



The KDM Dairy Report - October 7th, 2005

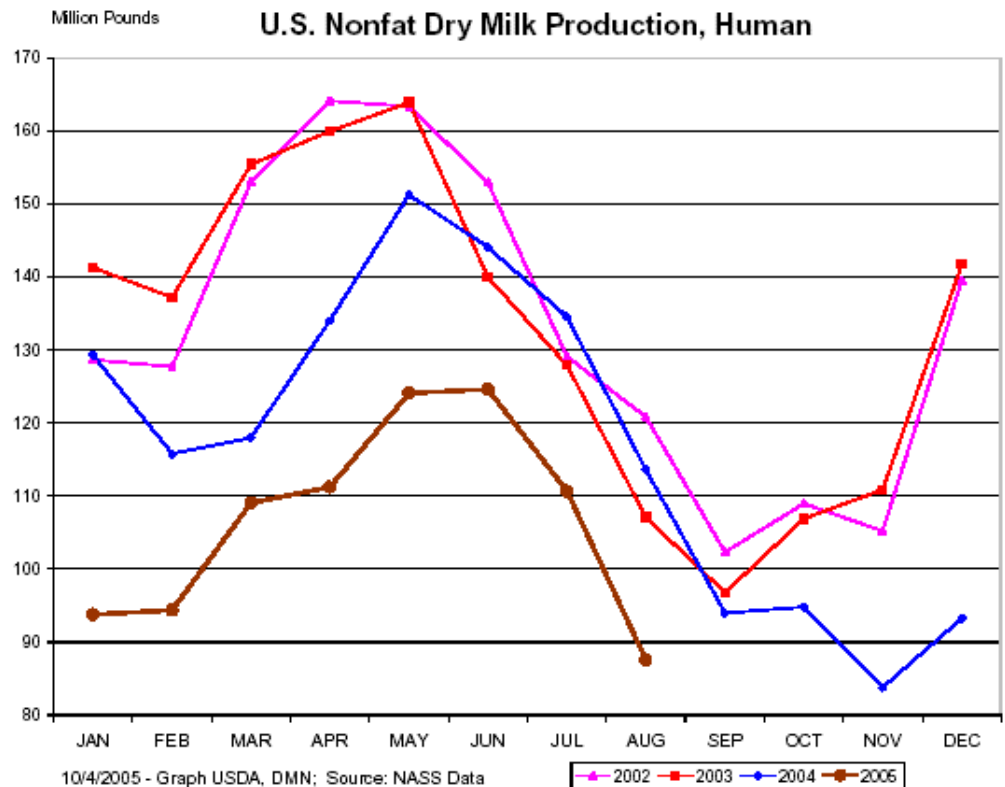
On the bright side:

- NASS average cheese prices [continued to make gains](#), with blocks up 2.9¢ from the previous week to \$1.55/lb. Barrels increased 1.2¢ to \$1.52/lb.
- Weekly cold storage numbers indicate a [strong drawdown](#) during the latter part of September. After being nearly unchanged most of the month, Wednesday's numbers show cheese stocks down 6% for the month, and butter stocks down 15%.
- Butter stocks at CME-approved warehouses [decreased by 4.1 million lbs](#) for the week ending 10/01 vs. a 3.4 million lb drawdown last year.
- Fluid Milk & Cream Review reports manufacturing milk interest has stayed steady, despite cheese buyers cutting orders after the recent drop in the cash price. The milk supply appears to be slightly tighter due to lower intakes.
- Florida [imported 59 more loads](#) of Grade A milk than they did last week, according to Fluid Milk & Cream Review. And milk handlers were hoping to get 40-50 more but couldn't due to lack of available trucking.
- Milk production in California is flat, according to Fluid Milk & Cream Review, and milk supplies are often [short of needs](#). Strong demand from bottlers and cheese plants is noted.

