



The KDM Dairy Report –November 19th, 2004

Dan Schindler, Mark Potter, and Keith Schnese

877-695-8538

www.kdmtrading.com

On the bright side:

- Milk Production Report: October milk production was up 1.3% from a year ago in the 20 major states and up 1.2% for all 50 states. While that may seem bearish, it was on the low side of expectations, and 11 of the 20 states recorded declines. In addition, the number of milk cows on farms was unchanged from the prior month, breaking a six-month streak of increases.
- Cold Storage Report: October butter stocks fell by 65.4 million lbs vs. the prior year, a 38% drop, according to USDA numbers released today. Butter holdings also fell 21% below the prior month, as supplies continue to be drawn out at a horrific rate. American cheese holdings were 5% below September levels, but up 7% vs. a year ago. Total cheese stocks recorded a 5% drop month-to-month, but were 4% higher than a year ago.
- Weekly cold storage numbers for this week are showing a big 32% drop in butter holdings for the period 11/01 - 11/15. Total cheese stocks also fell, by 2%. Butter stocks in CME-approved warehouses also took a dive and are currently 66.4% below year ago levels. Stocks for this week in November have not been this low since 2000.
- Churning activity is limited in much of the country, according to Dairy Market News. Cream supplies are tight and little excess is available to butter makers, meaning fresh butter is particularly tight.
- NASS prices reversed direction and started to head higher. Average prices received for blocks was \$1.55/lb, up 3¢ for the week, and barrels increased 1½¢ to \$1.54/lb.
- Fluid Milk & Cream Review reports that in the Midwest, the tight milk supply could continue through mid-December, and excess milk will easily find a home during Thanksgiving week.
- Due to the tight milk supply, many butter/powder plants in the East are operating on greatly reduced schedules, according to Fluid Milk & Cream Review. They also write that the fluid cream market is very firm, and to some buyers, price is not an issue when keeping production lines running.
- The CME cash markets came to life this week as spot blocks climbed 9½¢ above last Friday, settling at \$1.79½ today. Buyers came up empty with no trades for the week. Barrels gained 8¼¢ to settle at \$1.75 today, despite a one day 10¢ drop on Tuesday. 11 loads exchanged hands during the week. Spot butter climbed 8¼¢ to settle at \$2.10¼ today, with 16 loads trading during the week.
- On Wednesday, CWT announced that it had accepted 378 bids to retire 51,700 cows, representing 0.55% of the nation's milk supply. The retirements will remove 931 million pounds of milk, exceeding their goal by 7%.
- US dairy exports are hot. January through September 2004 exports totaled \$1.024 billion, up 37.7% vs. 2003, according to USDA numbers. The nine month sum exceeds the entire year totals of 4 of the last 5 years.
- If 2nd case of mad cow is confirmed, it could keep borders locked up tight.

| Futures Month | Friday 11/19 Close | Friday 11/12 Close | Change | Avg Since 1995 | Top 3rd Price | Top 5th Price |
|---------------|--------------------|--------------------|----------|----------------|---------------|---------------|
| Nov-04 | \$14.92 | \$14.75 | \$0.17 | \$11.92 | \$12.97 | \$14.00 |
| Dec-04 | \$15.95 | \$14.75 | \$1.20 | \$11.92 | \$12.97 | \$14.01 |
| Jan-05 | \$14.40 | \$13.57 | \$0.83 | \$11.89 | \$12.71 | \$13.52 |
| Feb-05 | \$13.15 | \$12.71 | \$0.44 | \$11.34 | \$11.90 | \$12.45 |
| Mar-05 | \$12.66 | \$12.61 | \$0.05 | \$11.66 | \$12.34 | \$13.01 |
| Apr-05 | \$12.50 | \$12.25 | \$0.25 | \$12.08 | \$13.31 | \$14.52 |
| May-05 | \$12.36 | \$12.20 | \$0.16 | \$12.21 | \$13.60 | \$14.98 |
| Jun-05 | \$12.45 | \$12.35 | \$0.10 | \$12.26 | \$13.38 | \$14.49 |
| Jul-05 | \$12.80 | \$12.70 | \$0.10 | \$12.70 | \$13.62 | \$14.53 |
| Aug-05 | \$13.35 | \$13.30 | \$0.05 | \$13.25 | \$14.21 | \$15.16 |
| Sep-05 | \$13.55 | \$13.54 | \$0.01 | \$13.72 | \$14.66 | \$15.58 |
| Oct-05 | \$12.89 | \$12.90 | (\$0.01) | \$13.10 | \$13.91 | \$14.71 |
| Nov-05 | \$12.23 | \$12.18 | \$0.05 | \$11.92 | \$12.97 | \$14.00 |
| Dec-05 | \$12.13 | \$12.10 | \$0.03 | \$11.92 | \$12.97 | \$14.01 |
| Jan-06 | \$12.00 | \$12.00 | \$0.00 | \$11.89 | \$12.71 | \$13.52 |

however....

- Livestock Slaughter Report: October dairy cow slaughter was 197,100 head, nearly unchanged from the prior month, but 78,800 head fewer than a year ago. However, part of the difference was due to last year's CWT herd retirement program kicking off in October of 2003. For the first three quarters of 2004, dairy cow slaughter was 1,948,200 head vs. 2,381,800 during the same period in 2003, meaning the YTD cull is down 18.2%.
- With prices up in the stratosphere again, dairyman continue to hang on to their aging herd. Weekly dairy cow slaughter for the week ending 11/06 was 47,300 vs. 59,300 during the same period a year ago, a 20% decline.
- Economy: The U.S. government was forced to raise its debt ceiling by \$800 billion dollars or risk running out of

operating funds.

- Too much bullish news!

Recommendation:

Demand is winning the battle with supply, and price rationing is occurring as the cash cheese price rockets higher. Perhaps Dairy Market News captures the current situation best in this week's cheese highlights, which is quoted below:

"The cheese market is firm. At the CME prices continue to advance, despite the one-day decline in barrels. Current cheese supplies are tight and production levels do not seem to

be increasing fast enough to cover needs. Surplus milk volumes are tight across much of the country and there have been reports of plants having to curtail processing due to the lack of milk. Many buyers continue to have difficulty in securing spot loads of current varieties. Also, finding trucks and truckers continues to be an issue. Aged cheddar supplies are tight, depending on age, and interest is improving along seasonal patterns."

It appears that another reason prices have strengthened this late into the season is due to late ordering of product. Dairy Market News also writes:

"Some contacts believe that buyers have not been as covered for their fall needs as they usually are because of this year's pricing pattern. The spring record prices followed by prices near \$1.60 for much of the late summer had buyers delaying purchasing decisions and some are now having to make purchases to cover sales without regard to current price patterns."

Indeed, plants we work with generally state orders are unusually strong for this time of year, while milk intakes are off. With the exception of last week, we've been recommending since September that producers stay open first quarter, or use risk reversals to allow some upside to hedging in those months. So far, that looks to have paid off. Current cash prices come out to about \$16.90 Class III. If the market stays firm for the next few weeks as many think it will, December and the front months will be forced to rise to meet it. But at these levels, volatility has returned. Expect more limit moves on any sign of weakness or strength while we trade in the heights of thin air. What to do. Buy PUT options!! Target the December 1500 PUT for 10¢, the January 1350 PUT for 20¢ and the February 1250 PUT for 25¢.

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

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