



## The KDM Dairy Report - November 11<sup>th</sup>, 2005

### On the bright side:

- Dairy cow slaughter was [above year ago levels](#) again this week. 48,800 head were culled vs. 47,600 during the same period last year. Thank you CWT.
- Fluid Milk & Cream Review reports [Class II demand improved](#) this week as manufacturers produce specialty items such as dips and sour cream for the holidays.
- Florida continues to [import high volumes](#) of Grade A milk. 236 tankers entered the state last week, vs. only 128 last year.
- International: Dairy Market News reports the adverse weather conditions for the past month in New Zealand are impacting milk production. Milk handlers report [peak levels have not reached last year's levels](#).

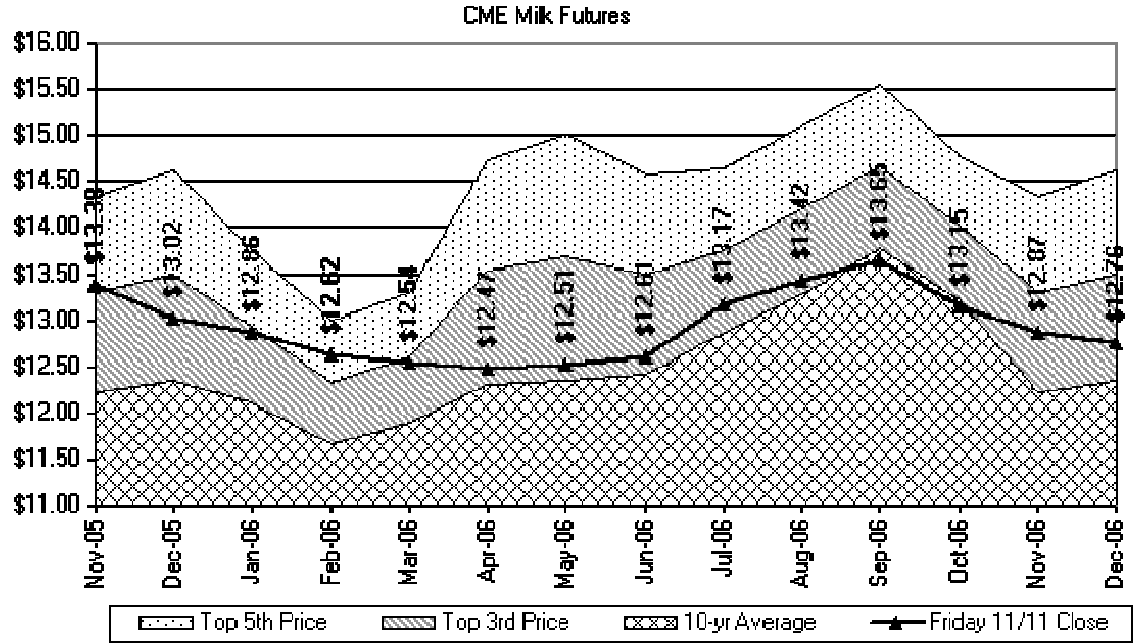
Futures Month	Friday 11/11 Close	Friday 11/04 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Nov-05	\$13.38	\$13.44	(\$0.06)	\$12.22	\$13.29	\$14.34
Dec-05	\$13.02	\$13.15	(\$0.13)	\$12.34	\$13.49	\$14.61
Jan-06	\$12.86	\$12.94	(\$0.08)	\$12.10	\$12.93	\$13.74
Feb-06	\$12.62	\$12.61	\$0.01	\$11.64	\$12.33	\$13.00
Mar-06	\$12.54	\$12.60	(\$0.06)	\$11.88	\$12.60	\$13.30
Apr-06	\$12.47	\$12.45	\$0.02	\$12.31	\$13.52	\$14.71
May-06	\$12.51	\$12.52	(\$0.01)	\$12.35	\$13.69	\$15.01
Jun-06	\$12.61	\$12.59	\$0.02	\$12.41	\$13.50	\$14.56
Jul-06	\$13.17	\$13.19	(\$0.02)	\$12.85	\$13.75	\$14.64
Aug-06	\$13.42	\$13.39	\$0.03	\$13.28	\$14.19	\$15.09
Sep-06	\$13.65	\$13.61	\$0.04	\$13.78	\$14.67	\$15.54
Oct-06	\$13.15	\$13.15	\$0.00	\$13.21	\$14.00	\$14.77
Nov-06	\$12.87	\$12.86	\$0.01	\$12.22	\$13.29	\$14.34
Dec-06	\$12.76	\$12.76	\$0.00	\$12.34	\$13.49	\$14.61

### however....

- Cash market: This week it was butter's turn to crash, as it shed 7½¢, closing at \$1.40/lb today. Blocks were steady the entire week, closing unchanged at \$1.37/lb. Barrels managed to gain 1¾¢, but it was really window-dressing to close the block/barrel spread to more typical levels. Barrels settled at \$1.32¼/lb today.
- NASS [prices continued to slide](#) this week. Blocks fell 1.4¢ to \$1.44/lb while barrels dipped 0.3¢ to \$1.41/lb. Butter plunged 6.1¢ to \$1.55/lb.
- Butter inventories at CME warehouses are [27% higher](#) than they were a year ago, according to this week's numbers. 49 million lbs are on hand, vs. 38.7 million lbs last year at this time.
- Dairy Market News reports the cash butter market remains weak. Cream [supplies are abundant](#) coast to coast and churning activity is strong.
- This week's Crop Production Report confirmed we're headed towards the [second largest](#) corn and soybean crops on record.
- World Ag Supply & Demand Report: USDA increased [their 2005/06 milk production forecast](#) from last month on higher output per cow numbers. At the same time, they lowered their cheese and butter price forecasts on increased supplies. As a result, their Class III forecast for 2006 was lowered as well.

## Recommendation:

Only 2 loads of barrels, 11 loads of blocks and 21 loads of butter traded on the cash market this week. It looks like we've put in a near-term bottom with good support for blocks at \$1.37. The main seller doesn't appear interested in pushing things lower either. With supplies readily



available, a major push higher doesn't look realistic. But the lower prices should stimulate demand over the coming weeks with time running out for buyers to have orders in place to guarantee holiday delivery. November and December futures came off their mid-week lows and finished 1-2¢ higher today.

**Short-term:** It's possible we could see December and January benefit from increased demand and the ongoing CWT cow cull. Target to sell December at \$13.25 or higher, and January at \$13.10 or higher. Be patient and let the price come to you.

**Long-term:** This week saw continued higher trade volumes in all 2006 contracts as buyers and sellers met. Producers were motivated to sell and get covered, and commercials hedged against higher prices. We continue to have a negative outlook for 2006 and recommend selling 50-75% of your milk at current prices. For larger dairies, consider this strategy for 25% of your milk. Sell January through June 12.00 put options and 13.00 call options, collecting 40¢ premium (\$800 per contract). This trade is known as a straddle and works well in times of lower price volatility. The rationale for the trade? Assuming cheese trades in those months from \$1.25 to \$1.45, cheese will average \$1.35 which is about \$12.50 Class III milk, right in the middle of your straddle. Both options would expire worthless, allowing you keep the 40¢, adding that to your final milk price. If for some reason we believe the market conditions have changed, cover the options with futures positions. Prices would need to move below \$11.60 or above \$13.40 to lose money on the trade, otherwise you would keep all or part of the initial premium received.

Call us if you'd like further explanation on this trade or would like help putting together a hedge program for your dairy!

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