



## The KDM Dairy Report –December 3<sup>rd</sup>, 2004

Dan Schindler, Mark Potter, and Keith Schnese

877-695-8538

www.kdmtrading.com

### On the bright side:

- November Class III settlement at \$14.89/cwt is the highest since 1998, when it closed out at \$16.84.
- Cash cheese continued its meteoric rise. Blocks jumped up another 12¾¢ vs. a week ago, to finish at \$1.95¼/lb. Buyers were able to secure 11 loads. Barrels followed blocks, moving 5¾¢ higher to settle at \$1.83¾/lb today, with 10 loads trading on the week.
- NASS numbers came in higher for all Class III components. Blocks increased 7.7¢ to average \$1.65/lb, barrels were up 6.5¢ to \$1.66/lb, butter moved 4.6¢ higher to \$2.02/lb, NDF was up 0.3¢ to 86.1¢/lb and dry whey was up slightly to 24¢/lb.
- Weekly cold storage holdings are showing sustained drawdown on both butter and cheese stocks. For the period 11/01-11/29, butter stocks are reported down 45% and cheese down 3%. It will be interesting to see if the monthly Cold Storage Report due in mid-December will reflect similar numbers.
- We could run out of butter! Stocks at CME-approved warehouses are down to 14.3 million lbs and we had a net out movement of 5.2 million lbs last week. If the current rate of drawdown continues, in a few weeks it will be gone. Current levels are down 80% vs. a year ago, when we had 71.6 million lbs on hand.
- Fluid Milk & Cream Review reported that from East to West coast, manufacturing milk easily found a home over the long holiday weekend.
- As the cheese price rises, less milk is available for the churn. According to Fluid Milk & Cream Review, butter makers in the Midwest were actively out looking for additional loads.
- Forage quality is affecting more than dairies in the Midwest, who had a poor growing season. In the Pacific Northwest, some producers are reporting that milk production is not at expected levels due to the forage issue, and output per cow is expected to be impacted all winter.
- Fresh butter supplies remain very tight, according to Dairy Market News, and it's getting a little late for most printers to bring frozen bulk out of storage, temper it, and package it in time for the year-end holiday needs.
- A fire destroyed 3 million lbs of butter at an AMPI packaging plant in New Ulm, MN on Wednesday. According to yesterday's Daily Dairy Report, it was the largest butter packaging plant in the nation, and the loss accounted for 4% of the nation's butter in storage.

