



The KDM Dairy Report - May 20th, 2005

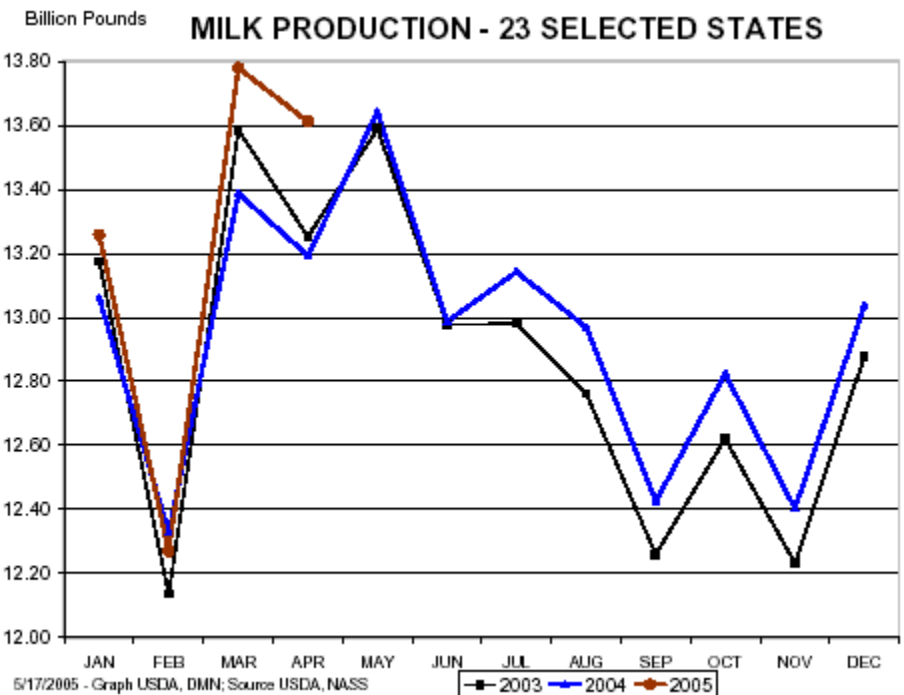
On the bright side:

- The cash markets staged a brief rally this week, with blocks gaining 5¼¢ from last Friday, to close at \$1.52¾ today. Barrels picked up 7¢ to close at \$1.51 today. 28 loads of blocks and 13 loads of barrels exchanged hands. Butter gained 3¢ to close at \$1.44¼ today. 35 loads of butter traded during the week.
- Weekly cold storage numbers show a 2% gain in cheese stocks since the beginning of the month, but that was unchanged from last week.
- Dairy cow slaughter for the week ending 05/07 was 40,600 head vs. 39,700 during the same period a year ago. Recent strength in the beef price and falling milk prices could be attributed to the 2.3% increase.
- Mozzarella sales are very strong, according to cheese plants we work with.
- Fluid Milk & Cream Review reports that milk production in California has begun to move lower as the seasonal peak has been put in. Hotter weather has arrived in Arizona and production is declining slowly.
- From California to the Pacific Northwest to the Midwest, quality hay is in short supply due to winter kill (Midwest) and excess moisture (West). Some producers are getting close to running out of forage.

