



# The KDM Dairy Report – February 25<sup>th</sup>, 2005

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## On the bright side:

- Cold Storage Report: Released Tuesday afternoon, USDA numbers show American Cheese stocks in January were 7% below a year ago, Total Cheese stocks down 6% and butter stocks at just 50% of year-ago levels. Cheese stocks did increase 1% from December to January, however, the 3.3 million lb increase was far short of the average increase since 1998 of 23 million lbs.
- The cash cheese market took off this week, with blocks climbing 14¼¢ to \$1.58/lb, and barrels jumping 12¼¢ to \$1.51¼/lb. 16 loads of blocks traded and 4 loads of barrels.
- Weekly cold storage numbers are bullish for cheese. During a month we're typically building inventory, cheese stocks have actually decreased 1% during the first 21 days of February.
- While below previous year numbers, weekly dairy cow slaughter remains robust, with 46,200 head being culled vs. 50,800 during the same period a year ago.
- The weather out West and the hardship to the dairy industry in Southern California is making national headlines. An AP story was picked up by several news organizations, including USA Today. Local sources tell us milk production in the area is dropping rapidly.
- Fluid Milk & Cream Review reports that the rain in California is delaying the harvest of hay, which is already in tight supply. Quality could also suffer.
- Economy: 4th quarter GDP was revised up to 3.8% vs. the 3.1% originally reported, indicating the economy grew faster than previously thought. For the year, GDP grew 4.4%, the strongest for any year since 1999.

Futures Month	Friday 02/25 Close	Friday 02/18 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Feb- 05	\$14.70	\$14.73	(\$0.03)	\$11.34	\$11.90	\$12.45
Mar- 05	\$15.13	\$13.66	\$1.47	\$11.66	\$12.34	\$13.01
Apr- 05	\$15.48	\$13.75	\$1.73	\$12.08	\$13.31	\$14.52
May- 05	\$15.25	\$13.90	\$1.35	\$12.21	\$13.60	\$14.98
Jun- 05	\$14.83	\$13.90	\$0.93	\$12.26	\$13.38	\$14.49
Jul- 05	\$15.10	\$14.45	\$0.65	\$12.70	\$13.62	\$14.53
Aug- 05	\$15.09	\$14.63	\$0.46	\$13.25	\$14.21	\$15.16
Sep- 05	\$14.96	\$14.68	\$0.28	\$13.72	\$14.66	\$15.58
Oct- 05	\$14.00	\$13.75	\$0.25	\$13.10	\$13.91	\$14.71
Nov- 05	\$13.55	\$13.05	\$0.50	\$12.22	\$13.29	\$14.34
Dec- 05	\$13.25	\$12.86	\$0.39	\$12.34	\$13.49	\$14.61
Jan- 06	\$12.91	\$12.60	\$0.31	\$12.10	\$12.93	\$13.74
12-month avg		\$14.52	\$0.73			

## however....

- Livestock Slaughter Report: 216,500 dairy cows were culled in the month of January, according to USDA statistics released today. That trails the cull a year ago when 219,000 went to slaughter, and is way below 2003, when 267,600 animals exited the milking herd.
- Only 11% of California's milk production is in affected areas. Milk output is actually 2 to 4% higher in the Central Valley this week, according to Fluid Milk & Cream Review.
- NASS prices are falling while cash prices are rising, due to the near 2-week delay between the two. 40-pound blocks decreased 7.3¢ from the prior week, to average \$1.54/lb, and barrels fell 11.7¢ to \$1.49/lb.
- Florida remains a net exporter of milk, shipping 179 loads out of state this week, vs. 148 the previous week and 76 during the same period a year ago.

Futures Month	Friday 02/25 Close	Friday 02/18 Close	Change
Jan- 06	\$12.91	\$12.60	\$0.31
Feb- 06	\$12.95	\$12.55	\$0.40
Mar- 06	\$13.10	\$12.65	\$0.45
Apr- 06	\$12.96	\$12.65	\$0.31
May- 06	\$12.90	\$12.60	\$0.30
Jun- 06	\$12.90	\$12.60	\$0.30
Jul- 06	\$13.10	\$12.95	\$0.15
Aug- 06	\$13.20	\$13.15	\$0.05
Sep- 06	\$13.50	\$13.40	\$0.10
Oct- 06	\$12.90	\$12.90	\$0.00
Nov- 06	\$12.65	\$12.65	\$0.00
Dec- 06	\$12.50	\$12.50	\$0.00
2006 avg		\$12.96	\$0.22

## Recommendation:

There's nothing like the futures market to keep one humble. We'll be the first to admit our recommendation last week to sell March on rallies above \$13.90 wouldn't have yielded the best fill, depending on where you put your order. However, we have been recommending selling March since it peaked in January at nearly \$16. The gains this week in March, April and May were certainly impressive, and it emphasizes why you need to buy call options once you've marketed

your milk. Case in point: last week we sold 3 March contracts for a producer at prices between 13.90 and 14.00, then picked up 3 March 14.25 calls at 25¢ each. March promptly fell further, making us wonder if that had been the right thing to do. With those same calls trading today at 90¢, that question has been answered. The producer put in a profitable floor, then covered their upside risk by buying the calls. There's no fretting now about how much higher the market will go, because they're along for the ride.

The outlook in the near term looks positive for prices. The weather out West, combined with a bullish cold storage report is supporting the market, and while the trend is certainly for higher prices, we're mindful that a big percentage of milk producing areas in California is largely unaffected by the current weather. When things dry out, they might recover more than is expected. Industry contacts also tell us that cheese sales have definitely slowed. There is very real potential that the markets could move right back down if production were to come back.

With that in mind, it is worth taking action to protect current prices. Enter orders to buy the March 15.25 PUT for 25¢, and the April 15.00 PUT for 30¢. These are close enough to their current prices that continued strength into next week would allow them to be filled. Continue looking to buy PUTs June through September for about 30¢, with the intention of buying higher levels of protection should the market give you the opportunity later.

Finally, 2006 contracts also made solid gains this week. With a current average of \$12.96, consider marketing some of your milk at these levels. Will we really have three years in a row of \$14+ milk?

We want to hear from you! Call us and we'll help you put together a risk management plan for your dairy!

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