



## The KDM Dairy Report - December 23<sup>rd</sup>, 2005

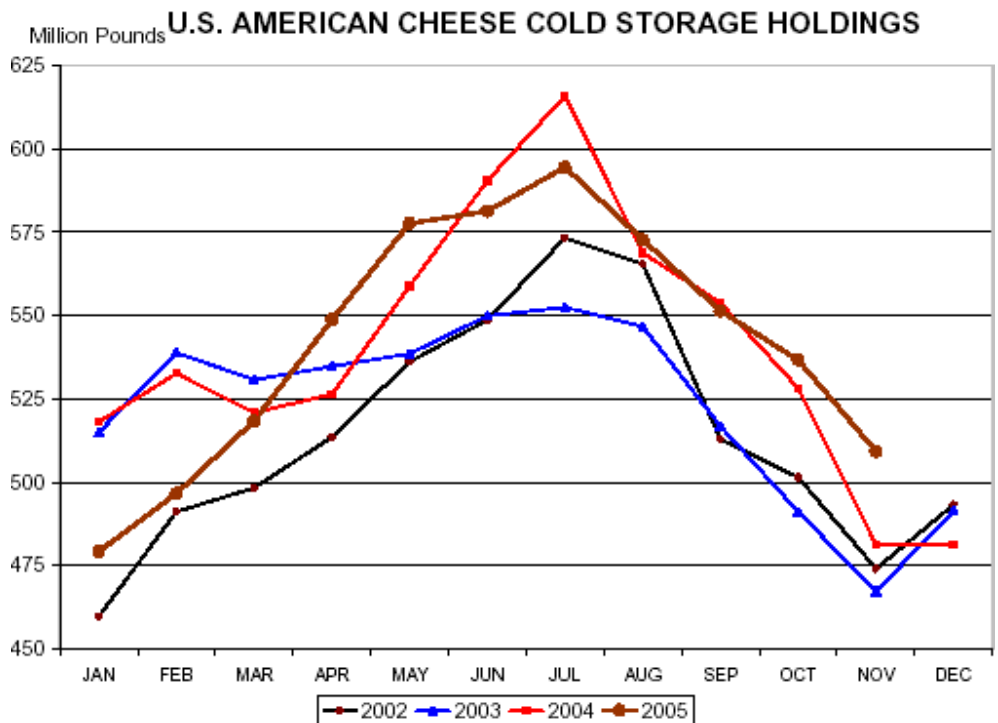
### On the bright side:

- USDA NASS average cheese prices [continue to rebound](#) from their recent lows. US 40 lb blocks increased 2.2¢ to \$1.40/lb, while 500 lb barrels moved 2.3¢ higher to \$1.39/lb. Butter was also higher, up 1¢ to \$1.37/lb, NDM was up 0.5¢ to stay at \$1.00/lb and dry whey moved 0.2¢ higher to 32.6¢/lb.
- Dairy Market News reports New Zealand milk [production is trailing last year by about 2%](#), which is on top of last year's decline of 3-4%. Supplies of manufactured dairy products remain tight.
- For the period 12/01 through 12/19, butter stocks have declined 11% and [cheese stocks are down 1%](#) at USDA select storage centers. Cheese stocks had been flat as of last week, so the 1% decline shows buyers are still going after product.
- Weather conditions in the Pacific Northwest are wet. Heavy rains are making for [muddy feed lots](#), with the associated herd health concerns from the damp weather increasing. Fluid Milk & Cream Review notes some concern over shipments during the holidays due to the poor weather.
- Whey exports for the first 10 months of the year were 355.1 million lbs, [up 24%](#) from a year ago, according to Dairy Market News. Main importers are China (95 million lbs), Japan (46 million lbs), Canada (40 million lbs), Korea (38 million lbs) and Thailand (28 million lbs). The market continues to be firm with little international competition for exports.
- Economy: Consumer prices fell a record 0.4% last month, according to the Commerce Department, due in large part to the fall in energy prices following the hurricane season peaks. In addition, consumer spending rose 0.7% and personal income grew 0.3%. These figures support the idea that inflation is under control, while the economy continues to grow at a moderate pace.