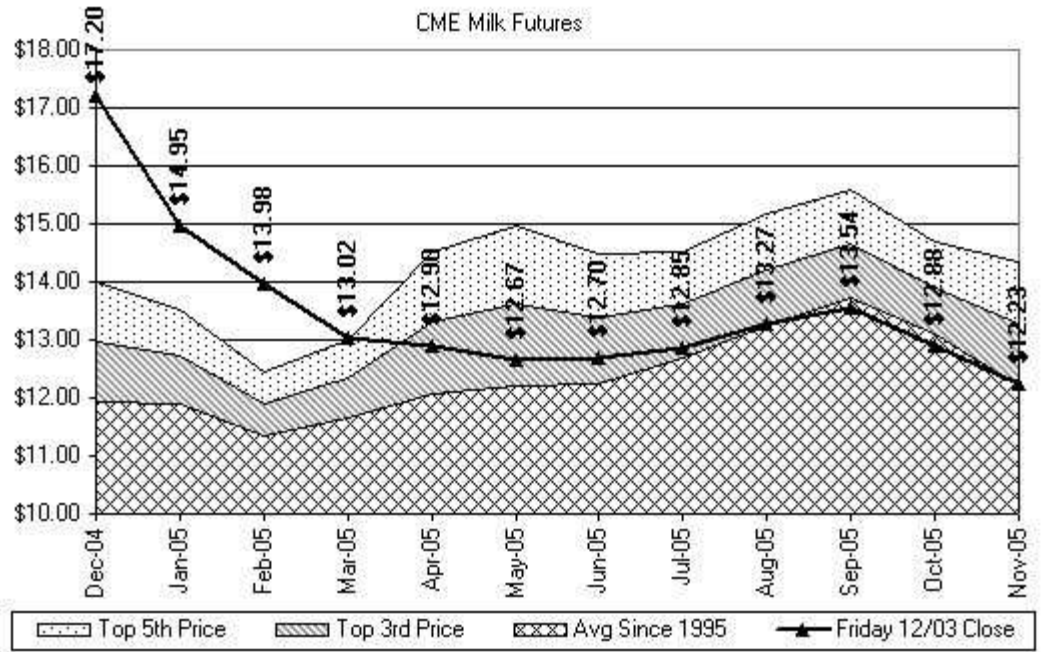
Futures Month	Friday 12/03 Close	Wed. 11/24 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Dec-04	\$17.20	\$16.67	\$0.53	\$11.92	\$12.97	\$14.01
Jan-05	\$14.95	\$14.66	\$0.29	\$11.89	\$12.71	\$13.52
Feb-05	\$13.98	\$13.35	\$0.63	\$11.34	\$11.90	\$12.45
Mar-05	\$13.02	\$12.89	\$0.13	\$11.66	\$12.34	\$13.01
Apr-05	\$12.90	\$12.60	\$0.30	\$12.08	\$13.31	\$14.52
May-05	\$12.67	\$12.46	\$0.21	\$12.21	\$13.60	\$14.98
Jun-05	\$12.70	\$12.49	\$0.21	\$12.26	\$13.38	\$14.49
Jul-05	\$12.85	\$12.76	\$0.09	\$12.70	\$13.62	\$14.53
Aug-05	\$13.27	\$13.28	(\$0.01)	\$13.25	\$14.21	\$15.16
Sep-05	\$13.54	\$13.53	\$0.01	\$13.72	\$14.66	\$15.58
Oct-05	\$12.88	\$12.85	\$0.03	\$13.10	\$13.91	\$14.71
Nov-05	\$12.23	\$12.20	\$0.03	\$12.22	\$13.29	\$14.34
Dec-05	\$12.15	\$12.11	\$0.04	\$11.92	\$12.97	\$14.01
Jan-06	\$12.08	\$12.06	\$0.02	\$11.89	\$12.71	\$13.52

### however....

- Dairy Products Report: Cheddar cheese output in October increased 0.8%% vs. the prior year and 4.1% vs. Sept, according to USDA numbers released today. Butter production increased 6.4% vs. last year and 11.8% vs. the prior month. However, these increases in production may be more related to increased demand. So far, we're seeing very little of it destined for the warehouse.
- While NASS prices were all up, they haven't risen as quickly as the cash market, despite the lag.
- Only 45,900 dairy cows were culled the week ending 11/20, vs. 62,000 during the same period a year ago, according to the Weekly Slaughter Report.
- Economy: November job growth was unexpectedly weak, according to figures from the Labor Department. 112,000 new jobs were created during the month, but that was well off the forecast of 180,000.
- Economy: Holiday retail sales appear to be off to a slow start. November sales increased only 1.7% vs. a year ago. The prior year, sales were up 3.7%.

**Recommendation:**

Stocks of dairy products in storage may hold a big key into where prices go in 2005. Stock acts as a buffer during volatile markets; drawn down when demand increases, and replenished when demand weakens. As we mentioned above, butter stocks are way down, and cheese is getting back to manageable levels. The lack of current cheese allows bidders to keep moving the cash price higher, with some saying \$2 is now in sight. With little to no cheese available to sell on the cash market, one begins to wonder what a "rational" price is.



The run-up, however, offers great opportunities to hedge. Our recommendation remains unchanged for Q1. Buy PUT options, Jan-Mar for 25¢ at the best strike price available. For April - Oct, buy 15.00 CALL options for 10¢, then be prepared to sell in to them if prices increase. This will also protect those hedgers who have already sold their milk in these months. The aging herd and recent bad weather in the Southwest is suggesting that the Spring flush may not be as large as expected.

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

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