



The KDM Dairy Report - August 05th, 2005

On the bright side:

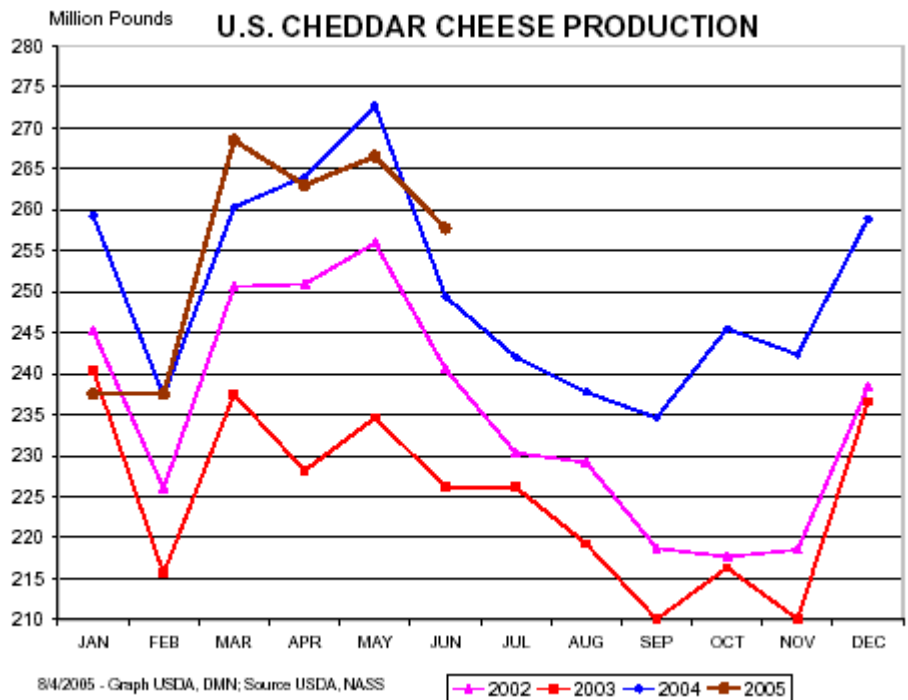
- July Class III settlement of \$14.35 was 50¢ lower than last year, but still well above it's top-third historical average of \$13.75.
- The NASS surveyed price for cheddar blocks was \$1.54/lb, [up 1.2¢](#) from the previous week. Barrels increased 0.8¢ to \$1.51/lb. It will be interesting to see if the NASS prices over the coming weeks ever get as low as the cash price of \$1.35¾ as we saw this week. The majority of cheese is bought and sold off-market, so the surveyed prices, which are delayed by about two weeks, may not ever get as low. This could help August milk futures, currently at \$13.54, move higher in the weeks to come.

Futures Month	Friday 08/05 Close	Friday 07/29 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Aug-05	\$13.54	\$13.60	(\$0.06)	\$13.25	\$14.21	\$15.16
Sep-05	\$14.45	\$14.16	\$0.29	\$13.72	\$14.66	\$15.58
Oct-05	\$14.30	\$14.09	\$0.21	\$13.10	\$13.91	\$14.71
Nov-05	\$13.50	\$13.40	\$0.10	\$12.22	\$13.29	\$14.34
Dec-05	\$13.41	\$13.40	\$0.01	\$12.34	\$13.49	\$14.61
Jan-06	\$12.90	\$13.00	(\$0.10)	\$12.10	\$12.93	\$13.74
Feb-06	\$12.80	\$12.98	(\$0.18)	\$11.64	\$12.33	\$13.00
Mar-06	\$12.82	\$12.98	(\$0.16)	\$11.88	\$12.60	\$13.30
Apr-06	\$12.75	\$12.82	(\$0.07)	\$12.31	\$13.52	\$14.71
May-06	\$12.75	\$12.83	(\$0.08)	\$12.35	\$13.69	\$15.01
Jun-06	\$12.87	\$12.88	(\$0.01)	\$12.41	\$13.50	\$14.56
Jul-06	\$13.20	\$13.20	\$0.00	\$12.85	\$13.75	\$14.64
12-month avg		\$13.27	(\$0.00)			

