



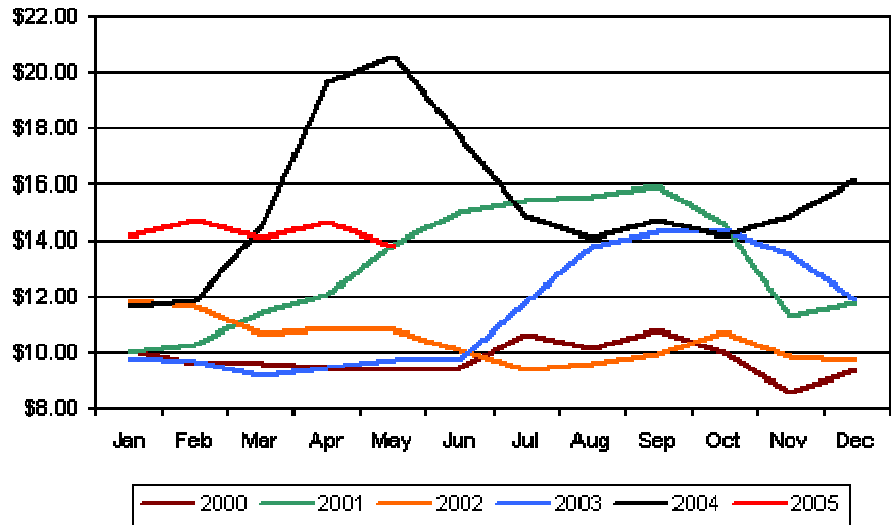
The KDM Dairy Report - June 3rd, 2005

On the bright side:

- The May Class III contract settled today at \$13.77. While finally breaching the \$14 mark we've enjoyed the past 14 consecutive months, it is still above its top-third historical price of \$13.69.
- The cash cheese market continued to rebound off its lows. Blocks gained 5¢ for the week to close at \$1.51/lb today. Barrels climbed 5½¢ to settle at \$1.47/lb. Demand was strong, with 31 loads of blocks and 6 loads of barrels exchanging hands.
- NASS surveyed prices for cheese are back on the rise, with blocks rising more quickly than expected. Blocks averaged \$1.49/lb, up 5.6¢ vs. last week, while barrels averaged \$1.45/lb, up 3.8¢. Butter increased 2.6¢ to average \$1.42/lb.
- Butter stocks in CME-approved warehouses dipped back below 2004 levels by 147,000 lbs, after briefly moving above them last month. The 102.2 million lbs in storage is still well below the 195 million lbs we had in 2003.
- Cheese sales in May were "excellent", according to contacts at cheese plants we work with. Some are getting calls from buyers they've not heard from before.
- Fluid Milk & Cream Review reports that milk production in California continues to trend lower as warmer conditions and biting flies have arrived. In the Pacific Northwest, some herds are experiencing production declines even on new crop hay, due to its poor quality.
- Dairy Market News reports that most natural American plants have limited uncommitted supplies.
- Dairy Products Reports: While both American and Total Cheese production in April was up over 2004, they declined vs. March, the prior month. Output of American cheese was 331.4 million lbs, up 1.9% over 2004 but down 0.1% vs. March. Total cheese output was 763.9 million lbs, up 0.4% vs. 2004, but down 4.4% vs. March.

Futures Month	Friday 06/03 Close	Friday 05/27 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Jun-05	\$13.88	\$13.76	\$0.12	\$12.26	\$13.38	\$14.49
Jul-05	\$14.30	\$14.08	\$0.22	\$12.70	\$13.62	\$14.53
Aug-05	\$14.63	\$14.38	\$0.25	\$13.25	\$14.21	\$15.16
Sep-05	\$14.73	\$14.45	\$0.28	\$13.72	\$14.66	\$15.58
Oct-05	\$13.93	\$13.80	\$0.13	\$13.10	\$13.91	\$14.71
Nov-05	\$13.55	\$13.45	\$0.10	\$12.22	\$13.29	\$14.34
Dec-05	\$13.23	\$13.15	\$0.08	\$12.34	\$13.49	\$14.61
Jan-06	\$12.96	\$12.95	\$0.01	\$12.10	\$12.93	\$13.74
Feb-06	\$12.73	\$12.73	\$0.00	\$11.64	\$12.33	\$13.00
Mar-06	\$12.78	\$12.73	\$0.05	\$11.88	\$12.60	\$13.30
Apr-06	\$12.77	\$12.74	\$0.03	\$12.31	\$13.52	\$14.71
May-06	\$12.91	\$12.93	(\$0.02)	\$12.35	\$13.69	\$15.01
12-month avg		\$13.53	\$0.12			

Class III Historical Prices



however....

- Weekly cold storage holdings show an overall 10% increase in butter stocks and 4% increase in cheese stocks for the month of May.
- Dairy cow slaughter for the week ending 05/21 was 39,000 head, down 1,900 head vs. the same period a year ago.
- Milk supplies in the Midwest continue to be burdensome and fluid demand is slower with the continued closing of schools, according to Fluid Milk & Cream Review.
- The southeast region of the country exported 285 loads of Grade A milk out of state last week, vs. only 162 during the same period a year ago, according to Fluid Milk & Cream Review. Finding a home for the sea of milk this Memorial Day weekend was the worst in many years, with some reports of tankers waiting 24 hours to unload. Cool

weather has kept production near its peak, with contacts expecting the heavy milk supply to remain for several more weeks.

- Butter producers in the Midwest stated that cream supplies over the Memorial Day holiday were the heaviest in many years, according to Dairy Market News. Inventories continue to build and buyers are holding off placing orders, confident that prices will remain steady.
- Economy: The U.S. economy created just 78,000 new jobs in May, its weakest rate of job creation since August 2003, according to figures released by the Labor Department today. Expectations were for an increase of 175,000 new jobs.

Recommendation:

Conundrum – a paradoxical, difficult problem or riddle; a dilemma.

That clever little word is a great description of the milk market right now. On the one hand, we are awash with milk in the biggest flush in several years. At the same time, we see the cheese market going up. Who can solve this riddle? From what we can surmise, it's due to very strong demand for natural American varieties of cheese, and limited manufacturing capacity. Limited manufacturing capacity? Yes. Several cheese

plants out East closed last year, while others, due to a strong export market, have switched away from cheddar to other varieties such as hard Italian cheeses. And specialty import buyers, who would normally not look at domestic cheese, are now buying it due to its discount of up to 40% vs. its imported cousins. Do we have excess milk? Yes, but it's going into powder and butter. Demand for current cheddar is strong as was witnessed on the cash exchange this week. On Wednesday, a stunning 67 bids for blocks remained unfilled, while today 18 bidders came away empty handed. Surely they are bidding this type of volume for legitimate needs, and will most likely be back next week. In summary, it appears the cheese market is headed higher despite burdensome milk supplies.

So what do you do with this? Buy more PUT options! Enter orders to buy the July 1425 put for 15¢, the August 1425 put for 25¢, the September 1425 put for 25¢ and the October 1325 put for 25¢. Consider risk reversals for November and December. For November, buy the 1325 put and sell the 1450 call for a net cost of 15¢, and for December, buy the 1275 put and sell the 1425 call for a net cost of 13¢. Risk reversals give you a range of prices with the floor at the put option strike price and a ceiling at the call option strike price. We still remain concerned about 2006. We would sell a percentage of our milk for the entire year, which currently averages \$12.96. That's 52¢/cwt above the historical annual average since 1995 of \$12.40. Or, consider selling the first quarter of 2006 which is above its top-third historical average (see chart above).

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

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.

