
# The KDM Dairy Report - April 1st, 2005

## On the bright side:

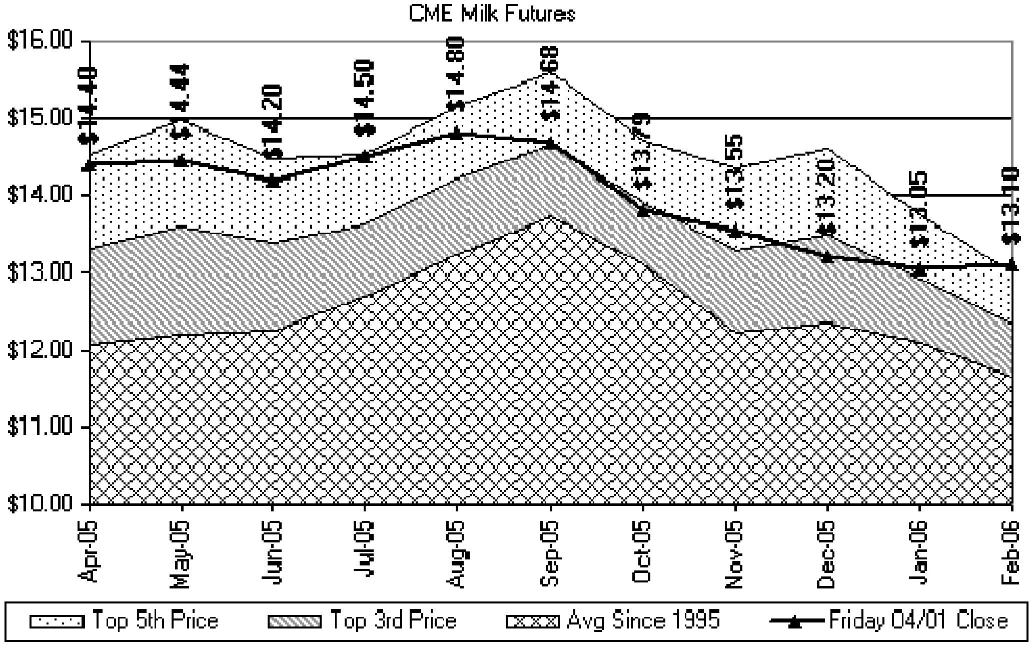
| Futures Month | Friday 04/01 Close | Thursday 03/24 Close | Change | Avg Since 1995 | Top 3rd Price | Top 5th Price |
|---|---|---|---|---|---|---|
| Apr-05 | $14.40 | $14.55 | ($0.15) | $12.08 | $13.31 | $14.52 |
| May-05 | $14.44 | $14.85 | ($0.41) | $12.21 | $13.60 | $14.98 |
| Jun-05 | $14.20 | $14.70 | ($0.50) | $12.26 | $13.38 | $14.49 |
| Jul-05 | $14.50 | $14.75 | ($0.25) | $12.70 | $13.62 | $14.53 |
| Aug-05 | $14.80 | $14.85 | ($0.05) | $13.25 | $14.21 | $15.16 |
| Sep-05 | $14.68 | $14.84 | ($0.16) | $13.72 | $14.66 | $15.58 |
| Oct-05 | $13.79 | $13.95 | ($0.16) | $13.10 | $13.91 | $14.71 |
| Nov-05 | $13.55 | $13.70 | ($0.15) | $12.22 | $13.29 | $14.34 |
| Dec-05 | $13.20 | $13.22 | ($0.02) | $12.34 | $13.49 | $14.61 |
| Jan-06 | $13.05 | $13.19 | ($0.14) | $12.10 | $12.93 | $13.74 |
| Feb-06 | $13.10 | $13.19 | ($0.09) | $11.64 | $12.33 | $13.00 |
| Mar-06 | $13.15 | $13.10 | $0.05 | $11.88 | $12.60 | $13.30 |
| 12-month avg | | $13.91 | ($0.17) | | | |