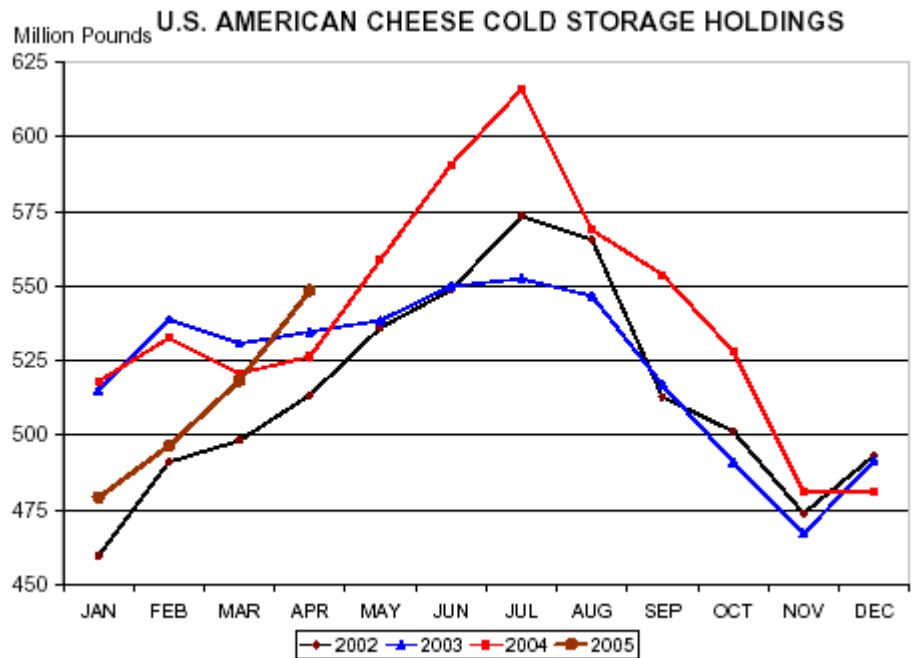
Futures Month	Friday 05/20 Close	Friday 05/13 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
May-05	\$13.72	\$13.68	\$0.04	\$12.21	\$13.60	\$14.98
Jun-05	\$13.84	\$13.86	(\$0.02)	\$12.26	\$13.38	\$14.49
Jul-05	\$13.75	\$14.06	(\$0.31)	\$12.70	\$13.62	\$14.53
Aug-05	\$13.95	\$14.16	(\$0.21)	\$13.25	\$14.21	\$15.16
Sep-05	\$14.03	\$14.25	(\$0.22)	\$13.72	\$14.66	\$15.58
Oct-05	\$13.65	\$13.65	\$0.00	\$13.10	\$13.91	\$14.71
Nov-05	\$13.35	\$13.31	\$0.04	\$12.22	\$13.29	\$14.34
Dec-05	\$13.08	\$13.10	(\$0.02)	\$12.34	\$13.49	\$14.61
Jan-06	\$12.96	\$12.89	\$0.07	\$12.10	\$12.93	\$13.74
Feb-06	\$12.78	\$12.67	\$0.11	\$11.64	\$12.33	\$13.00
Mar-06	\$12.73	\$12.68	\$0.05	\$11.88	\$12.60	\$13.30
Apr-06	\$12.70	\$12.65	\$0.05	\$12.31	\$13.52	\$14.71
12-month avg		\$13.44	(\$0.04)			

however....

- Milk Production Report: April milk production in the top 23 states was up 3.2% vs. a year ago. All but 5 of the top 23 states showed increases. Production per cow was 43 pounds above April 2004, and the number of milk cows was 8.11 million head, 44,000 head more than a year ago, and 12,000 head more than March 2005. Gains in production were led by Idaho, up 11.9% and Colorado, up 6.6%.
- Cold Storage Report: April American cheese stocks were up 4% vs. a year ago, and up 6% from the prior month, according to USDA numbers. Today's Daily Dairy Report indicates the 29.8 million lb increase is the largest April gain since 1999. Butter stocks were 5% higher than April 2004, and 23% higher than March 2005.
- Livestock, Dairy & Poultry Outlook Report: USDA predicts milk and dairy products prices to fall in 2006, as expansion in milk production outstrips demand. They calculate Class III milk to average between \$11.30 – \$12.40 during first quarter of 2006, and between \$11.95 - \$12.95 for the year.
- Livestock Slaughter Report: April dairy cow slaughter was 172,600 head, down 6,100 head from a year ago. January – April 2005 slaughter totaled 773,100 vs. 822,100 during the same period a year ago, down nearly 6%.



