



The KDM Dairy Report - May 27th, 2005

On the bright side:

- Strong rally in the grains this week increases feed costs for dairies, making expansions more costly. Soybean meal, which traded in the low \$150's/ton for all 2005 contracts, is now up over \$200/ton at the CBOT.
- An early hot spell hit the Southwest this week, with highs in the 100's. Fluid Milk & Cream Review reports that production in Arizona and New Mexico are trending lower as the cows are affected by the hot weather.
- Very little new crop hay is available in the Pacific Northwest, with some growers cutting early and hoping for the best on the second cutting. Growth has been uneven, weedy and the cows don't like it. Producers are not sure they'll see much of a boost in milk production.
- Milk production in New Zealand is estimated to trail last year by 3-4%, according to Dairy Market News. Australia output is off 0.3% and stocks of manufactured dairy products are short of full needs.
- The demand for dry whey remains firm, according to Dairy Market News. Exports during the first quarter of 2005 were up 39% vs. 2004. With the U.S. the only major world supplier, prices have continued to increase during the spring flush, making some buyers worry about availability this fall when milk supplies are tighter.
- Economy: The U.S. economy grew by 3.5% during the first quarter of 2005, according to numbers released by the Commerce Department. This came in higher than last month's estimate of 3.1%, showing the economy is still growing and expanding.
- Economy: Personal incomes in April rose at their fastest pace in five months, according to a report by the Commerce Department.

Futures Month	Friday 05/27 Close	Friday 05/20 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
May-05	\$13.73	\$13.72	\$0.01	\$12.21	\$13.60	\$14.98
Jun-05	\$13.76	\$13.84	(\$0.08)	\$12.26	\$13.38	\$14.49
Jul-05	\$14.08	\$13.75	\$0.33	\$12.70	\$13.62	\$14.53
Aug-05	\$14.38	\$13.95	\$0.43	\$13.25	\$14.21	\$15.16
Sep-05	\$14.45	\$14.03	\$0.42	\$13.72	\$14.66	\$15.58
Oct-05	\$13.80	\$13.65	\$0.15	\$13.10	\$13.91	\$14.71
Nov-05	\$13.45	\$13.35	\$0.10	\$12.22	\$13.29	\$14.34
Dec-05	\$13.15	\$13.08	\$0.07	\$12.34	\$13.49	\$14.61
Jan-06	\$12.95	\$12.96	(\$0.01)	\$12.10	\$12.93	\$13.74
Feb-06	\$12.73	\$12.78	(\$0.05)	\$11.64	\$12.33	\$13.00
Mar-06	\$12.73	\$12.73	\$0.00	\$11.88	\$12.60	\$13.30
Apr-06	\$12.74	\$12.70	\$0.04	\$12.31	\$13.52	\$14.71
12-month avg		\$13.50	\$0.12			

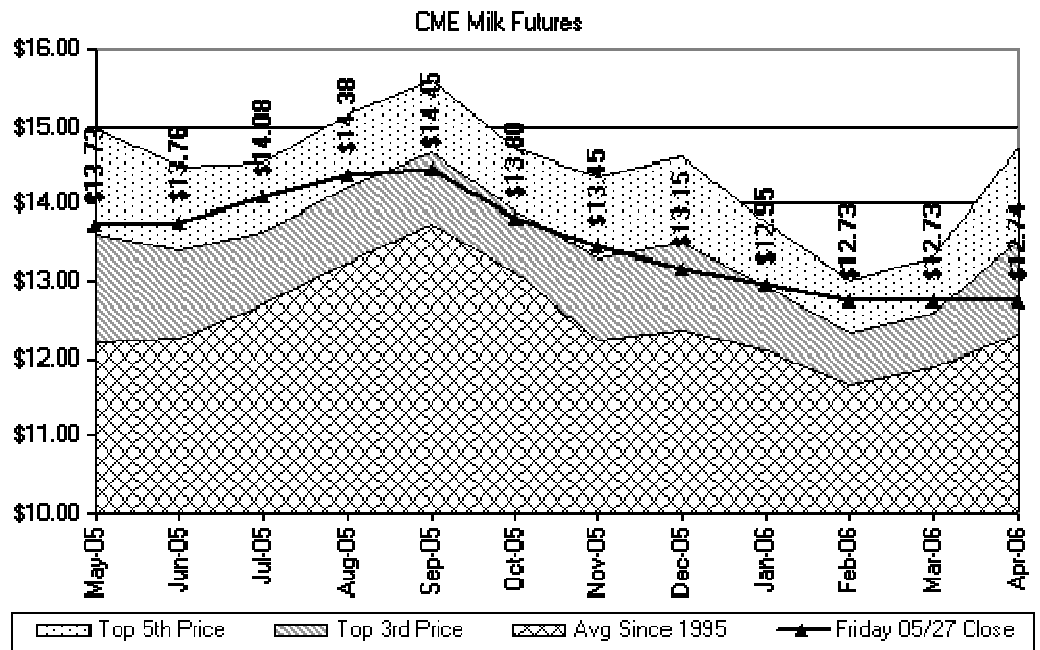
however....

- Dairy cow slaughter for the week ending 05/14 was 39,400 head, down 2,900 from the same period a year ago.
- Manufacturing plants in the Midwest are still running at full capacity, and expect to remain so until heat and humidity increase sufficiently to impact milk production, writes Fluid Milk & Cream Review. Spot loads of milk are available at sharp discounts for \$2.50 under class.
- Milk production is not falling very quickly in the Southeast and is still climbing towards peak in the Northeast, according to Fluid Milk & Cream Review. The absence of any real hot weather is making for burdensome supplies in much of the region, with tankers being forced into long waits to unload at facilities. Milk handlers believe the heavy situation will remain through June, as any declines in production will be offset by school lunch programs coming to an end.

- Fluid Milk & Cream Review reports that output in California is running ahead of last year by 3 to 5%.
- Butter inventories are now above year ago levels for the first time since August 2003, according to Dairy Market News.

Recommendation:

A lack of sellers mid week allowed the cash cheese market to move off its low of \$1.45 for blocks, and gain a penny to close at \$1.46 today. The second day in a row there were no trades, although 19 loads did trade for the week. Barrels managed to gain $\frac{3}{4}\text{¢}$ from its low on Wednesday of $\$1.40\frac{3}{4}$ to close at $\$1.41\frac{1}{2}$ today. The move higher provided support, with all the 2005 contracts



making gains for the week, with the exception of June (see chart above).

We took the rally as an opportunity to sell more milk, and to buy PUT option protection. August and September 13.50 puts were bought for 25¢ this week. While we hope they expire worthless, which would mean a producer is getting above 13.50 for their milk, they do provide an effective floor of 13.25, which gets very close to a 15.00 mailbox price.

With a heavy milk supply likely well into June and a current cash price that works out to about \$13.55 Class III, more gains in cheese will be necessary to justify current prices. Continue building a floor price position for your milk next week. Enter orders to buy the July 13.75 put for 15¢, August 13.50 put for 20¢ and the September 13.50 put for 20¢. Consider selling a percentage of your milk October through March 2006, which are near or above top-third historical prices (see graph above).

Note: Our offices will be closed on Monday in observance of Memorial Day. All U.S. financial markets will be closed.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.