



The KDM Dairy Report – October 15th, 2004

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On the bright side:

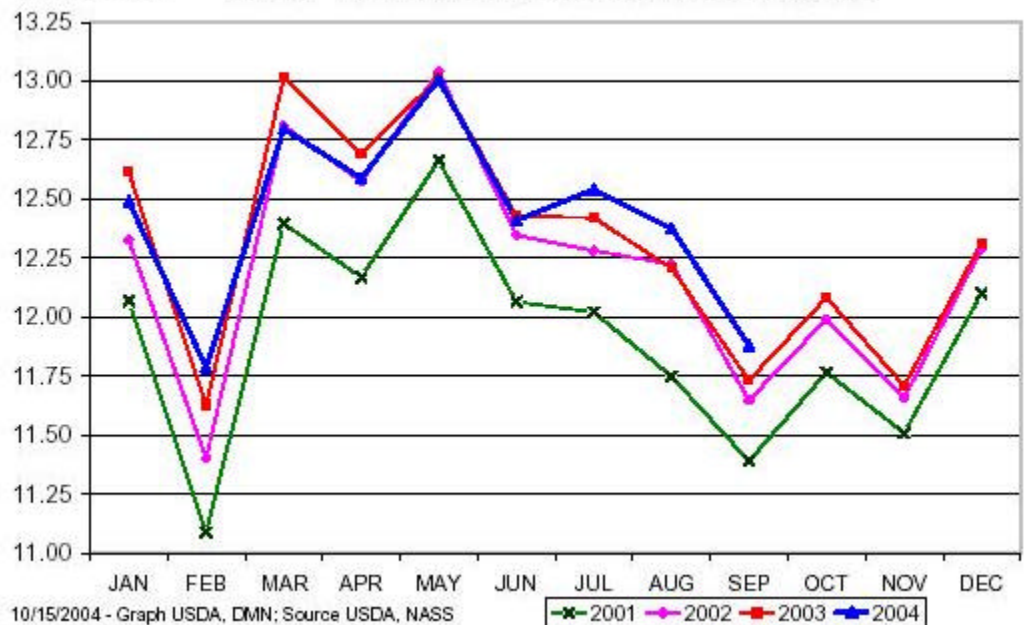
- Cash cheese made a strong comeback this week. Blocks rose 14.75¢ to settle at \$1.52/lb today, while barrels climbed 17.25¢ to finish at \$1.4875. Only two loads of blocks traded hands for the week, and no barrels. Cash butter was also up, tacking on 12.25¢ to settle at \$1.7275/lb.
- Seasonal demand for butter and cheese continues to draw down inventories. Weekly cold storage holdings for the period 10/01 through 10/11 shows a 5% drawdown in butter and 1% decrease in cheese.
- Spot shipments of Grade A milk into Florida remain at unseasonably high levels. 253 loads made their way in to the state this week, vs. only 181 during the same period a year ago, according to Fluid Milk & Cream Review. They also report that surplus milk volumes in the Northeast are lighter than expected.
- The second week in the 5-week October Class III calculation came in at \$14.43, according to NASS averages released today. Blocks moved 0.3¢ higher to \$1.56/lb, but barrels were down 1.5¢ to \$1.52/lb.
- Dairy Market News reports that milk production in New Zealand and Australia is trailing year ago levels. Milk output in Australia is off 0.4%, and cheese production is down 8.7% in the months of July and August. Handlers note that supplies have been heavily committed for the first half of the season, and now question is supplies will be even tighter than last season.
- The drop in international milk and cheese production, combined with a cut in European Union dairy subsidies, has resulted in an increase in the world cheese price, according to Tuesday's Daily Dairy Report. The international cheddar price is now reported at \$1.20-\$1.32/lb.