Futures Month	Friday 10/07 Close	Friday 09/30 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Oct-05	\$14.33	\$14.36	(\$0.03)	\$13.10	\$13.91	\$14.71
Nov-05	\$13.48	\$13.55	(\$0.07)	\$12.22	\$13.29	\$14.34
Dec-05	\$13.32	\$13.30	\$0.02	\$12.34	\$13.49	\$14.61
Jan-06	\$12.84	\$12.80	\$0.04	\$12.10	\$12.93	\$13.74
Feb-06	\$12.51	\$12.52	(\$0.01)	\$11.64	\$12.33	\$13.00
Mar-06	\$12.53	\$12.58	(\$0.05)	\$11.88	\$12.60	\$13.30
Apr-06	\$12.44	\$12.51	(\$0.07)	\$12.31	\$13.52	\$14.71
May-06	\$12.48	\$12.55	(\$0.07)	\$12.35	\$13.69	\$15.01
Jun-06	\$12.60	\$12.69	(\$0.09)	\$12.41	\$13.50	\$14.56
Jul-06	\$13.15	\$13.16	(\$0.01)	\$12.85	\$13.75	\$14.64
Aug-06	\$13.31	\$13.28	\$0.03	\$13.28	\$14.19	\$15.09
Sep-06	\$13.56	\$13.77	(\$0.21)	\$13.78	\$14.67	\$15.54
Oct-06	\$13.12	\$13.18	(\$0.06)	\$13.10	\$13.91	\$14.71
Nov-06	\$12.84	\$12.90	(\$0.06)	\$12.22	\$13.29	\$14.34
Dec-06	\$12.77	\$12.82	(\$0.05)	\$12.34	\$13.49	\$14.61

however....

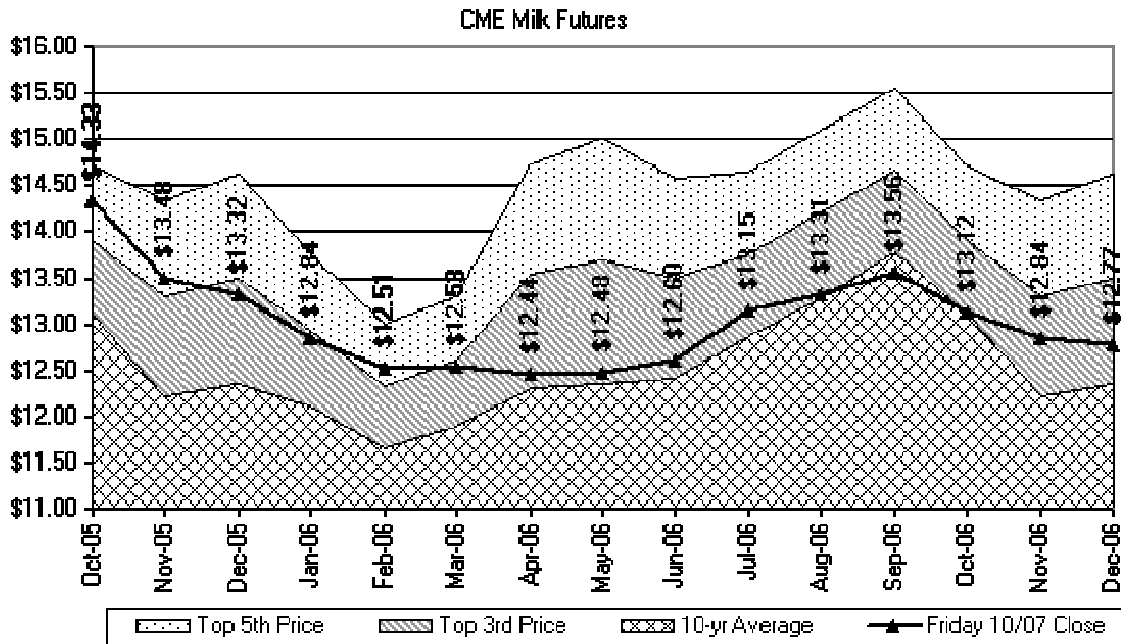
- Cash Crashed. After sitting on the wall at \$1.59½, cheddar blocks had a great fall, plummeting 16¾¢ during the week to close at \$1.42¾ today. Barrels also lost ground, dropping 4½¢ to close at \$1.39¼, putting the block/barrel spread back to more typical 3½¢. Butter stayed relatively strong, but still lost ¾¢ to settle at \$1.64 today. 16 cars of blocks, 1 load of barrels and 18 cars of butter exchanged hands.
- Weekly dairy cow slaughter for the week ending 09/24 was [44,400, vs. 45,600](#) during the same period a year ago.
- Dairy Market News calls the cheese market "weak", as buyers pull orders to take advantage of lower prices.
- While NASS cheese prices were up, other components were down this week. Butter fell 1.3¢ to \$1.69 and dry whey decreased 0.1¢ to 29.8¢/lb.
- Dairy Products Report: Dairy product output in August was [up in several categories](#). Cheddar cheese output increased 1.8% vs. a year ago, American cheese was up 2.7%, Hispanic cheese up 16.8% and Total cheese output up 4%. Butter production was up 1.2%. Finally, hard ice-cream production was up a strong 21.3%. However, NDM output was down 22.9% and dry whey decreased 1%.



