



The KDM Dairy Report –December 23rd, 2004

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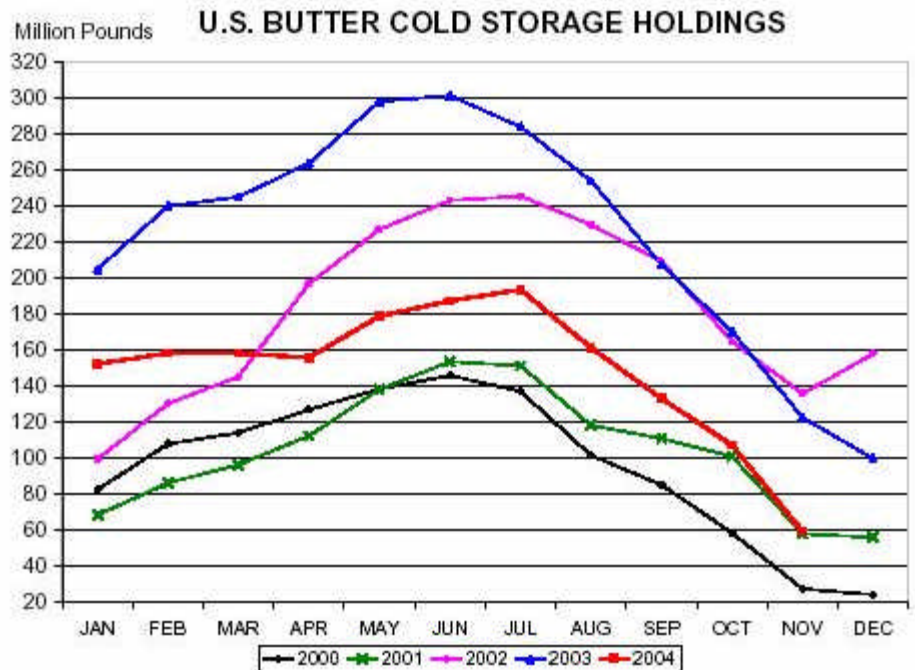
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On the bright side:

- Cold Storage Report: Putting a stamp of confirmation on the tight cheese supply, Commercial American cheese stocks fell a massive 8% (42 million lbs) during the month of November, according to USDA numbers released Tuesday. Since 1995, the average drawdown has been less than half that, at 3.6%. Butter stocks fell an even larger 45% below October levels, dropping 47.8 million lbs, and leaving only 59.3 million lbs left in storage.
- Just 8.7 million lbs of butter are left in CME approved warehouses as of 12/18. That's 84% less than the same period a year ago.
- Weekly cold storage holdings show a 26% drop in butter stocks for the period 12/01 through 12/20, and a 4% drop in cheese stocks, according to USDA numbers.
- While still trailing year ago levels, the weekly dairy cow slaughter was over 50,000 head for the second consecutive week.
- With the current unfavorable milk to cheese price ratio, manufacturers are looking for ways to limit production. Some are skimming excess cream from milk and selling it, rather than adding powder to cheese vats, according to Fluid Milk & Cream Review.
- On a similar note, Dairy Market News reports that demand for current cheese is good, while production in December is expected to be lighter due to the unprofitable price relationship between milk and cheese.
- Milk production in Australia and New Zealand continues to trend lower, according to Dairy Market News. Suppliers indicate that they do not have any extra product available, and are only able to fill orders for their "regular" customers.
- Economy: The Consumer Sentiment Index made an unexpected jump in December, according to survey data released Thursday. The index measures consumer attitudes on the economy.
- Economy: The U.S. economy grew at a higher than expected 4% in the 3rd quarter, according to the Commerce Department. The boost was a result of a surge in consumer spending, business investment and final sales.

Futures Month	Thur 12/23 Close	Friday 12/17 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Dec-04	\$16.48	\$16.49	(\$0.01)	\$11.92	\$12.97	\$14.01
Jan-05	\$13.72	\$13.43	\$0.29	\$11.89	\$12.71	\$13.52
Feb-05	\$13.70	\$13.10	\$0.60	\$11.34	\$11.90	\$12.45
Mar-05	\$13.33	\$12.71	\$0.62	\$11.66	\$12.34	\$13.01
Apr-05	\$13.43	\$12.79	\$0.64	\$12.08	\$13.31	\$14.52
May-05	\$13.45	\$12.80	\$0.65	\$12.21	\$13.60	\$14.98
Jun-05	\$13.55	\$12.92	\$0.63	\$12.26	\$13.38	\$14.49
Jul-05	\$13.65	\$12.94	\$0.71	\$12.70	\$13.62	\$14.53
Aug-05	\$13.82	\$13.45	\$0.37	\$13.25	\$14.21	\$15.16
Sep-05	\$14.01	\$13.68	\$0.33	\$13.72	\$14.66	\$15.58
Oct-05	\$13.15	\$12.95	\$0.20	\$13.10	\$13.91	\$14.71
Nov-05	\$12.68	\$12.50	\$0.18	\$12.22	\$13.29	\$14.34
Dec-05	\$12.44	\$12.25	\$0.19	\$11.92	\$12.97	\$14.01
Jan-06	\$12.09	\$12.09	\$0.00	\$11.89	\$12.71	\$13.52



however....

