



## The KDM Dairy Report - November 4<sup>th</sup>, 2005

### On the bright side:

- October Class III final price was announced today at \$14.35, well above its top-third historical price of \$14.00, and 5¢ higher than last month. Class III futures have now settled over \$14 in 17 of the last 20 months.
- Weekly cold storage numbers for the month of October show a [3% drawdown in cheese stocks](#) and 13% drop in butter stocks.
- Dairy cow slaughter for the week ending 10/22 was [51,500 head vs. 48,300 head](#) during the same period a year ago. The increase is most likely due to the CWT herd retirement program getting started.
- Weekly butter movement out of CME-approved warehouses was 4.27 million lbs vs. 3.47 million lbs during the same period a year ago. Inventories are still higher than a year ago, but getting closer.
- Some herds have been retired and the [drop in milk intakes](#) was noted by some California processors, according to Fluid Milk & Cream Review. But growth is expected again as cows freshen over the next few months. Bottled milk orders are strong and heifer prices are reported at near record levels.
- Economy: Alan Greenspan testified before Congress on Thursday that the economy is [set for solid expansion](#) despite the affects of recent hurricanes. Growth could be supported by the rebuilding efforts in the Gulf Coast areas.

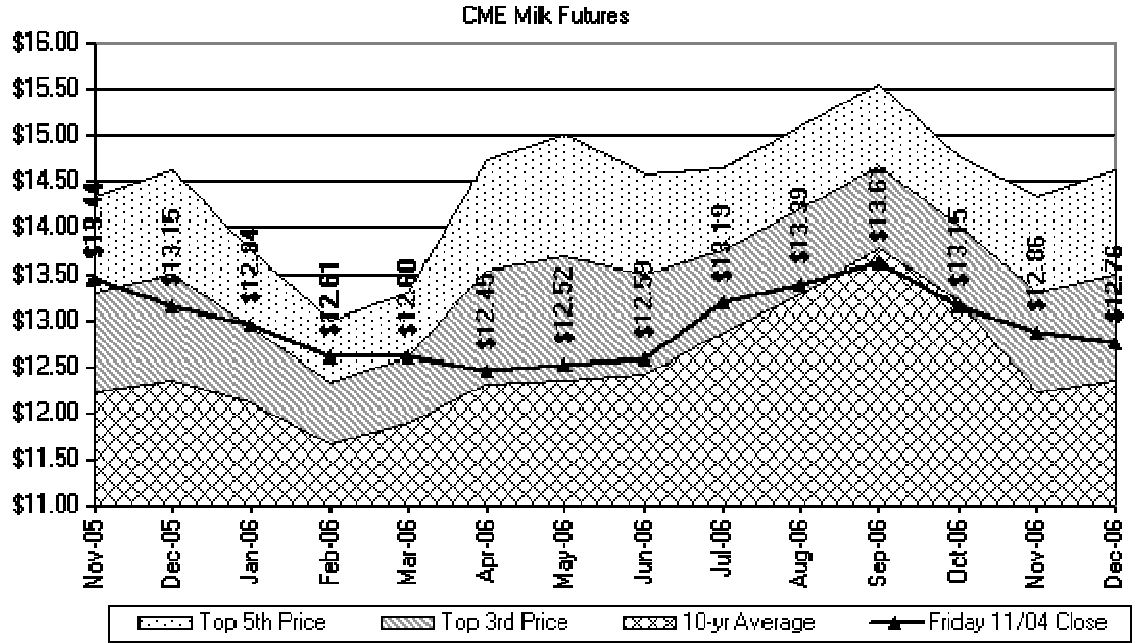
Futures Month	Friday 11/04 Close	Friday 10/28 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Nov-05	\$13.44	\$13.57	(\$0.13)	\$12.22	\$13.29	\$14.34
Dec-05	\$13.15	\$13.36	(\$0.21)	\$12.34	\$13.49	\$14.61
Jan-06	\$12.94	\$12.95	(\$0.01)	\$12.10	\$12.93	\$13.74
Feb-06	\$12.61	\$12.60	\$0.01	\$11.64	\$12.33	\$13.00
Mar-06	\$12.60	\$12.65	(\$0.05)	\$11.88	\$12.60	\$13.30
Apr-06	\$12.45	\$12.50	(\$0.05)	\$12.31	\$13.52	\$14.71
May-06	\$12.52	\$12.55	(\$0.03)	\$12.35	\$13.69	\$15.01
Jun-06	\$12.59	\$12.65	(\$0.06)	\$12.41	\$13.50	\$14.56
Jul-06	\$13.19	\$13.18	\$0.01	\$12.85	\$13.75	\$14.64
Aug-06	\$13.39	\$13.42	(\$0.03)	\$13.28	\$14.19	\$15.09
Sep-06	\$13.61	\$13.66	(\$0.05)	\$13.78	\$14.67	\$15.54
Oct-06	\$13.15	\$13.17	(\$0.02)	\$13.21	\$14.00	\$14.77
Nov-06	\$12.86	\$12.85	\$0.01	\$12.22	\$13.29	\$14.34
Dec-06	\$12.76	\$12.78	(\$0.02)	\$12.34	\$13.49	\$14.61