- The new cheese plant in Clovis, NM took its [first loads of milk](#) this week, with production projected to be at 30% of capacity by year's end.

Recommendation:

We were looking for a move higher in the barrels this week, but as we all know, that didn't happen. Instead, the block/barrel spread was closed via a dramatic drop in the block price. The 11¢ collapse in blocks on Tuesday got producers' attention, as trade activity in the 2006 contracts picked up dramatically for the remainder of the week. Producers are getting covered. We filled several April-December PAC orders at between a \$12.97-\$13.00 average, which as of today's close is now down to \$12.92.



The Jan-Dec 2006 PAC lost 5¢ from last week and now averages \$12.85.

The only USDA report to come out this week was the Dairy Products Report. The numbers are a mixed bag, really. Both milk production and demand were strong in August, so it's logical that output would be higher. And it's encouraging to see larger increases in specialty cheeses, such as Hispanic varieties, which draw milk away from cheddar. Dry products as well, continued to be in short supply as production of whey and NDM was lower. The strong export market for these dry products should last into 2006, and provide some support for Class III. Each penny gain in dry whey is equal to a six cent gain in Class III.

Short-term: Despite the crash in the cash market, our recommendation to leave Nov and Dec open for the time being remains unchanged. As we quoted from Dairy Market News last week, fall buyers are far from covering their holiday needs, and another push on the cheese price in 1-2 weeks is very possible. Consider again the following from this week's Dairy Market News:

Demand had slowed considerably as buyers believed there was a strong chance that block cheese prices might falter in the near term. Now that prices have moved lower, it is anticipated that buyers will return to the market. The consensus seems to be that within two weeks, buyers will need to return to the market in a big way to be able to cover fall needs in a timely fashion. However, a large boost in orders for a short period could cause some supply problems if they exceed current milk volumes available for cheese production. The gamble for buyers is whether cheese makers will have adequate time and milk to fill orders later.

Of course, there's no guarantee this will happen, especially if we have more than enough cheese, but we would take the risk to wait and sell Nov and Dec on a push higher. Interestingly, Oct-Dec Class III finished 4-5¢ higher today, despite another drop in the cash cheese market and weakness in all 2006 contracts. Will they lead the way next week?

Long-term: Though we have some guarded optimism for the front months, we are still very negative over the prospect for higher prices in 2006, and our recommendation remains unchanged; sell Apr-Dec 2006. As mentioned above, selling has started in earnest as producers began to do what we've been recommending for the past 5 months. In fact, looking back at our archives (available online at www.kdmtrading.com), we first recommended selling all of 2006 on 06/03 at a \$12.96 average, then again on 06/17 at \$12.98, 07/01 at \$13.09 and 08/05 at \$12.95. Any of those are a whole lot better than the current \$12.85 average, but you still have an opportunity to do something! Apr-Dec currently averages \$12.92. Enter orders next week to sell a percentage at \$12.92 to ensure you get something done, and then target further sales at \$12.95. We would target to sell Jan – Mar at a \$12.80 average or higher, counting on both the CWT herd retirement and export assistance programs to provide some support for prices in Q1.

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.