- After putting in the low referenced above, cash [cheese made a bottom and was bid higher](#) on Thursday and Friday. Blocks gained 1¼¢ on the week to settle at \$1.40¼/lb today, while barrels tacked on 1½¢ to close at \$1.38/lb today.
- Hot weather and tight cream supplies helped [cash butter gain 14¢](#) as aggressive bidders jumped over each other to secure product. Butter closed at \$1.73/lb today, with 31 cars trading on the week. The high butter to cheese price is supportive of cheese prices going forward, as the churn attracts milk away from the vat.
- Weekly cold storage numbers released Wednesday show an [8% decline in butter stocks](#) for the month of July.
- Butter stocks at CME-approved warehouses [continue to drop faster than new supplies come in](#). Total on hand for the week ending July 30th was 94 million lbs, vs. 108 million lbs during the same period last year.
- Fluid Milk & Cream Review reports that [hay supplies are expected to be limited](#) in the Midwest due to extensive winterkill, followed by hot and dry conditions this summer. Producers are looking for feed alternatives.
- The southeast part of the nation finally went into its seasonal [milk deficit condition](#), importing a total of 122 loads of grade A milk this week. Milk production continues to decline in the hot weather, while bottlers are starting to gear up for school lunch programs.
- The fluid cream market is very firm, according to Fluid Milk & Cream Review. Supplies have become very tight and demand has been strong. Ice cream producers are having difficulty obtaining enough cream for operations.
- The lower cheese price has encouraged less cheese production, resulting in lower volumes of dry whey produced. Dairy Market News reports that supplies are very tight and [some plants report being sold out](#). Each penny change in the whey price equates to a six cent move in Class III, so a firm whey market is supportive.
- Dairy Market News reports that butterfat levels are much lower than they have been in many years, for this time of the season. Butter producers have been forced to run their operations at below capacity levels
- The U.S. economy added 207,000 new jobs in July, the [most since last April](#), and above analyst expectations of 180,000. Unemployment also held steady at 5%

however....

- Sources tell us that a couple major players in the cheese biz bought too much inventory early on, and have excess product.
- Misters and other technologies are allowing producers to improve cow comfort and cope better during hot weather spells. 2006 contracts are not reacting positively to our current conditions, but are in fact, heading lower.
- Dairy cow slaughter for the week ending July 23rd was [way down](#). Only 40,900 head were culled vs. 47,700 during the same week a year ago. That's more than a 14% drop.
- Stress on the milking herd in California is down this week, according to Fluid Milk & Cream Review. This mirrors our own observations, as sources indicate [production has rebounded](#) somewhat from a couple weeks ago. In addition, the first heat wave in the Pacific Northwest is starting to impact milk production in that area of the country.
- Dairy Products Report: All that milk had to go somewhere. Cheddar cheese production in June of 257.7 million lbs was [up 3.3%](#) vs. a year ago (see chart), and other varieties saw an even larger increase. Total cheese output was up 6.4% and totaled 761 million lbs.
- Crude Oil futures settled at over \$62 per barrel today. Eventually, these costs will be passed on to farmers in the form of higher fuel prices, and goods for consumers will increase as transportation costs go up.



Recommendation:

The silver lining in the massive cheese output of the Dairy Products Report this week, is that the most recent Cold Storage Report showed June American cheese inventories were actually down slightly in June! This implies that commercial use and consumer consumption took care of the excess. Pretty amazing. The markets appear to have put in a low and are now rebounding. The focus right now is on the weather, and with an improving economy, the American appetite for cheese appears healthy. We think continued recovery in prices is likely next week, as the low weekly average cheese price this week will have buyers knocking on the doors of cheese plants on Monday.

September 15.25 calls traded at 12¢ today. Buy them early next week, then put in an order to sell your milk at \$15.40. If successful, you'll have a nice high floor with unlimited upside. The same can be done for October and November. Let's revisit 2006. There is much uncertainty, and prices have been slowly moving lower over the past month, despite the current heat. Perhaps everyone believes the time to sell 2006 will be during the fall rally, but if we all sell at once, prices will drop quickly. We'd recommend getting 25-50% sold in 2006 at a \$12.95 average or better. Do it a little at a time and slowly build your position. The Canadian border, expanding herd and sustained high mailbox prices are all factors that could result in a year of lower prices.

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