



The KDM Dairy Report - May 14th, 2004

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On the bright side:

- NASS numbers for the week came in higher than expected. 40 pound blocks averaged \$2.17/lb, up 2.2¢ from last week, and 500 pound barrels averaged \$2.20/lb, up 2.9¢. NDM increased 0.9¢ to average 83.4¢/lb and dry whey managed a small 0.1¢ increase to average 29.6¢/lb. Dry whey has added nearly 80¢ to the Class III price in the past two months.
- Replacement heifers are averaging close to \$2,000 apiece in the Midwest, with top animals out West now going for \$2,400-2,700.
- As the southern hemisphere heads toward winter, grazing-based milk production is rapidly coming to a close. Dairy Market News reports overall supplies are very tight, making it unlikely there will be significant imports.

Futures Month	Friday 05/14	Friday 05/07	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
May-04	\$20.40	\$20.34	\$0.06	\$11.27	\$11.94	\$12.59
Jun-04	\$15.85	\$17.22	(\$1.37)	\$11.65	\$12.48	\$13.30
Jul-04	\$14.52	\$15.70	(\$1.18)	\$12.46	\$13.38	\$14.28
Aug-04	\$14.50	\$15.80	(\$1.30)	\$13.16	\$14.17	\$15.17
Sep-04	\$14.35	\$15.45	(\$1.10)	\$13.61	\$14.59	\$15.56
Oct-04	\$14.30	\$14.65	(\$0.35)	\$12.98	\$13.82	\$14.65
Nov-04	\$13.00	\$13.10	(\$0.10)	\$11.92	\$12.97	\$14.00
Dec-04	\$12.15	\$12.20	(\$0.05)	\$11.92	\$12.97	\$14.01
Jan-05	\$11.95	\$12.05	(\$0.10)	\$11.89	\$12.71	\$13.52
Feb-05	\$12.00	\$12.00	\$0.00	\$11.34	\$11.90	\$12.45
Mar-05	\$11.95	\$11.95	\$0.00	\$11.66	\$12.34	\$13.01
Apr-05	\$12.06	\$12.06	\$0.00	\$12.08	\$13.31	\$14.52
May-05	\$12.00	\$11.95	\$0.05	\$11.27	\$11.94	\$12.59
Jun-05	\$12.05	\$12.05	\$0.00	\$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	\$12.75	\$0.00	\$13.61	\$14.59	\$15.56

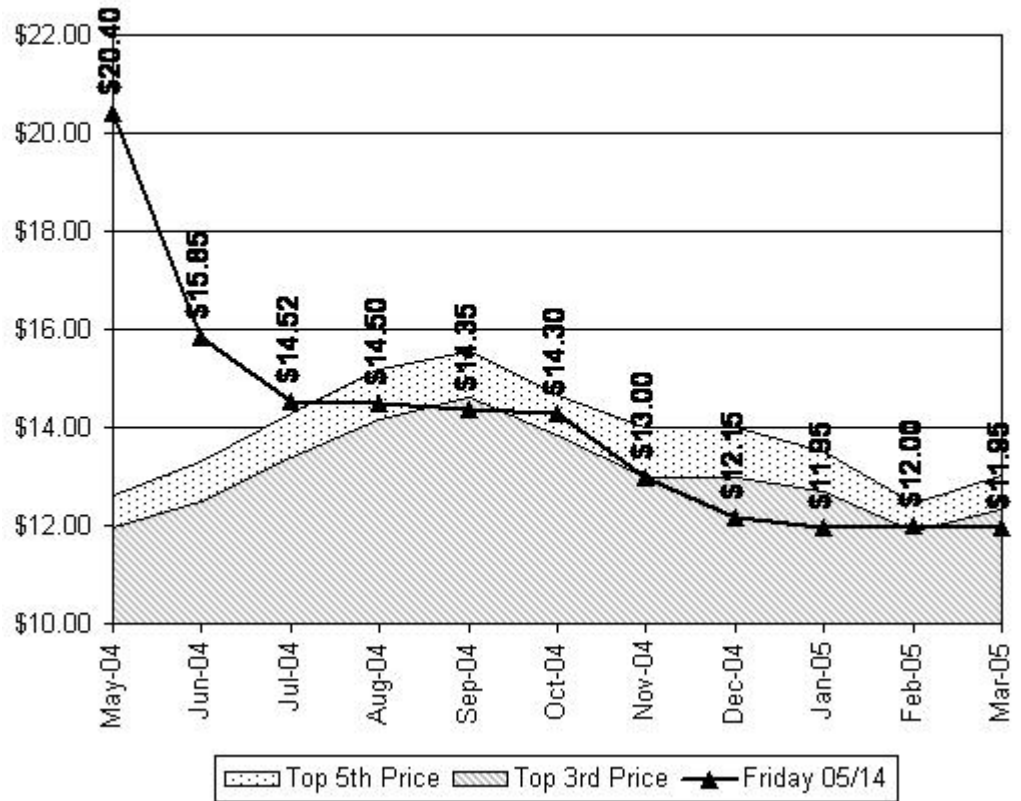
however....

