



# The KDM Dairy Report –November 5<sup>th</sup>, 2004

Dan Schindler, Mark Potter, and Keith Schnese

877-695-8538

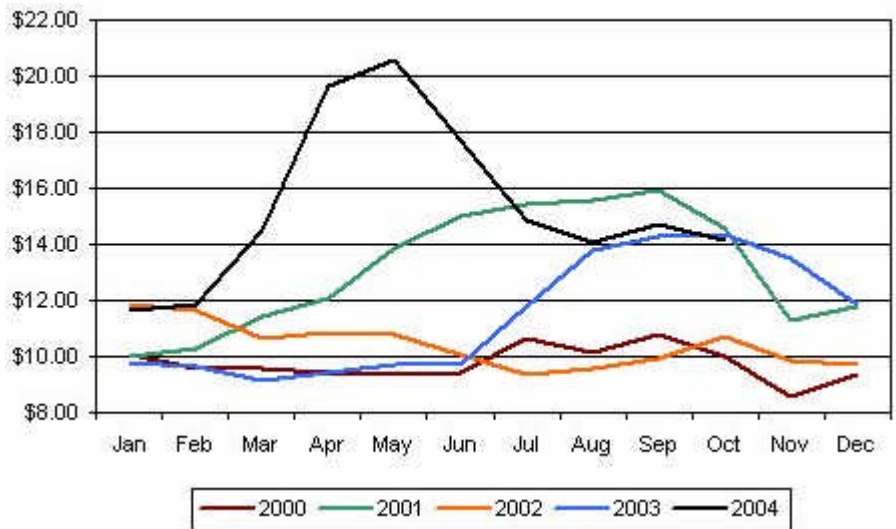
www.kdmtrading.com

## On the bright side:

- October came off the books at \$14.16, well over a top-third price and the 8th consecutive month over \$14, with November now shaping up to be the 9th (see chart below).
- Dairy Products Report: September cheddar cheese output was 1.1% below a year ago, and 1% below August production, according to numbers released by the USDA today.
- Weekly cold storage holdings are showing a 25% drawdown in butter stocks and a 2% drop in cheese stocks for the period 10/01 to 11/01.
- Fluid Milk & Cream Review reports that manufacturing milk demand is strong and supply remains tight in the Midwest.
- The same appears to be true in the Southeast. Florida imported 220 loads of Grade A milk this week, vs. only 128 during the same period a year ago, according to Fluid Milk & Cream Review. They also write that milk supplies are short of full needs for holiday item production, and demand for cream is aggressive.

Futures Month	Friday 11/05 Close	Friday 10/29 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Nov-04	\$14.40	\$14.10	\$0.30	\$11.92	\$12.97	\$14.00
Dec-04	\$13.60	\$13.05	\$0.55	\$11.92	\$12.97	\$14.01
Jan-05	\$12.70	\$12.45	\$0.25	\$11.89	\$12.71	\$13.52
Feb-05	\$12.31	\$12.26	\$0.05	\$11.34	\$11.90	\$12.45
Mar-05	\$12.35	\$12.36	(\$0.01)	\$11.66	\$12.34	\$13.01
Apr-05	\$12.12	\$11.96	\$0.16	\$12.08	\$13.31	\$14.52
May-05	\$12.10	\$12.00	\$0.10	\$12.21	\$13.60	\$14.98
Jun-05	\$12.37	\$12.30	\$0.07	\$12.26	\$13.38	\$14.49
Jul-05	\$12.67	\$12.66	\$0.01	\$12.70	\$13.62	\$14.53
Aug-05	\$13.25	\$13.25	\$0.00	\$13.25	\$14.21	\$15.16
Sep-05	\$13.45	\$13.45	\$0.00	\$13.72	\$14.66	\$15.58
Oct-05	\$12.75	\$12.75	\$0.00	\$13.10	\$13.91	\$14.71
Nov-05	\$12.12	\$12.12	\$0.00	\$11.92	\$12.97	\$14.00
Dec-05	\$12.03	\$12.02	\$0.01	\$11.92	\$12.97	\$14.01

Class III Historical Prices



- Dairy Market News reports that increased buyer interest in butter was stimulated by recent price weakness, with butter producers unable to fill all orders. They also write that post-Thanksgiving orders are developing quite well.
- Current American cheese supplies are tight to short, according to Dairy Market News, with orders for some holiday items well above forecast. In addition, getting supplemental supplies from the West has been difficult due to a trucker shortage and higher fuel costs.
- Cash blocks and barrel prices were unchanged for the week at \$1.57/lb and \$1.54/lb respectively. Mirroring reports of tight supplies, only one load of blocks traded the entire week.
- Cash butter, however, rebounded nicely, up 13½¢ for the week, with most of that coming in today's trade when the price jumped 10¾¢ to finish at \$1.68/lb. Reflecting strong demand for physical product, a whopping 101 loads exchanged hands during the week.
- Economy: The U.S. Labor Department reported 337,000 new jobs were added in October; the fastest hiring rate in seven months. Street analysts had expected a gain of only 175,000.

