



The KDM Dairy Report – September 10th, 2004

Dan Schindler, Mark Potter, and Keith Schnese

877-695-8538

www.kdmtrading.com

On the bright side:

- NASS surveyed prices were up for all Class III components this week. Block cheese averaged \$1.57/lb, up 2¢, barrels also increased 2¢ to \$1.58/lb, butter increased 6.4¢ to \$1.62/lb and NDM was up 0.7¢ to 86.2¢/lb. Dry whey reversed its decline of several weeks, finishing up "slightly" to 21.6¢/lb.
- Dry whey manufacturers are holding additional supplies in inventory, as demand from seasonal candy, bakery and blending operations is anticipated to increase, perhaps explaining the increase in the dry whey NASS number above. Month ending stocks are 13.8% below a year ago.
- Butter movement out of CME-approved warehouses spiked this week, with a net movement out of 9183 loads, 55% above the same period a year ago.
- Cash butter continued to rise on strong demand for fresh product, gaining 3¢ for the week to finish at \$1.75 today.
- Dairy Market News reports that while butter production was up 14.3% in July, it's still down 9.1% over the first seven months of the year. That equates to a deficit of 60 loads per week.
- Class I demand was very good this week, according to Fluid Milk & Cream Review. Most remaining schools opened after Labor Day, and milk supplies are described as "very tight" in the Midwest.
- Florida continued to get pummeled. Hurricane Frances caused widespread electricity outages, and trucks could not get through for milk pickups or deliveries. We heard rumors that up to 50 tankers had to be dumped. And now, hurricane Ivan may hit Florida with yet another blow later this week. While these events are supportive of the milk market, we wish all those, especially the dairy operations, a speedy return to normal.
- Heat in the Southwest this week is causing output to decline, reports Fluid Milk & Cream Review. The humidity is making heat abatement measures less effective. They also write that in the Pacific Northwest, heifers prices are firm, ranging from \$1,900 to \$2,150, but the numbers being sold are lighter than last month and last year.
- Marketing: 3-A-Day campaign to promote dairy will feature NFL quarterbacks Brett Favre and Jake Delhomme, with life-size displays in 31,000 school cafeterias.
- Economy: US jobless claims fell more than expected last week, with 44,000 fewer unemployed, according to Labor Department numbers.

| Futures Month | Friday 09/10 Close | Friday 09/03 Close | Change | Avg Since 1995 | Top 3rd Price | Top 5th Price |
|---------------|--------------------|--------------------|----------|----------------|---------------|---------------|
| Sep-04 | \$14.62 | \$14.50 | \$0.12 | \$13.61 | \$14.59 | \$15.56 |
| Oct-04 | \$13.25 | \$13.40 | (\$0.15) | \$12.98 | \$13.82 | \$14.65 |
| Nov-04 | \$12.40 | \$12.50 | (\$0.10) | \$11.92 | \$12.97 | \$14.00 |
| Dec-04 | \$12.15 | \$12.15 | \$0.00 | \$11.92 | \$12.97 | \$14.01 |
| Jan-05 | \$12.08 | \$11.85 | \$0.23 | \$11.89 | \$12.71 | \$13.52 |
| Feb-05 | \$12.13 | \$11.85 | \$0.28 | \$11.34 | \$11.90 | \$12.45 |
| Mar-05 | \$12.12 | \$11.86 | \$0.26 | \$11.66 | \$12.34 | \$13.01 |
| Apr-05 | \$12.24 | \$12.00 | \$0.24 | \$12.08 | \$13.31 | \$14.52 |
| May-05 | \$12.19 | \$12.00 | \$0.19 | \$12.21 | \$13.60 | \$14.98 |
| Jun-05 | \$12.50 | \$12.25 | \$0.25 | \$12.26 | \$13.38 | \$14.49 |
| Jul-05 | \$12.85 | \$12.65 | \$0.20 | \$12.70 | \$13.62 | \$14.53 |
| Aug-05 | \$13.20 | \$12.90 | \$0.30 | \$13.25 | \$14.21 | \$15.16 |
| Sep-05 | \$13.46 | \$13.20 | \$0.26 | \$13.61 | \$14.59 | \$15.56 |
| Oct-05 | \$12.75 | \$12.65 | \$0.10 | \$12.98 | \$13.82 | \$14.65 |
| Nov-05 | \$12.15 | \$12.15 | \$0.00 | \$11.92 | \$12.97 | \$14.00 |
| Dec-05 | \$12.05 | \$12.15 | (\$0.10) | \$11.92 | \$12.97 | \$14.01 |

however....

- World Ag Supply & Demand Report: Released today, the USDA increased their milk production forecast for both 2003/2004 and 2004/2005. They cite the cool summer and growing cow numbers as contributing factors.
- Dairy cow slaughter for the week ending 08/28 was 46,200 head, 13.3% off the pace set last year during the same period.
- Fresh cheese supplies are not as tight as is usual for this time of year, according to Dairy Market News.
- Feed costs look to head lower. Today's Crop Production Report forecast a record 11 billion bushel corn crop, 8% over 2003, and yields are predicted to be a record 149.4 bushels per acre, 7.2 bushels above last year. And, while the soybean forecast was revised lower, both corn and beans fell in today's trade, with December meal hitting an intraday low of \$163/ton.
- Economy: 2004 and 2005 economic growth forecasts were revised lower, as analysts expect higher energy prices have taken a bite out of consumer spending.

Recommendation:

Commercial buying of 2005 contracts continued into the early part of this week. Today, however, we say light producer selling take about dime out of the market. Most 2005 contracts did finish higher for the week, however.

Cheese was bought and sold at the mid \$1.50's level, and it appears we've found some equilibrium in the cash cheese market with willing buyers and sellers at these levels. We expect to see more cheese coming next week, but hopefully not in large quantities. If blocks and barrels stay above \$1.50 for the next several days, the October contract will need to begin moving higher to meet the cash price, with November and December to get a bump up as well.

So, our recommendation remains largely unchanged from last week. You're probably OK to leave September open at this point, so if you haven't bought any PUT options for that month yet, move to October and November. Enter resting orders to buy the Oct 13.50 PUT for 25¢ and the Nov 13.00 PUT for 35¢. If cash cheese can hold for awhile, you have a good chance to get filled.

Our recommendation for 2005 remains the same as well, with an alternative for first quarter. For affordable "disaster" insurance (avoiding \$9 milk), buy 11.25 PUTs for the year, Jan to Dec, offering to buy them at 25¢ for an effective floor of \$11.00 Class III base price. If we have higher prices, you lose only 25¢ per CWT, while remaining open to unlimited upside. An even lower cost alternative for Q1 would be to buy the 11.00 PUT and sell the 13.50 CALL Jan - Feb for even money. This trade would give you an \$11 floor and \$13.50 cap on your milk for those months, a just the commission cost. For example, the February 11.00 PUT settled today at 22¢, as did the February 13.50 CALL. To execute the trade, you PAY 22¢ to buy the PUT, and receive 22¢ selling the CALL, for a net transaction cost of zero + commission. If February settles below \$11, your PUT option will make up the difference in your milk check. You'll also participate in prices higher than your \$11 floor, all the way up to \$13.50. Above \$13.50, the higher price you receive from your milk check will be offset by the loss in your brokerage account, effectively capping you at \$13.50. In light of historical prices for these months, this is a fairly safe risk. Should prices move higher than \$13.50, however, be aware that you would need to make margin calls on your position.

If you have any questions or want to discuss further any of the above options, please give us a call!

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.

CME Milk Futures

