



The KDM Dairy Report –January 14th, 2005

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On the bright side:

- The cash markets rocketed back to life, with blocks gaining 13¾¢ for the week to close at \$1.63/lb today, and barrels jumping 15¢ to settle at \$1.60/lb. Cash butter also moved higher, increasing 4¾¢ to \$1.63¼/lb.
- CWT continues to bump up slaughter numbers. 42,700 dairy cows were culled for the week ending 01/01/05, vs. 35,300 during the same period a year ago.
- Dairy Market News reports that the butter market is firming, as many handlers believe prices during the first half of 2005 will be higher than normal. Low carryover stocks from last year and current demand are primary factors.
- Current nonfat dry milk production in the East is barely keeping pace with sales, according to Dairy Market News. Traders would like to accumulate stocks while they can but little is available to store. And dry whey exports are running at a good pace, with few other sources of whey in the world at this time.
- Economy: Falling energy prices yielded the biggest drop in the Producer Price Index since April 2003, according to the Labor Department. The index is a forecast for future inflation and the drop eases those fears.
- Canada's third case of mad cow disease was confirmed on Tuesday. That's likely to keep the border closed to dairy replacement animals for some time.

Futures Month	Friday 01/14 Close	Friday 01/07 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Jan- 05	\$14.00	\$13.85	\$0.15	\$11.89	\$12.71	\$13.52
Feb- 05	\$15.42	\$14.16	\$1.26	\$11.34	\$11.90	\$12.45
Mar- 05	\$15.25	\$13.87	\$1.38	\$11.66	\$12.34	\$13.01
Apr- 05	\$15.00	\$13.70	\$1.30	\$12.08	\$13.31	\$14.52
May- 05	\$14.00	\$13.65	\$0.35	\$12.21	\$13.60	\$14.98
Jun- 05	\$13.75	\$13.61	\$0.14	\$12.26	\$13.38	\$14.49
Jul- 05	\$13.80	\$13.72	\$0.08	\$12.70	\$13.62	\$14.53
Aug- 05	\$13.94	\$13.90	\$0.04	\$13.25	\$14.21	\$15.16
Sep- 05	\$14.15	\$14.02	\$0.13	\$13.72	\$14.66	\$15.58
Oct- 05	\$13.66	\$13.21	\$0.45	\$13.10	\$13.91	\$14.71
Nov- 05	\$12.90	\$12.75	\$0.15	\$12.22	\$13.29	\$14.34
Dec- 05	\$12.57	\$12.50	\$0.07	\$12.34	\$13.49	\$14.61
Jan- 06	\$12.50	\$12.10	\$0.40	\$11.89	\$12.71	\$13.52

however....

- NASS cheese prices dropped further than expected, with blocks falling 7¢ to \$1.47/lb and barrels down 1.7¢ to \$1.45/lb.
- Inventories continue to build in the New Year. For the first ten days of 2005, Butter stocks are up 2% and cheese stocks are up 1%, according to USDA cold storage numbers.
- Sounding like a broken record, but the Southeast continues to produce more milk than is needed. Florida exported 51 loads of Grade A milk this week vs. 30 last week, according to Fluid Milk & Cream Review. They also write that the fluid cream market is sluggish, with excess loads moving to butter plants.
- This afternoon, Monsanto announced that current POSILAC customers can receive up to 115% of their historical shipments, beginning March 1st.

Recommendation:

As we suggested last week, weather played a major roll in the milk futures market. The rain has ended in Southern California, but drying out is almost worse, according to a local producer in the Chino area. Warmer weather and standing water make for an ideal bacterial climate. It will take quite some time to dry, and the soupy mud that was created during the rain,

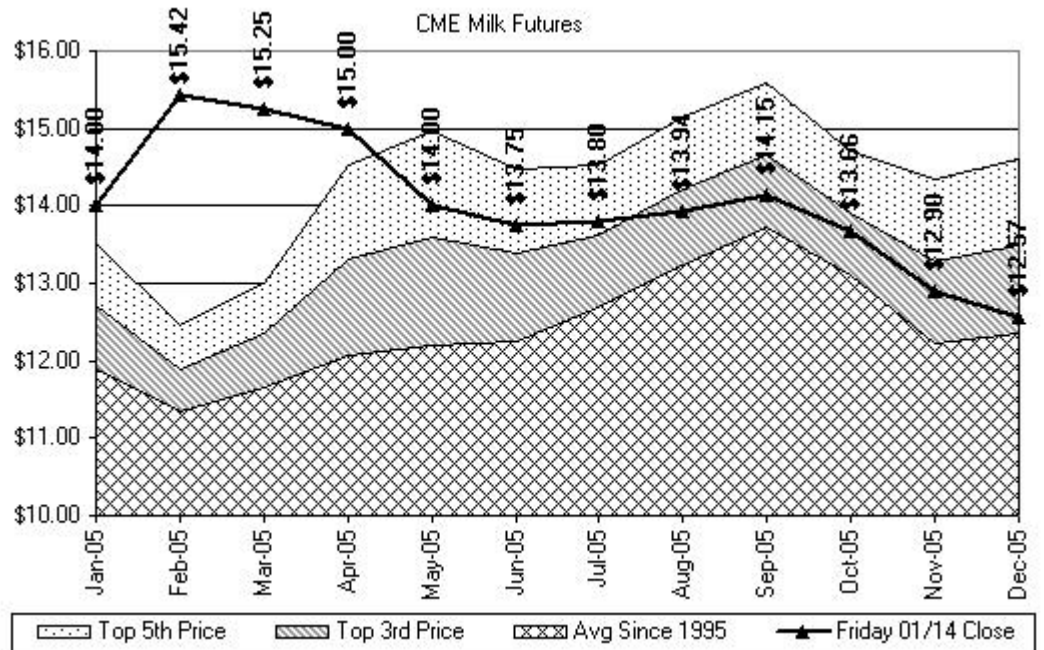
will gradually thicken, making it more difficult for the animals to move, tiring them out. At least the rain kept the cows somewhat clean, but as they lie in the muck, prepping for milking becomes a real problem. Hospital pens continue to add numbers, and mastitis issues are a real concern. Ditto for parts of New Mexico and Texas.

The fear of a drop in production in an area containing a third of the nation's dairy herd is what drove prices up this week. It will take several weeks before we know the real impact the storm had, but the street isn't waiting. Add to that a third confirmed case of BSE in Canada and continued strong cheese demand, and you have a 2005 that looks to be very strong indeed. However, at these heights, we expect the volatility to increase significantly. Remember the limit up, limit down days of last spring? The first sign of weakness in the cash market will result in a violent correction, so while we believe the general trend towards higher prices is justified, be prepared for a wild ride.

With so many bullish fundamentals in play again, you'll want to keep as much of your upside open as possible. We would recommend sticking to PUT options for all of 2005. They're still quite expensive in the deferred months, but are quite inexpensive up front. Buy some cheap insurance in case this thing falls apart! The February 14.75 PUT traded as low as 20¢ today. Buy it! The March 14.25 PUT settled at 38¢. Enter a standing order to buy it for 25¢.

Note: The KDM Trading offices will be closed on Monday in observance of Martin Luther King day. All financial markets will be closed as well.

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