



The KDM Dairy Report – October 29th, 2004

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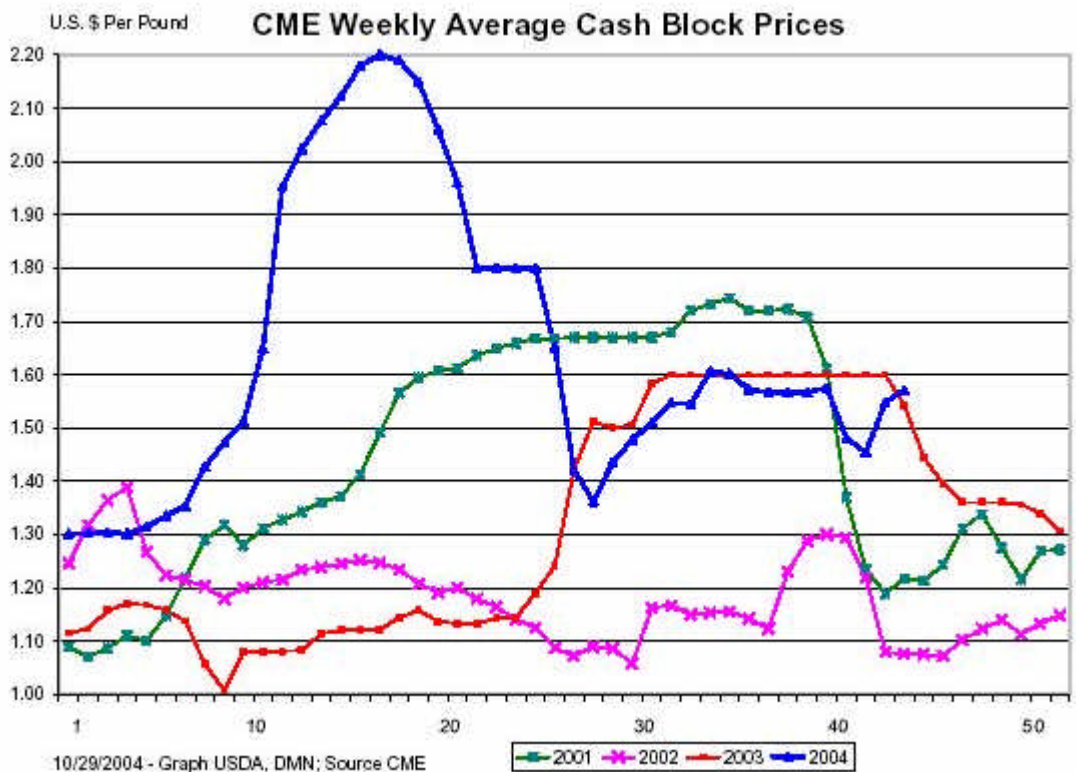
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On the bright side:

- Holiday products are starting to show up on store shelves, according to Fluid Milk & Cream Review. Eggnog can be found in some dairy cases, and handlers expect Class I and II use to strengthen over the next few weeks to fill orders for dips, sour and heavy cream. They also report that spot manufacturing milk demand is higher than available offerings.
- Florida continues to import milk at higher than historical averages. 183 loads entered the state this week, vs. 155 during the same period a year ago. In addition, Fluid Milk & Cream Review reports that milk supplies in the Southeast are tight and cheese output is lighter than expected.
- The Chino, CA area has recorded the most rainfall since 1879 which is starting to affect milk production, and hospital pens are growing. The rainy season usually begins in January, so if the wet weather continues, it could make for a long winter in CA.
- Only two loads of block cheese traded in the cash market this week, and no barrels. Blocks hit a high of \$1.57¼ on Tuesday, and finished the week at \$1.57, up a ½ cent from a week ago. Barrels climbed ¾ cent for the week, settling at \$1.54.
- The cheese market remains steady to firm for the short term, according to Dairy Market News. Orders for natural chunks, slices and shreds are generally good. Aged cheddar interest has picked up, but supplies are limited.
- For the week ending 10/23, butter stocks in CME approved warehouses were down more than 56% compared to the same period a year ago. 49.6 million lbs are currently on hand, vs. 113.9 million lbs in 2003.
- With less than half the inventory we had a year ago and end-of-year holiday orders incomplete, some butter handlers feel the recent 18¼ cent decline in the cash butter market is somewhat premature, according to Dairy Market News.
- Milk production is near seasonal peak levels in New Zealand and Australia, but is still trailing last year's output, according to Dairy Market News. Handlers report there is no additional milk available for processing facilities, and feel international prices will remain firm.

Futures Month	Friday 10/29 Close	Friday 10/22 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Oct-04	\$14.19	\$14.19	\$0.00	\$12.98	\$13.82	\$14.65
Nov-04	\$14.10	\$14.05	\$0.05	\$11.92	\$12.97	\$14.00
Dec-04	\$13.05	\$13.15	(\$0.10)	\$11.92	\$12.97	\$14.01
Jan-05	\$12.45	\$12.40	\$0.05	\$11.89	\$12.71	\$13.52
Feb-05	\$12.26	\$12.22	\$0.04	\$11.34	\$11.90	\$12.45
Mar-05	\$12.36	\$12.26	\$0.10	\$11.66	\$12.34	\$13.01
Apr-05	\$11.96	\$12.00	(\$0.04)	\$12.08	\$13.31	\$14.52
May-05	\$12.00	\$12.03	(\$0.03)	\$12.21	\$13.60	\$14.98
Jun-05	\$12.30	\$12.22	\$0.08	\$12.26	\$13.38	\$14.49
Jul-05	\$12.66	\$12.75	(\$0.09)	\$12.70	\$13.62	\$14.53
Aug-05	\$13.25	\$13.30	(\$0.05)	\$13.25	\$14.21	\$15.16
Sep-05	\$13.45	\$13.46	(\$0.01)	\$13.72	\$14.66	\$15.58
Oct-05	\$12.75	\$12.75	\$0.00	\$12.98	\$13.82	\$14.65
Nov-05	\$12.12	\$12.14	(\$0.02)	\$11.92	\$12.97	\$14.00
Dec-05	\$12.02	\$12.03	(\$0.01)	\$11.92	\$12.97	\$14.01
Jan-06	\$11.95	\$11.95	\$0.00	\$11.89	\$12.71	\$13.52