Futures Month	Friday 10/15 Close	Friday 10/08 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Oct-04	\$14.14	\$13.86	\$0.28	\$12.98	\$13.82	\$14.65
Nov-04	\$13.02	\$12.57	\$0.45	\$11.92	\$12.97	\$14.00
Dec-04	\$12.40	\$12.20	\$0.20	\$11.92	\$12.97	\$14.01
Jan-05	\$12.16	\$12.04	\$0.12	\$11.89	\$12.71	\$13.52
Feb-05	\$12.09	\$11.95	\$0.14	\$11.34	\$11.90	\$12.45
Mar-05	\$12.11	\$12.00	\$0.11	\$11.66	\$12.34	\$13.01
Apr-05	\$12.04	\$12.03	\$0.01	\$12.08	\$13.31	\$14.52
May-05	\$12.09	\$12.00	\$0.09	\$12.21	\$13.60	\$14.98
Jun-05	\$12.18	\$12.28	(\$0.10)	\$12.26	\$13.38	\$14.49
Jul-05	\$12.75	\$12.70	\$0.05	\$12.70	\$13.62	\$14.53
Aug-05	\$13.26	\$13.10	\$0.16	\$13.25	\$14.21	\$15.16
Sep-05	\$13.41	\$13.30	\$0.11	\$13.72	\$14.66	\$15.58
Oct-05	\$12.75	\$12.75	\$0.00	\$12.98	\$13.82	\$14.65
Nov-05	\$12.18	\$12.12	\$0.06	\$11.92	\$12.97	\$14.00
Dec-05	\$12.08	\$12.00	\$0.08	\$11.92	\$12.97	\$14.01

however....

- Milk Production Report: September milk production in the 20 major States was 1.3% higher than a year ago, according to USDA numbers. That's the third consecutive month of increasing production. Output per cow was 1,529 pounds, up 18 pounds. And, the number of milk cows increased by 4,000 head over the prior month. California production was up 4.9% on more cows and milk per cow. Biggest percentage increases were recorded by Arizona, up 10.8%, Florida, up 7.7%, and Texas, up 7.7%.
- Tuesday's USDA Crop

Billion Pounds MILK PRODUCTION - 20 MAJOR STATES



Production Report shocked the market with forecasts far above expectations. Corn production is forecast at an all-time record 11.6 billion bushels, up a whopping 600 million bushels from the previous month forecast. Yields are forecast at record levels for all corn belt states except MN and WI. Soybean production is also expected to be the largest ever on record, forecast at 3.11 billion bushels, up 270 million bushels from last month's forecast.

- Last week we learned that the supply of Monsanto's POSILAC product would be limited well into 2005. However, on Tuesday, Monsanto announced that starting December 1st, current customers would have their allocations increased from 50% to at least 70%.
- Weekly dairy cow slaughter for the week ending 10/02 was 45,500 head, 23.5% below the same period a year ago, when 59,500 head were culled.
- Fluid Milk & Cream Review reports California milk output is growing at levels 4 to 7% above last year. They also write that more cows are being added in the state, and concerns are growing about the state's ability to handle the building milk supply over the year end holidays.

Recommendation:

Seasonal demand for current cheese and butter saw the cash markets come right back this week, yielding healthy gains in the 2004 contracts. However, higher cow numbers, increasing milk production, the possibility of the Canadian border reopening, availability of POSILAC, decreasing feed costs and continued dairy expansion, continue to give us serious concern over the sustainability of 2005 prices. For the last several weeks, we have been recommending getting a start on 2005 marketing, and this week we believe the need to get started is all the more

urgent. On Wednesday, we saw heavy commercial buying, and we were there, selling at 5 to 10 higher on the day. We may not see many more of these opportunities, especially when holiday cheese buying ends in a few weeks. With that said, here is what we have been recommending to our producers over the phone all week.

For 2004, target to sell November at \$13.25 or higher and December at \$12.70 or higher. While CWT does not have unlimited funds, the higher international price for cheese will enable the Export Assistance Program to spend less on compensation to exporters. This should hold the block price reasonably close to \$1.40 into the first quarter of 2005, and milk prices should stay above \$12.00. For that reason, we don't recommend starting your 2005 hedge program with January, but April. Selling February at today's close of \$12.09 does not protect against a real fall in prices, and could in fact end up being much lower than its final settlement. So, for 2005, we recommend selling the April - December contracts, which have a current average of \$12.53.

Today's production report may be seen as somewhat friendly to the market, since output was not as high as expected. Enter orders to sell the April - December months at 5 to 10 higher than our current \$12.53 average. For larger operations, target 25% at this level, then another 25% at 10 to 15 higher. We would like to have our producers 50-75% sold within the next few weeks.

If you would like to discuss this, or other hedge opportunities further, please call us toll free - 877.695.8538

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