- Commercial Disappearance: USDA numbers for January reveal strong demand for dairy products across the board. American cheese use was up 9.6% vs. a year ago and 1.6% higher than December. Butter use was up 16.1%, while nonfat dry milk use was up a whopping 181.5%. Finally, milk use in all products was up 7.7%.
- The March Class III contract settled at $14.08/cwt, its second highest price ever and the 13th consecutive month of over $14 milk.
- Demand for cheddar blocks and other natural American cheese is good, according to Dairy Market News. Current cheddar supplies are tight to short, despite the fact that the spring grilling season has yet to arrive. Buyers report they have been unable to acquire all the cheese they need for aging programs.
- Butter storage in CME approved warehouses showed a net out-movement of 65,000 lbs for the week ending March 26th, the first drawdown after several weeks of building inventory.
- The cash cheese market at the CME continued to draw buyers, as blocks increased 2¼¢ on the week, settling at $1.62½/lb today. Barrels rose 3¢ over the same period, to $1.59½/lb. 15 loads of blocks exchanged hands and 5 loads of barrels.
- Fluid Mild & Cream Review reports that cream demand has improved, and with the warmer weather, ice cream production has picked up.
- Wet weather over much of the Southwest has reduced the quality of new crop hay. First cuttings were late, allowing weeds and old growth into the mix, and it then got rained on. Prices are firm.

## however….

- Monsanto announced last Friday their intentions to gradually increase the supply of POSILAC to current customers, and to begin creating a waiting list for new customers.
- NASS prices for cheese continue to lag the cash market and are still searching for a bottom. Cheddar blocks fell 2.3¢ to average $1.49/lb and barrels shed 2.1¢ to $1.46/lb.
- Weekly cold storage numbers are showing a 4% increase in cheese stocks and 14% increase in butter stocks for the month of March.
- Dairy cow slaughter for the week ending March 19th was down 9% vs. the same period a year ago.
- Hopes of a recovery in milk production during the last half of the milking season in Oceania have not materialized, according to Dairy Market News. New Zealand continues to run 4-5% behind last year, with Australia down about 1%. Stocks are reportedly in close balance and often short of full needs.
- Economy: The U.S. economy created 110,000 new jobs in March according to the Labor Department, but that was less than half as had been expected by economists. The number suggests the economy is cooling.

**Recommendation:**




The week following Easter turned out to be a relatively quiet trading affair, with several market makers in the dairy pit out or gone on vacation. The lower trade volume resulted in generally low volatility, with the exception of today's losses. The cash market appears to be relatively in balance, with both a large buyer and seller very active. Reports indicate that the supply of current cheese (under 30 days) is very tight, so as long as buyers are still looking for product, the cheese price should be well supported. Local cheese manufacturers we work with also tell us orders are good. However, we don't expect an uncontested run on the cheese price like we saw last year. Milk production is definitely increasing across the country, and processors are turning it into cheese. The current cash price works out to about $15.25 milk, and after today's market, traders must feel a downturn is imminent as the April and May contracts are trading at nearly a 75¢ discount to cash. But holiday weeks and light trading volume can be deceptive – let's see what happens next week when most of the industry is back.

Using the current cash price as a guideline and assuming the cheese situation remains tight over the next few weeks, look at buying the April 14.50 CALL for 10¢, and then target to sell your milk at $14.50 or higher. This would give you an effective floor of $14.50, with unlimited upside above $14.60 (14.50 call + 10¢ premium). For May, enter an open order to buy the 14.75 CALL for 25¢ (currently 40¢), and then sell your May milk if it hits 14.75 or higher. For June and beyond, think about purchasing some cheap insurance in the 13.50 to 13.75 PUT options. This yields a reasonable floor, yet if markets move significantly higher, you can buy higher levels of protection through more PUTs with higher strike prices. Key to even sustained prices is a good economy which stimulates demand, however, we're seeing signs the commodity inflation (energy for one) is hampering gains in the stock market. Should corporate earnings suffer, a real economic downturn is possible, which would ultimately hurt dairy prices. All this to say, those 13.50 and 13.75 PUTs that are cheap now 25-35¢), could come in mighty handy later this year.

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