



The KDM Dairy Report - December 9th, 2005

On the bright side:

- The cash cheese market continued to make small, incremental gains this week due to holiday demand. Blocks gained 1¾¢ for the week, closing at \$1.43½ today, while barrels tacked on ¾¢ to finish at \$1.39½. There were no barrel trades all week, but steady selling of blocks, with 20 loads changing hands.
- Weekly dairy cow slaughter [continues to show strength](#) under the CWT herd retirement program. For the week ending 11/26, 39,300 head were culled vs. 34,700 during the same period a year ago.
- Fluid Milk & Cream Review reports production of dips, sour cream and other holiday specialty products [remains strong](#) in the Midwest.
- World Ag Supply & Demand Report: USDA lowered their milk production forecast slightly for 2005 and 2006, citing a marginally smaller herd size and lower milk per cow growth rate. As a result, they [increased their average Class III price forecast](#) for 2006 by 15¢, to \$12.45. However, that's still about 50¢ lower than the current futures-priced 2006 average.
- Improved demand for Class II milk in the Southeast is [helping ease the volumes](#) going into Class III and Class IV plants, according to Fluid Milk & Cream Review. In addition, 127 loads of Grade A milk were imported into the region this week, vs. only 36 loads at this time a year ago.
- International: Milk receipts in New Zealand continue to run about [2% below last year](#), according to Dairy Market News. With milk volumes now declining seasonally, current output is in close balance with demand, but inventories remain light.
- International: Dairy Market News reports cheese demand is strong in Western Europe. Buyers looking for cheese for immediate delivery, including cheddar, are [finding supplies limited](#).
- Though dry whey prices remain firm, fear of strong export demand has end [users are contracting loads](#) for 2006 to guarantee their supplies, according to Dairy Market News.
- NASS prices for both [blocks and barrels were up slightly](#), as they react to recent gains in the cash market. Blocks gained 0.4¢ to \$1.36/lb while barrels picked up 1¢ to \$1.35/lb. Nonfat dry milk threatened to break \$1, moving up 1.1¢ to 99.5¢/lb.

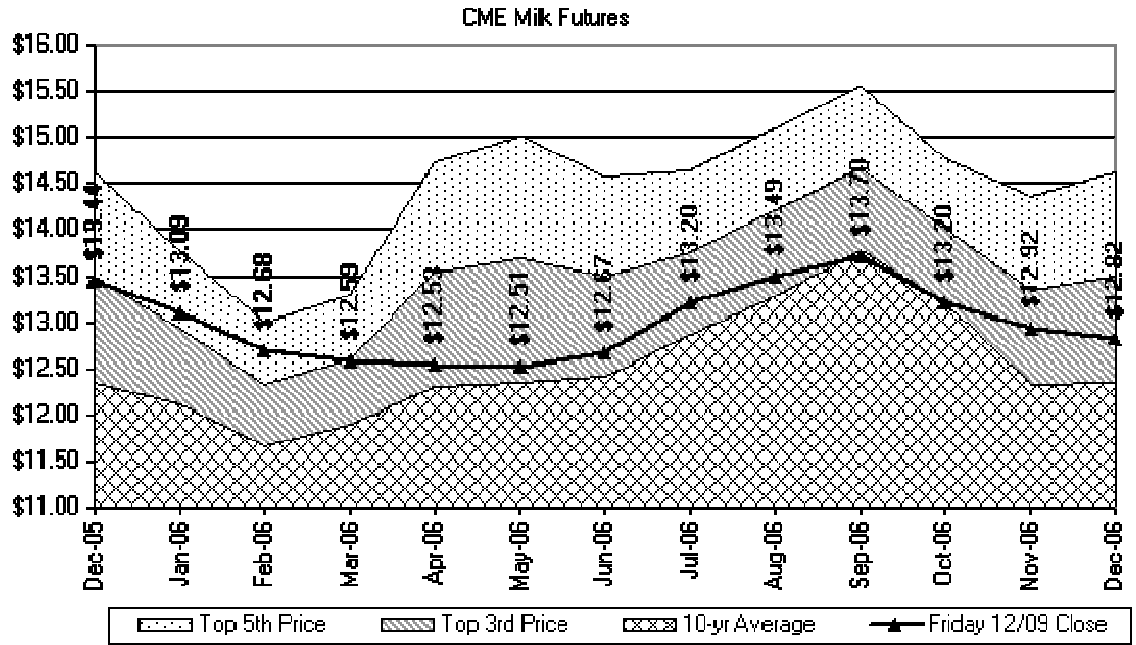
Futures Month	Friday 12/09 Close	Friday 12/02 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Dec-05	\$13.44	\$13.30	\$0.14	\$12.34	\$13.49	\$14.61
Jan-06	\$13.09	\$12.87	\$0.22	\$12.10	\$12.93	\$13.74
Feb-06	\$12.68	\$12.52	\$0.16	\$11.64	\$12.33	\$13.00
Mar-06	\$12.59	\$12.48	\$0.11	\$11.88	\$12.60	\$13.30
Apr-06	\$12.53	\$12.42	\$0.11	\$12.31	\$13.52	\$14.71
May-06	\$12.51	\$12.47	\$0.04	\$12.35	\$13.69	\$15.01
Jun-06	\$12.67	\$12.60	\$0.07	\$12.41	\$13.50	\$14.56
Jul-06	\$13.20	\$13.16	\$0.04	\$12.85	\$13.75	\$14.64
Aug-06	\$13.49	\$13.43	\$0.06	\$13.28	\$14.19	\$15.09
Sep-06	\$13.70	\$13.63	\$0.07	\$13.78	\$14.67	\$15.54
Oct-06	\$13.20	\$13.16	\$0.04	\$13.21	\$14.00	\$14.77
Nov-06	\$12.92	\$12.88	\$0.04	\$12.32	\$13.34	\$14.35
Dec-06	\$12.82	\$12.77	\$0.05	\$12.34	\$13.49	\$14.61