Futures Month	Friday 12/23 Close	Friday 12/16 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Dec-05	\$13.40	\$13.40	\$0.00	\$12.34	\$13.49	\$14.61
Jan-06	\$13.28	\$13.15	\$0.13	\$12.10	\$12.93	\$13.74
Feb-06	\$12.82	\$12.67	\$0.15	\$11.64	\$12.33	\$13.00
Mar-06	\$12.70	\$12.63	\$0.07	\$11.88	\$12.60	\$13.30
Apr-06	\$12.64	\$12.55	\$0.09	\$12.31	\$13.52	\$14.71
May-06	\$12.58	\$12.55	\$0.03	\$12.35	\$13.69	\$15.01
Jun-06	\$12.71	\$12.68	\$0.03	\$12.41	\$13.50	\$14.56
Jul-06	\$13.17	\$13.16	\$0.01	\$12.85	\$13.75	\$14.64
Aug-06	\$13.38	\$13.41	(\$0.03)	\$13.28	\$14.19	\$15.09
Sep-06	\$13.56	\$13.62	(\$0.06)	\$13.78	\$14.67	\$15.54
Oct-06	\$13.16	\$13.18	(\$0.02)	\$13.21	\$14.00	\$14.77
Nov-06	\$12.85	\$12.87	(\$0.02)	\$12.32	\$13.34	\$14.35
Dec-06	\$12.75	\$12.76	(\$0.01)	\$12.34	\$13.49	\$14.61

### however....

- Cold Storage Report: Higher milk output is resulting in [higher dairy stocks](#). American cheese stocks in November were 6% higher than a year ago, while Total cheese stocks were up 2%. The 509.2 million lbs of American cheese on hand are well above the 6-year average for this date of about 470 million lbs. In addition, butter stocks were up 7% from 2004 levels.
- After moving 3¢ higher to \$1.46/lb this week, cash blocks fell Thursday and Friday to finished unchanged from a week ago at \$1.43/lb. 2 offers and 0 bids remained after today's cash trade. Barrels finished ¼¢ higher this week to \$1.40/lb, but is largely just maintaining the 3¢ spread with blocks. Cash butter, on the other hand, fell to its lowest price since December 2003, losing 2¼¢ this week to close at \$1.33½.
- The USDA expects cheese and [milk prices to be much lower next year](#).

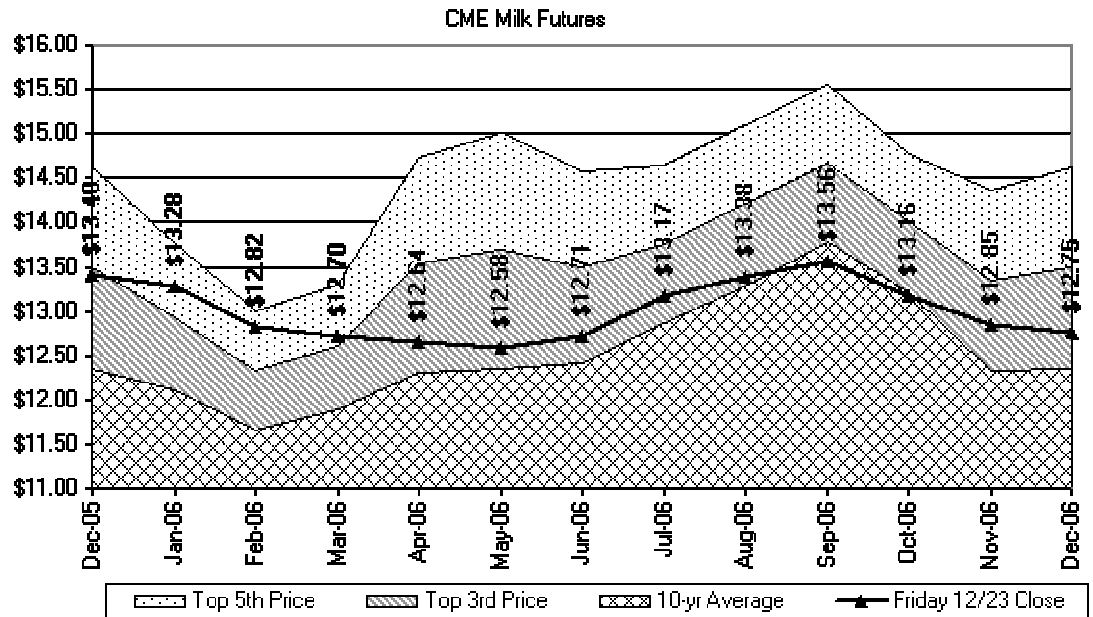


Their most recent forecast has block cheese averaging about \$1.33/lb for the year and predicts Class III milk will average about \$12.30/cwt. The current 2006 average, as of Friday's closing Class III futures prices, is \$12.97/cwt.