## however....

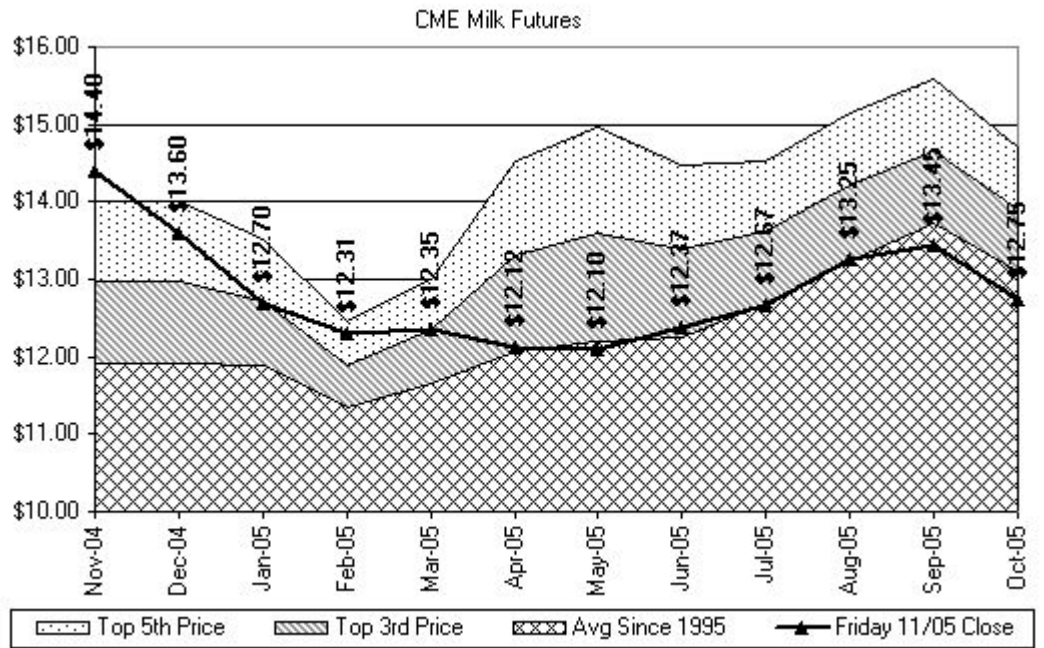
- Dairy Products Report: While there was a drop in cheddar cheese production, September butter output was up 25.8% vs. a year ago, and 4% higher than the prior month. However, this may be more a manufacturing reaction to

low inventories and strong demand.

- Dairy cow slaughter for the week ending 10/23/04 was 48,300 head vs. 64,400 for the same period a year ago. The 25% drop continues the trend of lighter culling in response to tight heifer replacement availability.
- Despite the heavy rains last week in CA, Fluid Milk & Cream Review reports that production leveled off, but did not go down. Milk production is still above year ago levels on higher cow numbers and output per cow. Production in Arizona and New Mexico is also trending higher.

**Recommendation:**

While output was up for most other types of cheese, it's only the cheddar variety that trades at the CME, and for that, the drop in production reported by the Dairy Products Report was friendly to Class III futures. Dairy products remain in a tight situation prior to Thanksgiving. Cheese especially, and now butter is making for a strong market. December Class III reached \$13.60 today, which is equivalent of about \$1.50 cheese. It's hard to imagine the month of December averaging \$1.50 cheese, but we do believe that the current supply/demand factors in play will yield some additional upside in the December contract.



13.50 December put options closed at 25¢ today, with 13.75 puts at 38¢. To protect December, enter the following resting order, good for the next two weeks. Buy the December 13.75 put for 25¢, which would give you an effective floor of 13.50. That is an exceptional price for December, and well above the top third historical price of \$12.97. At this point, there is not much need to protect November, but at \$14.50 or higher, we would be a seller.

For January through March, stay open or bid to buy 12.25 puts at 25. For April through June, bid for 12.00 puts at 25¢, or sell futures (or plant contract) at current or 5-10¢ higher prices. With an expected drop in the cheese price sometime in December of the first part of the year, defend your sales by purchasing call options at their newly discounted prices.

In any event, get some coverage in the April, May and June 2005 flush period.

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

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.