



# The KDM Dairy Report –January 21<sup>st</sup>, 2005

Dan Schindler, Mark Potter, and Keith Schnese

877-695-8538

www.kdmtrading.com

## On the bright side:

- The cash markets continued to provide volatility to milk futures. Blocks increased 12¾¢ to \$1.75¾/lb for the week, while barrels jumped 12½¢ to \$1.72½/lb. Seven loads of blocks traded and no barrels. Blocks were left with double-digit bids unfilled during the two most recent sessions, showing good demand is there for product.
- Milk Production Report: December milk production was up only 0.7% in all 50 states, and up 1% in the top 20 states, as forage quality and wet weather affected production. Last December, Texas was up 9.4% and NM was up 6.5%. This year, record rainfall caused a 0.6% drop in production in Texas, and a 5.5% drop in NM. Finally, there were 4,000 fewer milk cows in December than in November.
- Livestock Slaughter Report: Credit CWT - 33,000 more dairy cows were culled in December than in November, according to numbers released today. 224,900 dairy cows went to slaughter in December, vs. only 191,900 in November.
- More current weekly slaughter numbers are encouraging. For the week ending 01/08, 52,100 dairy cows were culled vs. 48,800 during the same period a year ago. Cow numbers appeared to have peaked last Aug/Sept and are now showing steady but slight decreases, following the long-term trend.
- Livestock, Dairy & Poultry Outlook Report: Released today, USDA commented that strong exports removed surplus nonfat dry milk during the year end holidays without a sale to the government - the first time that's happened since 1989. Commercial exports are expected to stay strong for the first half of 2005, possibly longer, as U.S. prices are quite attractive and world supplies are tight.
- All NASS components were up this week. Cheddar blocks increased 1.1¢ to \$1.48/lb, barrels were up 0.3¢ to \$1.45/lb, butter was 2¢ higher to \$1.58/lb, nonfat dry milk improved 0.5¢ to 89.2¢/lb and dry whey was up 0.1¢ to 24.8¢/lb.
- Fluid Milk & Cream Review reports milk intakes are 3-5% lower in Southern California, the area hardest hit by recent rains.
- International: Milk production continues to trail last season in Western Europe, Australia and New Zealand, according to Dairy Market News. Many handlers and traders indicate they'll be fortunate to fill current commitments with this season's milk production, leaving little to nothing for export.
- Dry whey exports are better than at the end of the year, according to Dairy Market News. With few alternative sources in the world, buyers complain about the price, then ask when it can be shipped.

Futures Month	Friday 01/21 Close	Friday 01/14 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Jan- 05	\$14.10	\$14.00	\$0.10	\$11.89	\$12.71	\$13.52
Feb- 05	\$16.05	\$15.42	\$0.63	\$11.34	\$11.90	\$12.45
Mar- 05	\$15.65	\$15.25	\$0.40	\$11.66	\$12.34	\$13.01
Apr- 05	\$14.78	\$15.00	(\$0.22)	\$12.08	\$13.31	\$14.52
May- 05	\$14.30	\$14.00	\$0.30	\$12.21	\$13.60	\$14.98
Jun- 05	\$14.00	\$13.75	\$0.25	\$12.26	\$13.38	\$14.49
Jul- 05	\$14.10	\$13.80	\$0.30	\$12.70	\$13.62	\$14.53
Aug- 05	\$14.05	\$13.94	\$0.11	\$13.25	\$14.21	\$15.16
Sep- 05	\$14.15	\$14.15	\$0.00	\$13.72	\$14.66	\$15.58
Oct- 05	\$13.63	\$13.66	(\$0.03)	\$13.10	\$13.91	\$14.71
Nov- 05	\$13.05	\$12.90	\$0.15	\$12.22	\$13.29	\$14.34
Dec- 05	\$12.85	\$12.57	\$0.28	\$12.34	\$13.49	\$14.61
Jan- 06	\$12.50	\$12.50	\$0.00	\$11.89	\$12.71	\$13.52

