



The KDM Dairy Report –December 10th, 2004

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On the bright side:

- NASS prices continued to trend higher on recent cash market strength. US 40 lb blocks were up 7.4¢ to average \$1.73/lb and 500 lb barrels moved 6.8¢ higher to \$1.72/lb. Butter increased 0.1¢ to \$2.02/lb, nonfat dry milk was up 0.8¢ to 86.9¢/lb and dry whey was up 0.1¢ to 24.1¢/lb.
- For the first week in December, butter stocks dropped 20%, according to the weekly cold storage report. However, cheese stocks were unchanged.
- Fluid Milk & Cream Review reports that demand for Class I milk is strong, and expected to last until the week of December 20th, when schools start to close for the holidays.
- Milk production is declining. In Southern California, output is down, surprising handlers, according to Fluid Milk & Cream Review. Production is also lower across New Mexico, as wet conditions continue to impact the herd, and rain has also tempered output in Arizona. Conditions are extremely wet in the Pacific Northwest. Some low land flooding has been reported, cow lots are in poor shape and herd health issues are increasing. Finally, Utah and Idaho have been wet and cold, and a warming trend has turned frozen cow lots into mud. Mastitis cases have increased.
- Despite the dramatic drop in cash prices, Dairy Market News reports that cheese buyers will return to the market when a bottom is nearing, and that buying interest will be strong in January.
- Milk production in Australia and New Zealand continues to drag below year ago levels, according to Dairy Market News. 104 degree temps have been recorded in Australia, which is drying pastures and limiting growth. Output in Western Europe is also trailing last year. Little stock is available for export, with most sales activity bound to the domestic market.
- The weak dollar and limited international supply is making a good export market for dry whey. Dairy Market News reports that an export tender for the Far East will be filled with U.S. powder, and prices in Europe are firm due to limited availability. U.S. stocks of edible powder are down 22.1% from last year. Each 1¢ increase in dry whey amounts to a 6¢ increase in Class III milk.

Futures Month	Friday 12/10 Close	Friday 12/03 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Dec-04	\$16.55	\$17.20	(\$0.65)	\$11.92	\$12.97	\$14.01
Jan-05	\$13.58	\$14.95	(\$1.37)	\$11.89	\$12.71	\$13.52
Feb-05	\$12.95	\$13.98	(\$1.03)	\$11.34	\$11.90	\$12.45
Mar-05	\$12.68	\$13.02	(\$0.34)	\$11.66	\$12.34	\$13.01
Apr-05	\$12.77	\$12.90	(\$0.13)	\$12.08	\$13.31	\$14.52
May-05	\$12.68	\$12.67	\$0.01	\$12.21	\$13.60	\$14.98
Jun-05	\$12.92	\$12.70	\$0.22	\$12.26	\$13.38	\$14.49
Jul-05	\$12.93	\$12.85	\$0.08	\$12.70	\$13.62	\$14.53
Aug-05	\$13.36	\$13.27	\$0.09	\$13.25	\$14.21	\$15.16
Sep-05	\$13.65	\$13.54	\$0.11	\$13.72	\$14.66	\$15.58
Oct-05	\$12.92	\$12.88	\$0.04	\$13.10	\$13.91	\$14.71
Nov-05	\$12.30	\$12.23	\$0.07	\$12.22	\$13.29	\$14.34
Dec-05	\$12.22	\$12.15	\$0.07	\$11.92	\$12.97	\$14.01
Jan-06	\$12.09	\$12.08	\$0.01	\$11.89	\$12.71	\$13.52

however....

- The cash markets went into freefall as buyers stepped aside. Butter fell a record 45¼¢ to finish at \$1.60/lb today. Blocks dropped 25¼¢ to \$1.70/lb and barrels finished the week down 24¼¢ to \$1.59½/lb. Ouch! For the week, 18 loads of blocks traded, 8 loads of barrels and 13 loads of butter.
- Most holiday, cream-based dairy products have been shipped, according to Dairy Market News. As a result, demand is weakening, and buyers are holding off due to the price declines in the cash market.
- Weekly dairy cow slaughter for the week ending 11/27 was 34,700 head, 10,600 fewer than a year ago; a 23.4% drop.
- Fluid Milk & Cream Review reports that interest in manufacturing milk has lessened, due to higher Class III prices and sharply lower cheese prices.
- Monsanto announced this week that as of January 1st, rBST shipments will increase from a 70% allocation to 85%.

Recommendation:

It appears that buyers got tired of bidding close to \$2/lb and not getting any cheese, so they just stepped aside. As a result, on Monday, a single load was offered 20¢ lower without a buyer. While supplies of current cheese is still tight, the "cheese tree" has been shaken and a few loads have fallen out. Buyers were able to secure 8 loads of blocks today. Year-end orders are largely filled, but New Year's and Superbowl orders have not. But with a 40¢ drop in cash butter today, buyers may be reluctant to re-enter the market until they are sure a bottom has been made.

There appears to be some support for blocks at the \$1.70 level, but weakness in the process/barrel market is leaving us with an unusual 10½¢ spread between blocks and barrels. We may have to live with it for a while, however. According to sources we talked to this week, it seems unlikely that blocks will fall below the \$1.60 level any time soon, and may even sit at \$1.70 for a time.

What to do. Current cash prices, despite the drop, still work out to about \$15.50 milk. If prices hold near current levels next week, Q1 months may begin to recover. Sometimes, a valid strategy is not to do anything. We'd sit out next week, unless we see January rally to \$14.50 or higher. Then get back with the PUT program, or sell your milk at selectively higher prices. We also continue to recommend getting calls bought April - December for existing sold positions.

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

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