however....

- Butter stocks in CME-approved warehouses are now [more than double](#) what we had last year. 29.9 million lbs are on hand vs. only 12.6 million lbs at this time a year ago. Drawdown for the week ending 12/03 was 920,000 lbs, but a year ago, stronger demand pulled 1.7 million lbs out of storage.
- [Too much cream!](#) That's the situation in the Southwest, according to Fluid Milk & Cream Review. Butter production is active, attempting to process the excess, but ice cream production is winding down for several plants, and will put more cream on the market.
- [Butter demand is weak](#), according to Dairy Market News. Cream supplies are heavier than anticipated, and with most holiday orders shipped, only fill-in orders are likely to be placed this late in the season.
- While cheese and NDF were higher, the NASS butter price continued to show weakness, falling 3.4¢ from the previous week to \$1.39/lb.
- Cash butter drifted a half-cent lower this week, settling at \$1.37, with 12 loads changing hands. In light of fundamentals, prospects do not look good for prices to move much higher in the near term, if at all.

Recommendation:

Short-term: We filled our December 13.25 put option this week at 5¢ in the event holiday buying ended this week. It didn't, and December continued to move higher. That's great! We only spent a nickel and still participate in the higher price. At this point, we are far enough into December to leave it alone. We'll now focus on January. No one knows when the current cash cheese demand will



end, but logistically, we don't think it can go much past the middle of December in order to receive product by Super Bowl Sunday. Yes, we could see continued buying past that date to restock warehouses, but as school lets out, more milk will need to go into manufacturing plants, putting pressure on the current cheese and butter price. So sell January milk at \$13.15 or higher, or place an order to buy the 13.00 PUT for 10¢.

Long-term: We continue to have a negative outlook for prices in 2006. This week we continued to see producers getting covered, with Thursday's trade volume revealing 30-40 contracts or more in all 2006 futures months. We've recommended not selling Feb-Jun while they were mired at the \$12.50 level, but they have made some nice gains this week. You need to start asking yourself, which do I fear most? Not selling milk at a \$13 average for the year and prices falling to the 12 dollar level, or selling on a forward contract at \$13 and watching prices rise to the 14 dollar level? The price move is the same – you are \$1 dollar/hundredweight worse off either way. But the economic impact to your dairy, favors selling at \$13, since it represents a profit and the loss of \$1 on the upside means only fewer profits. The \$1 on the downside could mean red ink to your bottom line. Fear of pricing and seeing prices rise is strong because it requires taking action and accountability, while taking no action and accepting the same or greater risk, does not seem as bad. With that bit of market psychology said, consider taking the following actions: Sell Jan-Dec at \$12.95 average; last week it was \$12.87. Sell July-Dec at \$13.22 average, Jan at \$13.15 or higher per above, and Feb-June at \$12.80 or higher. We think you should get covered Apr-Dec on 50-75% of your production.

Please feel free to call us if you would like help putting together a risk management plan for you operation!

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