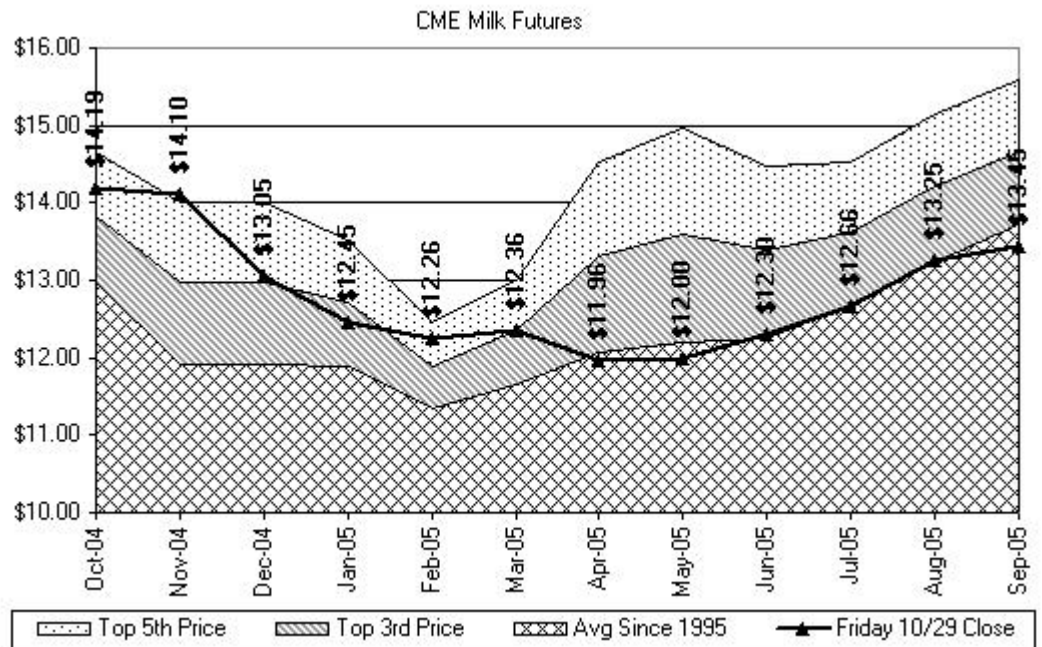
- Dairy Market News also reports that milk production in Western Europe continues to trail the prior year. Stocks of manufactured dairy products are in close balance, to lighter than desired levels, and handlers feel the international supply situation could remain tighter than usual.
- Livestock, Dairy & Poultry Outlook Report: Commercial disappearance of American cheese increased 9.9% in August, according to USDA numbers released Tuesday. Higher demand reversed declines in the three prior months. Butter use increased an even more impressive 24.6%.

however....

- Dairy cow slaughter for the week ending 10/16 was 26.5% below the same period a year ago. 45,000 head were culled, vs. 61,200 last year.
- NASS prices continued to trend lower, with 40 pound blocks losing 3.9¢ from the prior week to average \$1.50/lb. Barrels were also lower, falling 2.6¢ to average \$1.45/lb. Butter came in at \$1.66/lb, falling 2.8¢, nonfat dry milk was 84.5¢/lb, decreasing 1.9¢ and dry whey finished at 22.7¢/lb, down 0.1¢.
- Cash butter continued to feel the weight of heavy offers. 48 loads exchanged hands this week, with the price falling 5¼¢ to \$1.54½/lb.
- Continued anti-seasonal price for cash blocks is moving against historical norms (see chart). How long will it last?

Recommendation:

On Wednesday, December Class III futures peaked at a contract high of \$13.45 before cash cheese traded. However, the prominent cooperative that was vying for product, stopped bidding, and the market quickly sold off. An additional block sale on Thursday brought the price down a ¼ cent to \$1.57, causing another sell off and a December close of \$12.91. However, with no activity today and cheese prices holding, the market appears to be in balance, and nearby months moved higher in response, with December correcting to \$13.05 milk, but the futures market does not believe it will hold, and if history is correct, it will be right (see cheese chart again). In 1998, we saw cheese prices stay strong until the middle of January, until the USDA found a few hidden caves of product and prices dropped from \$1.90/lb to \$1.30/lb in a matter of a week, while Class III futures fell \$4/cwt.



With that in mind, continue to take advantage of the current market, which may last another week or two, and bid to buy the December 13.00 PUT at 20¢. At this point, we would leave November open. For 2005, our strategy remains unchanged. A tight international market and current strong demand should yield above average prices into first quarter. Focus on April and beyond, targeting prices at 5-15¢ higher than the current close. Why the focus on April? Because as one client put it, "A wall of milk is forming in the West and is gurgling its way East". It should arrive in April.

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

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