- Livestock Slaughter Report: November dairy cow slaughter, aided the by CWT program, was 8.6% higher than a year ago. That's good, but the more important YTD measurement shows January through November [dairy cow slaughter trailing last year](#) by 4.1%, or 87,600 head.
- The CWT herd retirement program is over, if this week's cow slaughter numbers are any indication. The dairy cow cull fell [back below year ago levels](#) this week, with 48,000 head going to slaughter vs. 51,500 last year.
- Butter stocks at CME-approved warehouse are now [more than triple](#) year ago levels. For the week ending December 17<sup>th</sup>, 27.7 million lbs were on hand vs. only 8.7 million lbs last year.
- Fluid Milk & Cream Review reports surplus [milk volumes are expected to be heavy](#) over the holiday period, as schools and universities are closed. Spot loads of milk are clearing anywhere from \$1 to \$3 under class.
- Cream [offerings are heavy and will increase](#) over the next two weeks, according to Dairy Market News. Most of the surplus cream will be churned into butter.
- Dairy Market News reports Western cheese stocks are not tight and [orders are not fantastic](#). Cheese production is heavy and expected to increase over the next couple weeks.
- Florida went from a milk deficit to [milk surplus state](#) this week. Nothing was imported, and a few loads actually left the region for other areas. That compares with last week, when 104 loads of Grade A milk were shipped in.
- Weather conditions are near ideal in California's Central Valley, according to Fluid Milk & Cream Review. December has been warmer than usual and milk [output is steady to higher](#).
- Though it won't be as generous, the Senate on Wednesday approved the [renewal of the MILC program](#) for two years at a cost of 1 billion dollars. It is widely believed the program lengthened the 18-month period of low prices from mid-2002 through 2003 by encouraging overproduction despite low milk prices. The measure hasn't yet passed the House, but it is all but certain.
- Economy: New [home sales fell](#) in November by their largest amount in nearly 12 years, according to the Commerce Department. The decline of 11.3% from October was even greater than analyst expectations of an 8.7% drop.

**Recommendation:**

January continued to rock early in the week, hitting a contract high of \$13.70 intraday on Tuesday, before the party ended as cash cheese finally stumbled. There were some amazing opportunities to hedge! We purchased several 13.50 PUT options for 14-15¢ and sold futures outright for producers between \$13.50-\$13.60. 1<sup>st</sup> quarter prices finally moved higher as well, with Feb and Mar moving above \$12.80. The 2006 average is now \$12.97, and at one point this week, you could easily have sold the entire year for over a \$13.00. average. But were you ready to take



action? You need to have a plan in place to execute when opportunities like this come your way. Sure, it didn't feel good selling at \$13.50 when Jan zoomed up to \$13.70, but it feels a lot better now, with January settling at \$13.28 today. And in the end, if January does go higher, we know we've locked in a profit for those operations who chose to sell at that level. Check out the cold storage holdings chart for American cheese above. It paints a pretty good picture of what we're headed for. We're going to need some big demand in 2006 to accommodate the extra milk and manufactured dairy goods we're likely to produce. So, sell January at \$13.28 or higher. There are still four weeks left in its calculation, and a lot can happen to the cheese market in that time. Or try to buy the Jan 13.25 PUT for 10¢. Feb went over \$13 during the week and March went over \$12.90. Enter orders to sell Feb at \$12.85 or higher and March at \$12.80 or higher. Longer term, look at selling 2006 at \$13.00 or higher. That's 70¢/cwt higher than USDA's forecast, and 60¢/cwt higher than the 10-year annual average!

Call us and we'll help you put together a risk management plan for you operation! Toll free 877.695.8538. Visit us on the web at <http://www.kdmtrading.com> and register online for our weekly commentary.

**NOTE:** We will be closed on Monday, December 26<sup>th</sup> in observance of Christmas. Dairy markets will be closed.

Finally, on behalf of KDM Trading, we wish you and yours a very Merry Christmas!

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