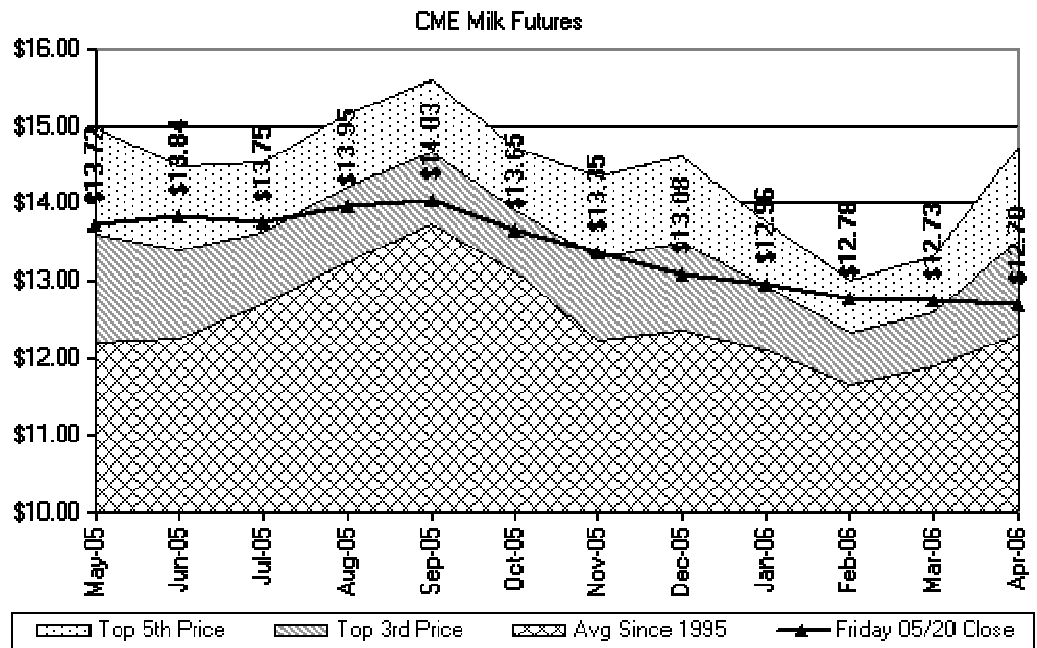
- Dairy Products Prices for cheddar blocks fell 3.1¢ to \$1.46/lb, while barrels decreased 2.8¢ to \$1.41/lb. Butter fell 1.8¢ to \$1.38/lb.
- Milk supplies in the Eastern part of the country are excessive to burdensome, with surplus volumes pressuring regional plant capacity, according to Fluid Milk & Cream Review. Excess cream continues to be shipped to the Midwest for processing.
- Ice cream: Cool temperatures around the country have thus far stifled ice cream sales. In addition, a trend to produce more low-fat frozen deserts has hurt cream sales.
- The end of the school year for colleges and public schools has begun, with most to close their doors over the next month.



5/20/2005 - Graph USDA, DMN; Source USDA, NASS

Recommendation:

Following a bearish milk production report on Tuesday, the markets promptly rallied when the cash cheese market was moved higher on largely speculative bids. After hitting a high of \$1.57¾ mid-week, spec interest fled as offers came in to meet the higher price. This week was a perfect example of the market moving higher for no fundamental reason. We were happy to sell both June and July this week at over \$14 for several producers. July 14.00 puts got as low as 12¢ early in the week and settled at 52¢ today. I guess the lesson learned here is that when the market tosses a gift your way, take advantage of it. On Thursday we entered a slug of orders to buy the July 14.00 put for 10-15¢, but by then, cash cheese was already on the defensive and we came up empty handed.



Going forward, we expect additional product to show up next week on the cash market, and pressure prices. However, we don't foresee prices heading below \$1.40 for cheese. Continue to look for opportunities to buy put options on rallies in the market. Enter orders to buy the July 13.75 put for 15¢. Our recommendation for first quarter 2006 remains unchanged. Sell 1st quarter on a percentage of your milk, currently trading at \$12.79, which is above the top-third historical price for this quarter of \$12.62.

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