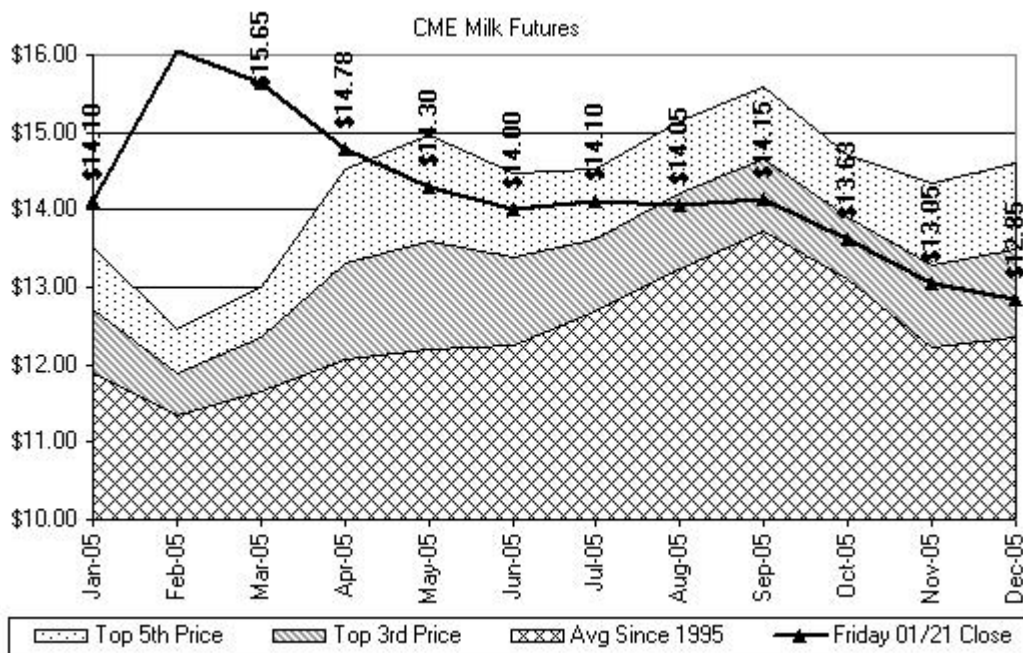
## however....

- Commercials continue to rebuild inventories of butter and cheese. Weekly cold storage holdings for the period 01/01 through 01/17 show a 42% increase in butter stocks and 1% increase in cheese stocks.
- Fluid Milk & Cream Review reports milk production is steady to higher in the East, and Florida has cooled allowing gains in milk output. Florida exported 29 loads of milk this week.
- Despite losses in milk output in Southern California, only 11.5% of the state's milk is produced there, according to Fluid Milk & Cream Review. Northern producing areas had steady to higher output this week.

- The butter market is weak and cream offerings are heavy, according to Dairy Market News.
- Sellers have returned to the cash market. Three loads traded Thursday and four on Friday. What will Monday bring?

**Recommendation:**

Our comment last week about volatility increasing proved true this week. The sky seems to be the limit when the cash cheese trade ends with uncontested bids, but when three loads showed up on Thursday and another four today, the market gets mixed signals and doesn't know where to go. Despite the fact that there were 13 bids remaining on Thursday and 11 today, the futures market worries about next week. Will five, ten or



fifteen loads show up? Did we get ahead of ourselves a little and move March, April and May too high? The correction off their mid-week highs reflects this new change in the market, which now has a prove it before I believe it attitude. If the cash market remains strong, these months, in time, will begin to move higher again, but that is not a sure thing. We know from last year that above \$1.80 cheese puts a crimp in demand. At the current \$1.75¾ price, \$1.80 is certainly in reach, but we may be topping out on the price. So, what do we do with this? Buy the February 15.50 PUT for 25-30¢. The gives you an effective floor of 15.25 with all the upside. Or, sell your milk to the plant at \$16.05, then buy a 17.00 CALL for 19¢. This yields an effective floor of \$15.86 (\$16.05 - .19) and upside above 17.00 should it go higher. Similar strategies can be used for March and April. Finally, with a Feb-Dec 2005 average of \$14.24, you could consider selling the entire year, but we would only do so if you buy out-of-the-money call options as described above for every month. 2005 looks to be a solid year, so it's still important to be open to any upside in the market.

Give us a call! We'll help you put together a risk management plan for your operation!

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