



# The KDM Dairy Report – September 17<sup>th</sup>, 2004

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## On the bright side:

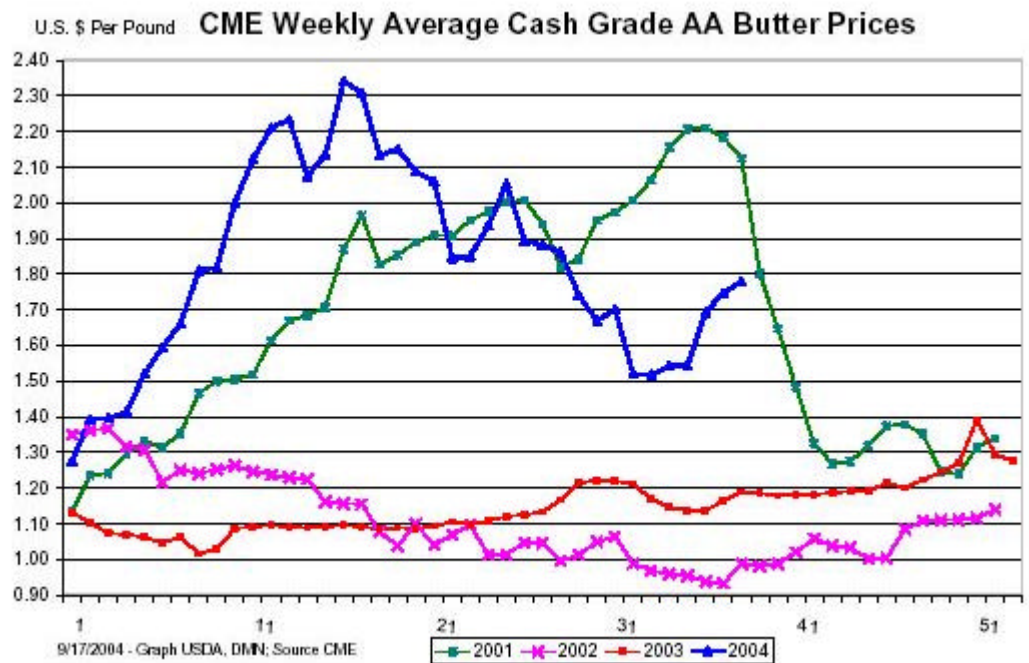
- NASS average prices for cheddar cheese are holding. Blocks and barrels were both priced at \$1.58/lb (blocks up slightly, barrels down slightly from the previous week). Butter gained 9.5¢ to \$1.72/lb, nonfat dry milk was up 0.1¢ to 86.3¢/lb and dry whey was unchanged at 21.6¢/lb. Friday's NASS prices work out to a \$14.82 Class III price.
- Weekly cold storage holdings show that from 9/01 - 9/13, butter stocks in selected storage centers are down 9%, while cheese is down 2%.
- Cash butter climbed 8.25¢ for the week, settling at \$1.8325/lb in today's trade. There were 23 loads traded this week, as demand for fresh butter appears to be on the rise. Cash butter has increased 39¢/lb since hitting a low of \$1.46/lb on August 6th (see chart).
- Strong demand for Class I milk is limiting supplies for manufacturing, according to Fluid Milk & Cream Review. End users are paying \$3-4 over class to obtain additional milk for cheese production.
- Tropical storms caused widespread disruption in dairy operations last week. Fluid Milk & Cream Review reports that with some dairy plants shut down, power outages, flooding, trucking issues and outright loss of farms and

