-04	\$15.50	\$14.78	\$0.72	\$13.16	\$14.17	\$15.17
Sep-04	\$15.69	\$15.04	\$0.65	\$13.61	\$14.59	\$15.56
Oct-04	\$14.60	\$13.97	\$0.63	\$12.98	\$13.82	\$14.65
Nov-04	\$13.31	\$12.80	\$0.51	\$11.92	\$12.97	\$14.00
Dec-04	\$12.80	\$12.18	\$0.62	\$11.92	\$12.97	\$14.01
Jan-05	\$12.20	\$11.80	\$0.40	\$11.89	\$12.71	\$13.52
Feb-05	\$11.98	\$11.80	\$0.18	\$11.34	\$11.90	\$12.45
Mar-05	\$11.88	\$11.70	\$0.18	\$11.35	\$11.91	\$12.47
Apr-05	\$11.85	\$11.60	\$0.25	\$11.24	\$11.76	\$12.27
May-05	\$11.90	\$11.60	\$0.30	\$11.27	\$11.94	\$12.59
Jun-05	\$12.20	\$11.90	\$0.30	\$11.65	\$12.48	\$13.30
Jul-05	\$12.25	\$12.05	\$0.20	\$12.46	\$13.38	\$14.28

- Burger joints seeing continued sales growth with McDonalds reporting record February sales up 23%, while Wendy's also reported "very strong February sales".
- Weekly dairy cow slaughter down just 1.7% vs. the same period a year ago. This compares favorably to the more than 10% deficit we have been running so far this year.

however....

- The 2004 annual average is now just 7¢ off the record set in 1998 of \$14.20. Time to start selling?
- PUTs should be getting cheaper with these higher prices, and some are, but the high volatility is holding their value. On February 27th, July futures settled at \$14.64, with the \$14.00 PUT settling at 40¢. Despite an 80¢ gain in the contract since then, that same \$14.00 PUT traded for 36¢ today.
- Another reason for the sustained value in the PUT options is the shortage of floor traders and outside speculators willing to sell them. Word we hear from the floor is that their books are full and they aren't willing, or able to sell a whole lot more.

### Recommendation:



Anticipation of a tight milk supply is driving the market to record levels. Some producers we talked to this week were getting lots of visits by area fieldman looking for milk. A quick read of Fluid Market News makes one think we still have a lot of upside potential:

*Milk supplies remain extremely tight for early March. Milk and cream users are worried about prospects for summer and fall supplies. Many manufacturing plant operators seek additional milk, generally unsuccessfully. Already it seems that availability is more important than the price.*

That last sentence bothers me a bit, however. When markets get this exuberant, fundamentals are this strong and there's virtually no negative news, watch out! We read a good article this week on price risk management and it was a good reality check. Referencing the chart above, the **hope** or optimism stage is the expectation for higher prices. The **greed** stage is the continued unrealistic expectation for higher prices, and the **fear** stage is the realization we waited too long. Where are we on this chart today? While the fundamentals certainly point to significant upside potential left in this market, make sure you are selling on the way up, not the way down.

With a somewhat illiquid options market, you might want to consider locking in a portion of your production with your plant, or selling futures to establish some price security for your milk. Leave April through May open, and focus on the July through January '05 contracts. If cash cheese hits \$1.60 next week, get started. Continue to market more of your production as cheese moves to higher levels, or on average gains over those months of 20-30¢.

To discuss this and more advanced strategies, give us a call! 877.695.8538

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