



# The KDM Dairy Report - May 7th, 2004

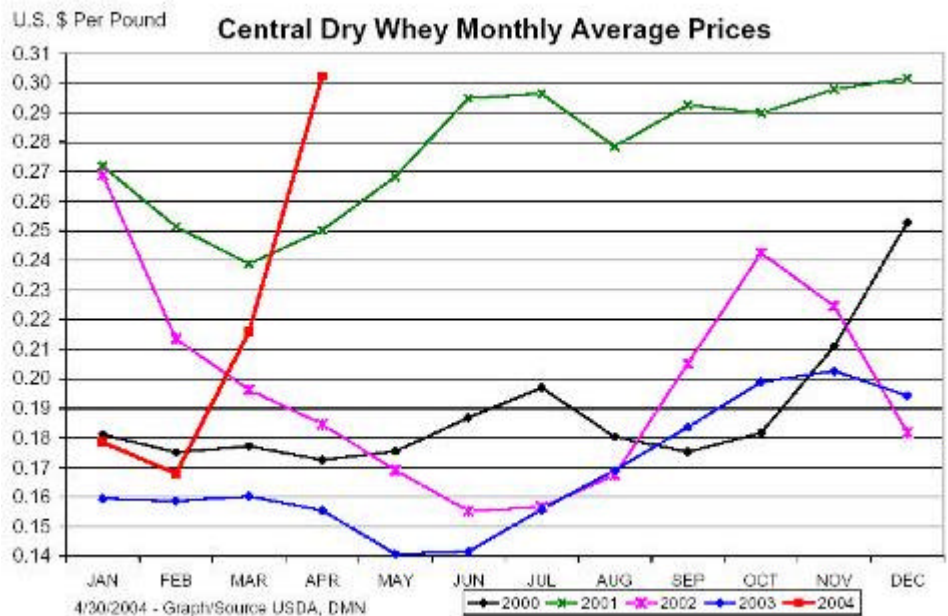
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## On the bright side:

- The first of five weeks in the May Class III calculation is in at \$21.14. Despite the recent decline in cash cheese, NASS prices, which typically lag the cash market, recorded further gains. Cheddar blocks averaged \$2.15/lb, up 4.4¢ from the prior week, while barrels came in at \$2.17/lb, up 2.3¢. NDM increased 0.5¢ to 82.6¢/lb, and dry whey continued to show strength, up 2¢ to 29.8¢/lb, its highest price since before August of 2000 (see chart below).
- Wednesday's USDA Dairy Products report indicated that March butter production was down 22.7% vs. a year ago, and down 7.7% vs. the prior month. NDM production declined 24% vs. a year ago, and dry whey was down 10.7%.
- Water availability could become an issue. Dairy Market News reports conditions in Idaho and Utah are 10-15 degrees warmer than normal, and hay growers are noting stress on their alfalfa.
- A major co-op bought 49 loads of blocks this week, holding the cash cheese price at \$2.15, which will help keep inventories to a minimum.
- CME weekly butter stocks fell 822,000 lbs last week and inventory levels are at two-year lows.
- Butter demand remained strong at current price levels. 23 loads exchanging hands this week and the price rose 3.75¢ to \$2.17.
- Economy: Nearly 300,000 new jobs were added in April, handily beating analyst expectations of only a 165,000 rise. In addition, the previous month's numbers were revised upwards, making a combined March-April job expansion of more than 600,000 jobs the highest two-month total in four years. "...businesses have reversed direction and are now pumping up their payrolls."
- Economy: The increases in employment also lowered the unemployment rate from 5.7 to 5.6%, considered near full employment.

Futures Month	Friday 05/07	Friday 04/30	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
May-04	\$20.34	\$19.79	\$0.55	\$11.27	\$11.94	\$12.59
Jun-04	\$17.22	\$16.28	\$0.94	\$11.65	\$12.48	\$13.30
Jul-04	\$15.70	\$15.25	\$0.45	\$12.46	\$13.38	\$14.28
Aug-04	\$15.80	\$15.20	\$0.60	\$13.16	\$14.17	\$15.17
Sep-04	\$15.45	\$14.99	\$0.46	\$13.61	\$14.59	\$15.56
Oct-04	\$14.65	\$14.25	\$0.40	\$12.98	\$13.82	\$14.65
Nov-04	\$13.10	\$13.00	\$0.10	\$11.92	\$12.97	\$14.00
Dec-04	\$12.20	\$12.07	\$0.13	\$11.92	\$12.97	\$14.01
Jan-05	\$12.05	\$11.95	\$0.10	\$11.89	\$12.71	\$13.52
Feb-05	\$12.00	\$11.90	\$0.10	\$11.34	\$11.90	\$12.45
Mar-05	\$11.95	\$11.85	\$0.10	\$11.66	\$12.34	\$13.01
Apr-05	\$12.06	\$12.05	\$0.01	\$12.08	\$13.31	\$14.52
May-05	\$11.95	\$11.90	\$0.05	\$11.27	\$11.94	\$12.59
Jun-05	\$12.05	\$11.85	\$0.20	\$11.65	\$12.48	\$13.30
Jul-05	\$12.50	\$12.50	\$0.00	\$12.46	\$13.38	\$14.28
Aug-05	\$12.50	\$12.50	\$0.00	\$13.16	\$14.17	\$15.17
Sep-05	\$12.75	\$12.60	\$0.15	\$13.61	\$14.59	\$15.56



however....

- The cash markets have peaked and NASS averages for the remaining four weeks in the May calculation will likely be lower. Blocks dropped 1.75¢ and barrels fell a full 11¢ for the week, leaving an unusual 11.5¢ spread.
- The USDA Dairy Products report referenced above showed that the high cheese price attracted more milk to the vat. March American cheese production was up 2.3% vs. a year ago and up 9.3% from the prior month. Total cheese production was up 6.6% vs. a year ago, and up 10.6% vs. the prior month.
- Dairy cow slaughter for the week ending 04/24/04 was down 22.3% vs. the same period a year ago.
- The high price for Class III milk has some cheese makers reducing schedules, and lower demand is resulting in some surplus spot milk sales at \$1.50 under class.
- Economy: While the ranks of the employed are rising, so are the costs of nearly all commodities, and with it, the likelihood of inflationary pressures.

### Recommendation:

Well, we were right about more cheese showing up on the cash market, but didn't anticipate the efforts of a major co-op to single-handedly hold the block price at \$2.15. As a result, the May contract responded by moving higher for the week. We're not sure how long and at what price blocks will be supported, but one thing we do know; it will attract more product. Cheese makers have no

interest in building inventory at these levels, so every load without a buyer's name on it will most likely end up on the CME. While block selling tapered off as the week went on, it's a good bet that at the current price, more will show up next week, and with it, continued volatility. The June contract moved from a \$15.64 low on Monday morning to a \$17.55 high on Tuesday, then back down to a low of \$16.20 before finishing the week at \$17.22. At the low, we had offers to buy 17.00 CALLS at 30¢ that very nearly filled. Had we bought them, their value Friday at the close would have been 93¢. Use these wild swings to your advantage. The July through December contracts still appear to be undervalued. Enter orders to buy 17.00 CALLs for 35¢ in each of these months. When they are bought, enter orders to sell your milk to your plant or through futures at \$17.35. If successful, this two-step process will give you a \$17.35 floor with unlimited upside potential.

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

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