Futures Month	Friday 09/17 Close	Friday 09/10 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Sep-04	\$14.65	\$14.62	\$0.03	\$13.61	\$14.59	\$15.56
Oct-04	\$13.60	\$13.25	\$0.35	\$12.98	\$13.82	\$14.65
Nov-04	\$12.75	\$12.40	\$0.35	\$11.92	\$12.97	\$14.00
Dec-04	\$12.25	\$12.15	\$0.10	\$11.92	\$12.97	\$14.01
Jan-05	\$12.07	\$12.08	(\$0.01)	\$11.89	\$12.71	\$13.52
Feb-05	\$12.03	\$12.13	(\$0.10)	\$11.34	\$11.90	\$12.45
Mar-05	\$12.15	\$12.12	\$0.03	\$11.66	\$12.34	\$13.01
Apr-05	\$12.05	\$12.24	(\$0.19)	\$12.08	\$13.31	\$14.52
May-05	\$12.00	\$12.19	(\$0.19)	\$12.21	\$13.60	\$14.98
Jun-05	\$12.45	\$12.50	(\$0.05)	\$12.26	\$13.38	\$14.49
Jul-05	\$12.81	\$12.85	(\$0.04)	\$12.70	\$13.62	\$14.53
Aug-05	\$13.15	\$13.20	(\$0.05)	\$13.25	\$14.21	\$15.16
Sep-05	\$13.45	\$13.46	(\$0.01)	\$13.61	\$14.59	\$15.56
Oct-05	\$12.85	\$12.75	\$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	\$12.05	\$0.00	\$11.92	\$12.97	\$14.01

animals, it may be quite some time before milk output returns to normal.

As a result, the Southeast imported 364 loads of Grade A milk, vs. only 171 the prior week, and 101 a year ago. Florida alone accounted for 309 loads.

- The participation level in CWT has reached 70%, according to a press release. And, starting October 1st, CWT will begin accepting bids from dairy farmers willing to sell their entire milking herd, as part of the herd retirement program. The program is targeted to remove 870 million pounds of milk by culling 49,000 cows over several months.
- Economy: U.S. inflation rose only 0.1% in August, according to government numbers. Analysts were expecting a slightly higher increase. With inflation appearing to be under control, the Federal Reserve won't feel as much pressure to raise interest rates.



however....

- Milk Production Report: Output was up for the second consecutive month, as the 20 major states increased production by 1.5% vs. August 2003, and production per cow rose 24 pounds. In addition, July production was revised 0.3% higher than originally reported last month, August production was up 1.2% for all 50 states and the number of milk cows increased for the third straight month. California production was up 105 million pounds (3.5%), showing what a cool August can do for them. Gains on a percentage basis were led by Arizona, up 13.6% and Texas, up 11.9%. Texas' number was all the more impressive as cow numbers were unchanged, but milk per cow was up a whopping 145 pounds.
- Weekly dairy cull of 48,800 for the week ending 09/04 is 1,100 head fewer than the same period a year ago (49,900), but was only a 2.2% drop.
- While the milk situation in the upper Midwest and Southeast is tight, production is up in the Southwest and Pacific Northwest. Fluid Milk & Cream Review reports California processors are stating that milk supplies are increasing and definitely above last year's levels (which makes sense, since CA was baking last August). Some are reporting up to a 6% increase in receipts.

### Recommendation:

When considering the weather difference between a hot August 2003 and unseasonably cool August 2004, the market expected an increase, and there were no real surprises in today's milk production report. Holding today's market together, however, is the considerable interest in fresh butter and cheese, and strong fluid demand. Undoubtedly, the weather in Florida (with yet another tropical storm developing) is helping the market as milk from the rest of the country makes its way south. That, and the strength in the butter price, is attracting

more milk, making less available for the vat. Local cheese plants we work with are reporting a significant increase in orders recently, and confirm they're having to pay \$3-4 over class to procure additional milk for their operations. With the cash cheese market drying up the last two days (there were no trades), it may be an indication that things will tighten up even more next week.

Despite the concern over increasing cow numbers and production, it appears as if renewed demand could neutralize today's bearish milk production numbers. Dairy analyst Jerry Dryer, in this week's Dairy & Food Market Analyst, writes that, "Retail cheese sales are beginning to make a comeback", and that, "orders have picked up steam." So, for the balance of 2004, stick with PUT options, but increase the strike price from last week. Target the October 14.00 PUT for 30¢ and the November 13.25 PUT for 35¢. For 2005, we still like cheap disaster insurance in the form of 11.25 PUTs for the year, or the risk reversal (buy the 11.00 PUT, sell the 13.50 CALL) for first quarter at even money.

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CME Milk Futures