- NASS prices for cheese continued to fall. Blocks decreased 2.2¢ to \$1.78/lb, while barrels fell 7.9¢ to \$1.67/lb. Butter lost 27.1¢, coming in at \$1.71/lb.
- Florida was a net exporter of milk this week, according to Fluid Milk & Cream Review. Demand from bottlers has dropped off due to school closings for the holidays, and output has steadily improved along the entire East coast.
- Dairy Market News reports that the market tone for butter is weak. Holiday orders have been filled, and butter/power producers

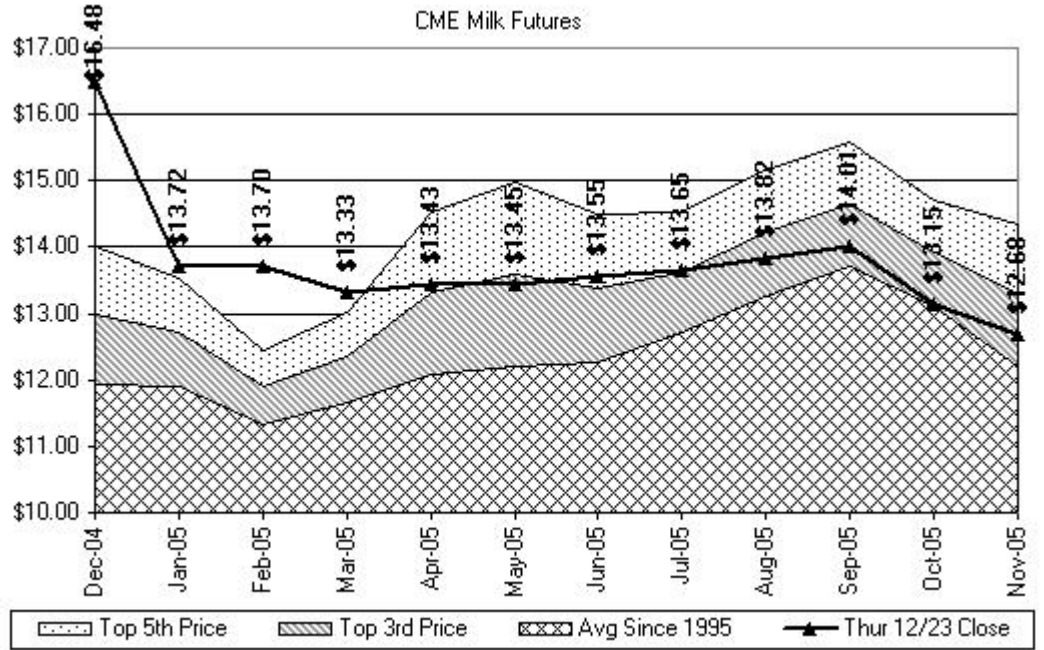
will likely need to absorb additional milk since cheese manufacturers are reluctant to take it.

- Economy: New housing starts fell 13.1% last month, the biggest decrease in 11 years, according to Commerce Department numbers.

Recommendation:

Supportive Milk Production and Cold Storage reports, and a small but significant rebound in the cash cheese market (blocks up 3¼¢ and barrels up 1¼¢) brought support back to Class III futures, with the first seven months of 2005 notching significant gains. Sensing a bottom had been made, buyers returned, looking for cheese 50¢ lower than just two weeks ago, securing 6 cars of blocks and 7 cars of barrels. Speculative and commercial buying, combined with few sellers, made for relatively easy gains in most futures contracts.

February at \$13.70 looks awfully good. You have to go all the way back to 1998 when it closed at \$13.32 as the most recent high, and its average close since 1995 is \$11.34. And we now sit on a 2005 average of \$13.41!



So, what do we do with this? We could hardly fault anyone for selling milk at these prices. For many, that could mean a \$15 or higher mailbox check the entire year. However, fundamentals are pointing to the potential for another strong year, and you may not want to be locked in. Unfortunately, current volatility has made both PUT and CALL options very expensive. Our bias would be to sell only 1st quarter. But realize that prices could continue to move higher, and buying CALL options to protect your upside costly, unless we get a significant correction. If you choose to sell, you need to be able to be happy with the sale, regardless of where prices go from here. As the business owner, only you can make that choice.

Finally, the financial markets and the KDM offices will be closed Friday in observance of Christmas.

We wish you and yours a very Merry Christmas,

Dan, Mark & Keith

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