



The KDM Dairy Report –December 30th, 2004

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On the bright side:

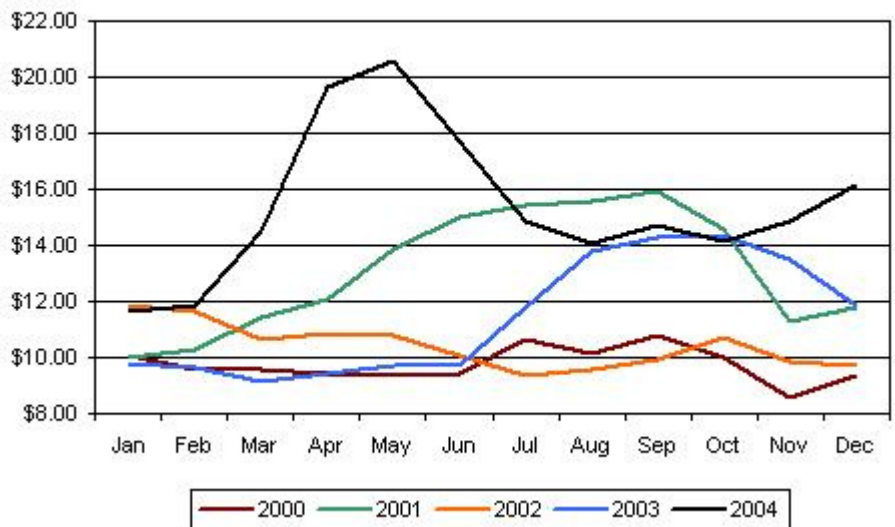
- December Class III futures settled at \$16.14, its highest since 1998 (see chart below). 2004 finished at a record high average of \$15.39 for the year, a full \$1.19/cwt higher than the previous record of \$14.20, set in 1998.
- Weekly cold storage numbers show a cumulative 26% drop in butter stocks and 3% drop in cheese stocks for the period 12/01 through 12/27.
- Dairy cow slaughter for the week ending 12/18 was 54,400, the third week in a row we've been above 50,000 head.
- More schools are switching from paper half-pint cartons to plastic bottles, after a study found that children drank 18% more milk from bottles than cartons. 1,250 schools are now using the bottles, up from zero in 2000. In addition, the bottles hold 2 ounces more than the old cartons.
- A Pacific storm has stalled over parts of the West coast, dumping record rainfall and causing localized flooding. Contacts we spoke to said milk production hasn't been affected yet, but the forecast is for continued damp conditions, which could cause the hospital pens to fill up.
- Local cheese plants we work with describe January orders as good with product for the month largely committed.
- Replacement dairy heifers are NOT part of the planned reopening of the Canadian border, announced by USDA this week. Starting March 7th, importations will be limited to cattle aged 30 months or younger, must be transported in sealed containers, have permanent markings showing the country of origin, cannot move to more than one feedlot, and must be slaughtered by age 30 months. In addition, a new case of suspected BSE was found in an Alberta dairy cow, which could delay the border opening for dairy animals.

Futures Month	Thur 12/30 Close	Thur 12/23 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Dec-04	\$16.14	\$16.48	(\$0.34)	\$12.34	\$13.49	\$14.61
Jan-05	\$13.67	\$13.72	(\$0.05)	\$11.89	\$12.71	\$13.52
Feb-05	\$13.80	\$13.70	\$0.10	\$11.34	\$11.90	\$12.45
Mar-05	\$13.56	\$13.33	\$0.23	\$11.66	\$12.34	\$13.01
Apr-05	\$13.60	\$13.43	\$0.17	\$12.08	\$13.31	\$14.52
May-05	\$13.60	\$13.45	\$0.15	\$12.21	\$13.60	\$14.98
Jun-05	\$13.60	\$13.55	\$0.05	\$12.26	\$13.38	\$14.49
Jul-05	\$13.70	\$13.65	\$0.05	\$12.70	\$13.62	\$14.53
Aug-05	\$13.90	\$13.82	\$0.08	\$13.25	\$14.21	\$15.16
Sep-05	\$14.10	\$14.01	\$0.09	\$13.72	\$14.66	\$15.58
Oct-05	\$13.20	\$13.15	\$0.05	\$13.10	\$13.91	\$14.71
Nov-05	\$12.67	\$12.68	(\$0.01)	\$12.22	\$13.29	\$14.34
Dec-05	\$12.50	\$12.44	\$0.06	\$12.34	\$13.49	\$14.61
Jan-06	\$12.10	\$12.09	\$0.01	\$11.89	\$12.71	\$13.52

however....

- Butter stocks in CME-approved warehouses increased by 2.7 million lbs, for the week ending 12/25. That's the first net increase since July.
- With most public schools still out of session this week, fluid milk demand is still below levels of a couple weeks ago, according to Fluid Milk & Cream Review.
- Florida continued to be an exporter of milk, shipping out 152 loads this week, vs. 110 last week and 129 a year ago.
- Cream offerings are very heavy and moving long distances to find a home, according to Dairy Market News. Churning activity is heavy and above anticipated levels.
- NASS prices are finally catching up to the recent cash drop of a couple weeks ago. 40 pound cheddar blocks fell 14.2¢ to \$1.64/lb, barrels decreased 14.9¢ to \$1.52/lb and butter dropped 17.3¢ to \$1.54/lb. Further decreases are

Class III Historical Prices



likely, since the cash cheese price is down another 15¢.

- Ag Prices Report: The December milk-feed price ratio climbed 16 points above the prior month, to 3.73, the highest mark in more than 3 years, according to yesterday's Daily Dairy Report. Historically, the higher the number, the more incentive and likelihood that expansion takes place.

Recommendation:

A very slow week in the cash cheese market allowed prices to hold unchanged, with only 2 trades in the blocks. Deferred contracts continued to make impressive gains, with the 2005 average now resting at \$13.49, up 8¢ from last week.

While fundamentals continue to point to a strong year in 2005, prices will not continue to rise indefinitely without a correction. Technically, the market appears to have topped out this week, and we would not be surprised to see some profit taking at the first hint of weakness. That's not to say prices won't move higher, but unless we feed the bull, prices may trend lower short term.

Looking at the chart above, January through June are trading above top-third historical prices, with Q1 even well above historical top-fifth prices. Our recommendation remains unchanged from last week, to sell Q1. We began to sell February and March this week, while some of our producers locked in a percentage of their milk for the year. Again, you need to make a business decision to sell or not, realizing that if you do, you may not get an opportunity to buy reasonable upside protection in the form of CALL options, unless there is a correction. But with the current 2005 average equivalent to about \$1.50 cheese, the risk of prices declining is weighing on producers' minds as well.

Please give us a call if you'd like us to help you put together a marketing plan for 2005!

Finally, the financial markets and the KDM offices will be closed Friday in observance of New Year's Day. We wish all of you a happy and prosperous 2005!

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