



The KDM Dairy Report –January 28th, 2005

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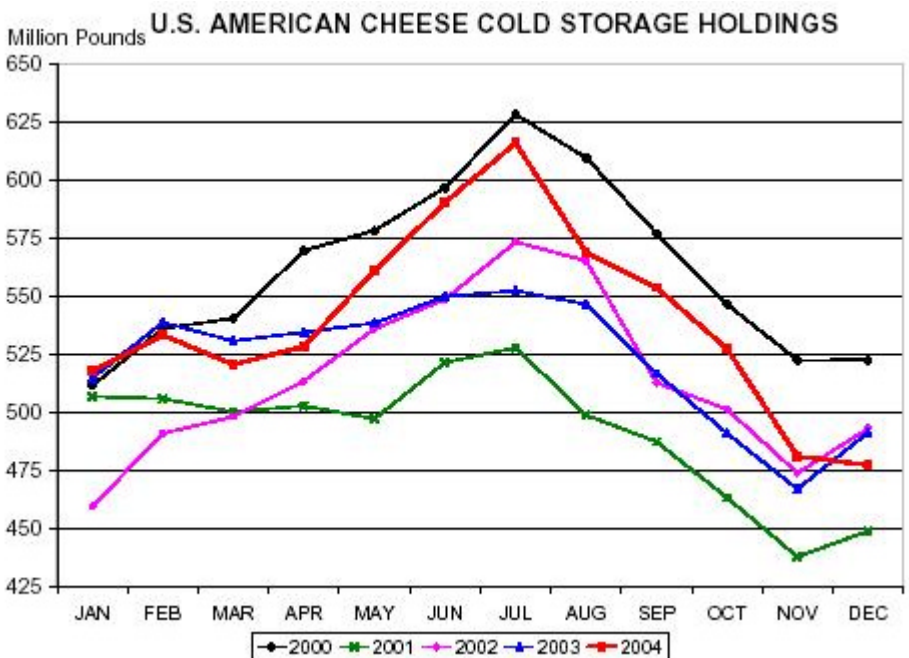
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On the bright side:

- Cold Storage Report: Released Monday, USDA numbers show December American cheese stocks were 3% below year ago, and 1% below November levels. In a month where inventories typically build, it was the first time in ten years that December stocks were less than November's. Butter stocks were down 48% vs. a year ago and 9% below November (see chart below).
- NASS cheese prices continued to tic higher, following the recent run-up in cheese. Blocks averaged \$1.52/lb, up 4¢ from the prior week, and barrels averaged \$1.51, up 5.1¢. NDM increased 0.6¢ to 89.8¢/lb.
- Weekly dairy cow slaughter remains robust in 2005. For the week ending 01/15, 58,800 animals were culled, vs. 56,900 during the same period a year ago.
- Milk is tight in the Midwest, according to Fluid Milk & Cream Review. Intakes have gone down in recent weeks, yet orders remain good for this time of year.
- Output in California and New Mexico is still feeling the negative affects of recent wet weather. Contacts we spoke to in CA reported intakes were down 5% in their area last week. In the Pacific Northwest, little quality hay is available and it's getting more expensive, according to Fluid Milk & Cream Review.
- Nonfat dry milk in the Midwest is in short supply, according to Dairy Market News. Plants are notifying buyers that none will be available for at least a month, and to seek additional supplies from the West. Cheese makers, who have been using NDM fortify their vats, are switching back to condensed skim due to the higher prices.
- Commercial disappearance of dairy products surged in November, according to USDA numbers updated in this week's Livestock, Dairy and Poultry Outlook report. American cheese use was up 11.9% vs. the prior year, while nonfat dry milk use was up 15.9%. Butter demand was up 11.6% in November, while milk use in all products was up 2.9%.

Futures Month	Friday 01/28 Close	Friday 01/21 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Jan- 05	\$14.15	\$14.10	\$0.05	\$11.89	\$12.71	\$13.52
Feb- 05	\$15.74	\$16.05	(\$0.31)	\$11.34	\$11.90	\$12.45
Mar- 05	\$14.69	\$15.65	(\$0.96)	\$11.66	\$12.34	\$13.01
Apr- 05	\$14.27	\$14.78	(\$0.51)	\$12.08	\$13.31	\$14.52
May- 05	\$13.85	\$14.30	(\$0.45)	\$12.21	\$13.60	\$14.98
Jun- 05	\$13.70	\$14.00	(\$0.30)	\$12.26	\$13.38	\$14.49
Jul- 05	\$14.10	\$14.10	\$0.00	\$12.70	\$13.62	\$14.53
Aug- 05	\$14.15	\$14.05	\$0.10	\$13.25	\$14.21	\$15.16
Sep- 05	\$14.20	\$14.15	\$0.05	\$13.72	\$14.66	\$15.58
Oct- 05	\$13.50	\$13.63	(\$0.13)	\$13.10	\$13.91	\$14.71
Nov- 05	\$12.91	\$13.05	(\$0.14)	\$12.22	\$13.29	\$14.34
Dec- 05	\$12.70	\$12.85	(\$0.15)	\$12.34	\$13.49	\$14.61
Jan- 06	\$12.60	\$12.50	\$0.10	\$11.89	\$12.71	\$13.52
2005 Average		\$14.00	(\$0.23)			