### however....

- Dairy Products Report: September [butter and cheese production was up](#) from a year ago. Butter output increased 7.2%, American cheese up 2.6%, Cheddar up 1.8% and Total Cheese up 3.9%. Cheese output was down from last month, but that was likely the result of cheese plants dealing with the unprofitable milk-to-cheese price ratio. Where did all the milk go? September butter production was up 10.3% from August. The only real positive in the report was the 24.2% drop in Nonfat Dry Milk, which has been in tight supply all year.
- NASS [cheese prices continued to sag](#) in light of recent pressure in the cash market. 40-lb blocks averaged \$1.45/lb, down 2.2¢ from the previous week, while 500-lb barrels averaged \$1.41/lb, down 0.8¢.
- The cash cheese market continued to come under pressure from sellers this week. Blocks dropped 3¢ from last Friday, closing at \$1.37/lb with a total of 21 loads exchanging hands. Barrels fell 4½¢ to \$1.30½/lb, with no buyers to be found the entire week. Butter was sharply lower, plunging 10¼¢ to settle at \$1.47½ today.
- Unseasonably mild weather in the Midwest is resulting in [stronger-than-usual milk production](#), according to Fluid Milk & Cream Review. Lows in the 40's and highs in the 60's have cows very happy.
- Production of seasonal and cream-based items is slow to fair, according to Fluid Milk & Cream Review. Cream supplies are heavy, with some plants opting to churn instead of marketing the cream because of the better return.
- It doesn't look like we'll see a post-Thanksgiving push like we did last year. Dairy Market News reports this year's butter drawdown is more gradual than last year, so handlers [do not expect a spike in prices](#) come December. Thanksgiving orders have been filled and orders for year-end have been placed. Handlers feel current churning schedules will be sufficient to handle year-end orders.
- Dairy Market News reports [cheese demand is sluggish](#). Offerings of current cheddar and natural American are adequate to handle the weak demand.
- Economy: Only 56,000 new jobs were created in October, according to figures released today by the Labor Department. The number was [well below analyst forecasts](#) of more than 100,000 new jobs. And August and September figures were revised lower, showing 35,000 fewer jobs were created than originally thought.

**Recommendation:**

Excess cheese continued to make its way to the CME cash market this week, pressing prices below the "theoretical" CWT support price of \$1.40. We say "theoretical", because the CWT export assistance program does not buy cheese itself directly from the CME, but instead, reimburses buyers in their program who export the cheese at a loss. Two things need to happen before a



transaction takes place. First, the exporter needs a buyer. With the world price for cheese down to about \$1.30/lb, there doesn't appear to be a lot of world-wide demand for cheese at the moment. Second, there needs to be enough incentive for the exporter to go through the hassle of buying from the CME cash market and going through the regulatory hoops to sell the product overseas. It's hard to quantify how many cents below \$1.40 we need to get to before that happens, but the block price sailed comfortably below \$1.40 this week before encountering buyers in the \$1.36 to \$1.37 range. All this to say that the CWT support price of \$1.40 doesn't necessarily guarantee we'll stay at or above \$1.40/lb on the CME cash market. It does probably mean we won't go below \$1.30/lb, but anywhere in between is fair game.

**Short-term:** Cheese plants we work with have indicated orders are slowing down, and it appears that we'll have plenty of butter on hand for the holidays. Cheese buyers may be waiting for the price to hit bottom before entering the market again, so we could see another push later in the month, but it's looking less likely. We're now in November, so there's not a whole lot we can do with that contract. Hopefully you bought those cheap \$13.75 put options when they were available, or sold above \$13.60 as we've recommended the past few weeks. December took the biggest hit this week, and could head below \$13. Target to sell December at \$13.25 or higher and then buy a \$13.50 call for 5-6¢ to protect your upside.

**Long-term:** We continue to have a negative outlook for 2006. We successfully sold Apr-Dec at \$12.95 average today. Assuming CWT can hold blocks at \$1.35 or higher, strength in the NDM and whey price are likely to continue due to strong export demand and shortage of product. This projects to an approximate floor for Class III milk of \$12.45. In addition to selling the Apr-Dec pac as we have been, one could alternatively sell selected months in 2006 that are significantly higher than \$12.45 (our projected floor), as they involve greater downside risk. For example, April, May and June all settled below \$12.60 today. You could skip those months, and sell July through December at a \$13.16 average. The risk in not selling Apr-May, however, is assuming CWT will have the capital to fund the export program through those months, which is not a given. It's for this reason we've been recommending selling Apr-Dec, and leaving Jan-Mar open.

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