- Cheese and butter took a beating in the cash markets this week. Blocks dropped 15¢ to finish at \$2.00, with 20 loads traded. Barrels fell another dime to \$1.83 with 9 loads traded. Finally, butter fell 5.25¢ to settle at \$2.02 today.
- The NASS butter price continued to decline, losing 9¢ vs. the previous week to average \$2.17/lb.
- We're currently flush with milk in the Midwest. Milk supplies far exceed current demand, according to Fluid Milk and Cream Review, with spot loads of milk being offered at \$2-3 or more under class. Why? With the price of cheese declining, manufacturers little incentive to build any inventories, and the high price has slowed sales.
- A fluid buyer for a large regional convenience store chain, told us this week that sales were down about 10% the first week after the price hike.
- The USDA Crop Production Report, released Wednesday, shows hay stocks are up 17% vs. last year. Stocks are up in 7 of 8 states out West.
- Some colleges and universities are finishing up the school year, with most public schools closing their doors in the weeks to come.
- Dairy Market News reports the butter market is showing signs of weakness. With the stall in cheese production, more milk is now available for butter churning and output is increasing. Demand has also dropped due to retail price increases which have slowed sales.
- CME weekly butter inventories increased by 3.2 million lbs over last week, and stocks have increased 5.2 million lbs over the last four weeks.
- Dairy Market News reports, "The combination of record high milk prices, falling cheese prices, seasonal increases in milk receipts, and sluggish sales, has cheese inventories accumulating at many locations despite prevention efforts."
- Feed costs may go down if the weather remains favorable. Most grains were down sharply this week, a result of excellent early planting progress and timely rains over much of the acreage.

Recommendation:

CME Milk Futures

Working with a short shelf-life commodity like milk is challenging. Small changes in the supply and demand equation can translate into major price adjustments. How quickly we've moved from a milk deficit to a milk surplus! But remember, it can move just as quickly back the other way. The cheese machine has slowed down and milk is backing up. Cheese makers do not want to build inventory at today's prices, and the extra milk on hand is having a hard time finding a home. More milk will go to the churn and the price of butter may go down, as well as the NDM and dry whey components. It's amazing how one cog in the wheel



can have such a multiplying affect! If there's a silver lining to all of this, it's that cheese makers are not building much inventory, but when they decide to start putting it away in the warehouse, we'll begin to head back the other direction. *Key to the whole equation is demand.* Is the consumer willing to stomach (pardon the pun) the higher dairy prices or will sales decline? While we've seen some initial indications that fluid sales have dropped, it's still too early to tell. If demand stays relatively unchanged, watch out, we'll be headed back up. Remember, we still have several important fundamentals that are very supportive of the market (Posilac, Canadian border, protein costs, declining herd, replacement costs, warmer weather).

May is basically done, and next week, attention will turn to June. Near term, things look bearish as it's very likely more cheese will show up on the cash market, and there's only one player supporting the price. This makes traders justifiably nervous. However, if block cheese holds at the \$2.00 level and we have a supportive Production Report on Monday, June futures should start to move back up. However, if significant quantities of cheese show up on the cash market, expect further downward pressure on prices. An opportunity exists now for discounted CALL options. Buy June - September CALLs at 15.00 to 16.00 strike prices for between 35-50¢ premium. If the markets in those months recover and reach those prices, you'll have the freedom to sell your milk to establish a floor, yet remain uncapped on the upside. If you are unsure how this strategy works, please give us a call and we'll be happy to explain it to you.

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

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