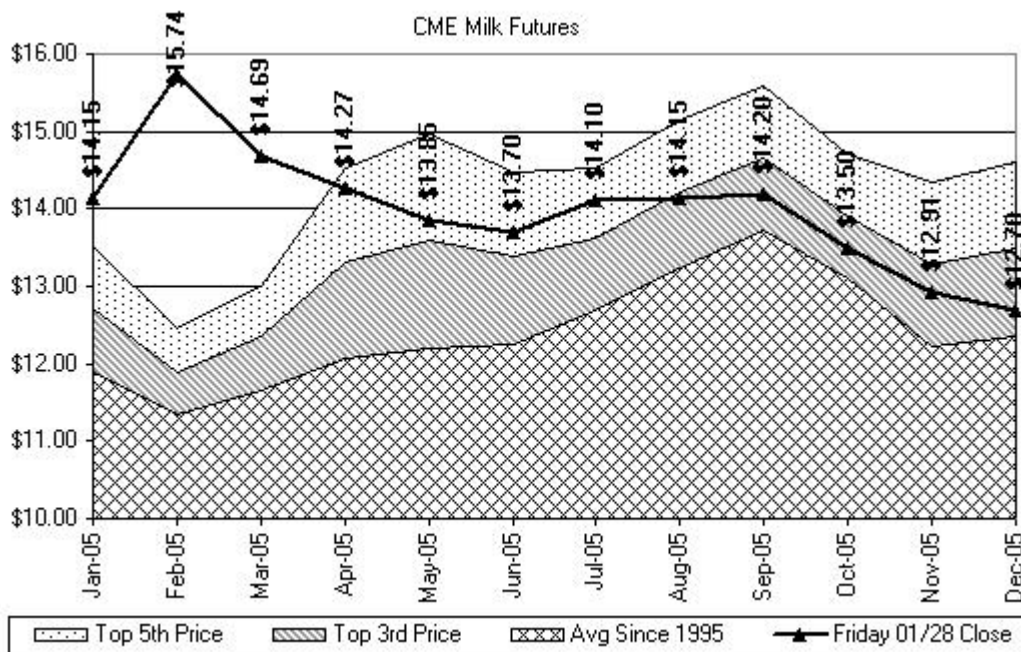
however....

- Cattle Inventory Report: The semi-annual report released today showed the total number of milk cows at 9.01 million, up only slightly from last year, but milk replacement heifers at 4.13 million was up 3% vs. a year ago. While it's likely a market response to demand/Canadian border, the total was the highest in ten years, and longer term, could become an issue.

- Weekly cold storage holdings show butter stocks up 65% during the period 01/01 through 01/24, and cheese stocks up 2%.
- Dairy Market News reports cream offerings are heavier than anticipated for this time of year. Current production is keeping pace with demand, while additional volumes are able to enter inventory programs.
- Cash blocks and barrels peaked and finally started to move lower. Blocks shed 4¼¢ to settle at \$1.71½/lb today, and barrels lost 3½¢ this week to settle at \$1.69/lb.

Recommendation:

Anticipation for a drop in cheese proved true. The crack in the cash market flooded into volatile selling as barrels were offered lower mid-week, followed by blocks today. However, buyers stepped in at prices perhaps higher than expected, holding cash cheese from further declines. With intraday lows in the March through August contracts at an equivalent cheese price of less than \$1.50/lb, the support shown in the cash market prompted a rally as traders realized some contracts had possibly been oversold, the logic being if there's buy interest in the low \$1.70's, there will be more in the \$1.60's and even more in the \$1.50's. We feel that \$1.50 cheese is a reasonable floor to expect over the next several months, which works out to about \$14.00 milk.



Don't expect the current cash price to stay where it is, however. With additional blocks and barrels offered and unsold today, they are likely to show up again next week, with further declines in price a possibility. We would lock in February with your plant at the current close of \$15.74, or sell February futures at \$15.75 to 15.80. The current cash prices equates to just over \$16.00, but we're not convinced we'll stay there the entire month. After selling, if you're worried about prices going higher, buy a February 16.00 CALL for 18¢. Sell March at \$15.00 or higher, and buy a 16.00 CALL for 18-20¢

April and beyond are trading close to or under \$1.50 cheese. Consider buying 16.50 to 17.00 CALLs for 10-15¢ in these months in anticipation of higher prices this Spring. Once bought, you can sell in to them as prices increase, and have your upside protection already in place!

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

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