The KDM Dairy Report - December 30th, 2005

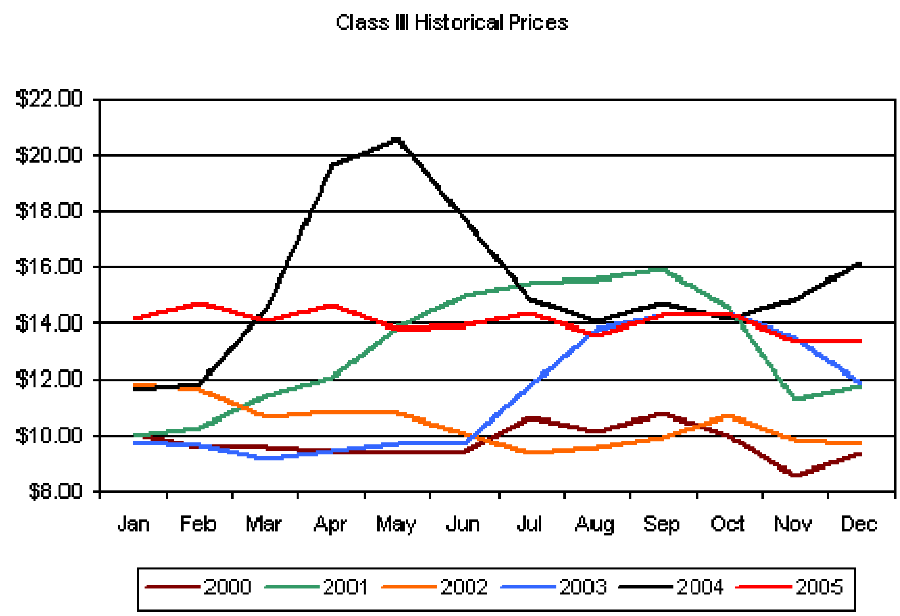
On the bright side:

Futures Month	Friday 12/30 Close	Friday 12/23 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Jan-06	$13.25	$13.28	($0.03)	$12.10	$12.93	$13.74
Feb-06	$12.91	$12.82	$0.09	$11.64	$12.33	$13.00
Mar-06	$12.80	$12.70	$0.10	$11.88	$12.60	$13.30
Apr-06	$12.65	$12.64	$0.01	$12.31	$13.52	$14.71
May-06	$12.58	$12.58	$0.00	$12.35	$13.69	$15.01
Jun-06	$12.73	$12.71	$0.02	$12.41	$13.50	$14.56
Jul-06	$13.16	$13.17	($0.01)	$12.85	$13.75	$14.64
Aug-06	$13.35	$13.38	($0.03)	$13.28	$14.19	$15.09
Sep-06	$13.55	$13.56	($0.01)	$13.78	$14.67	$15.54
Oct-06	$13.12	$13.16	($0.04)	$13.21	$14.00	$14.77
Nov-06	$12.85	$12.85	$0.00	$12.32	$13.34	$14.35
Dec-06	$12.74	$12.75	($0.01)	$12.44	$13.53	$14.60

- The December Class III announced price is $13.37, well above its historical 10-yr average of $12.44. For the year, 2005 averaged $14.05, its third highest average of all time.
- The latest Commercial Disappearance numbers released by USDA on Thursday show continued improvement in demand vs. a year ago. Use of milk in all products in October was up 1.9% vs. last year and butter use was up 4.1%. But usage of American cheese was down 4.5%.
- USDA NASS prices managed another week of increases, although we expect them to start dropping soon in light of recent cash price declines. U.S. 40-lb blocks averaged $1.42/lb, up 2¢ from the previous week, while 500-lb barrels gained 1¢ to $1.40. Dry whey continued its slow climb, up 0.2¢ to 32.8¢/lb.
- Weather: Northern California and the Pacific Northwest have been soaked by rain, which may hamper milk production at open-lot facilities. Forecasters are calling for an additional 8 or more inches of rain to fall as a new Pacific storm rolls in, with wind gusts up to 50mph. A strong Pacific jet stream could continue to bring a series of storms to the West Coast, and Southern California is expected to receive significant precipitation on Monday. There could be enough rain to cancel the Rose Bowl parade for the first time in 50 years, as well as cause flooding and mudslides.
- Economy: Consumer confidence has rebounded to its highest level since August. It had plummeted in October, just after hurricane Katrina, sending energy prices to record highs.

however….

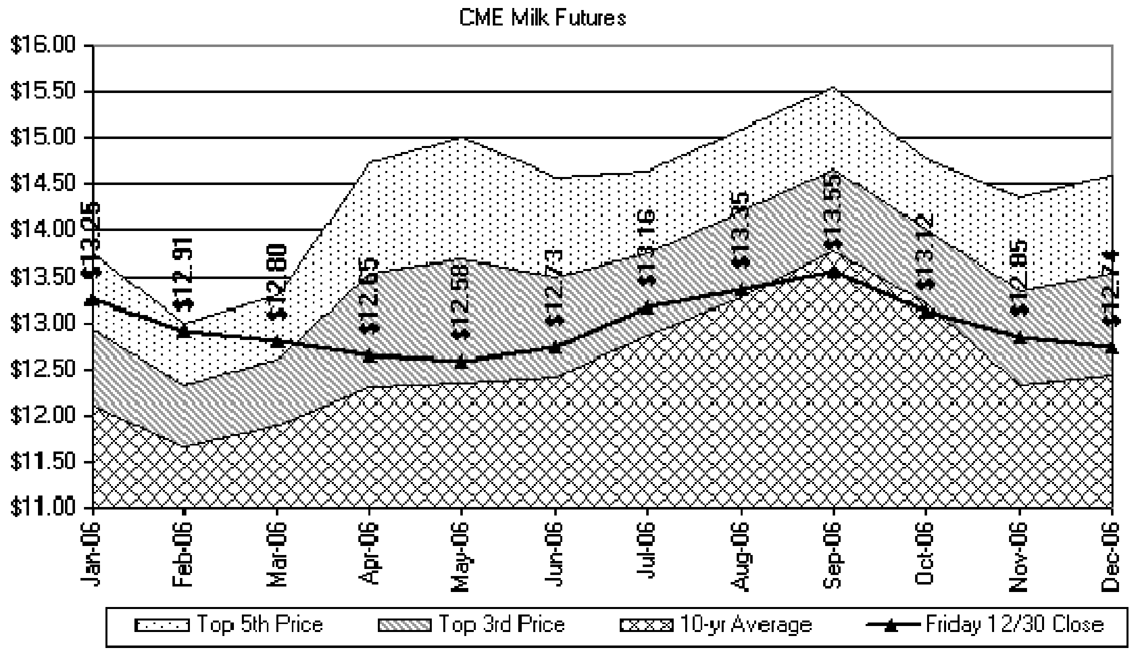
- The cash cheese markets at the CME continued to slip this week. Blocks fell 6¼¢ to $1.36¾/lb, and barrels dropped 6¢ to $1.34/lb.
- Weekly cold storage numbers show an inventory build in cheese. For the period 12/01 through 12/26, cheese stocks are up 1%.
- Dairy cow slaughter for the week ending 12/17 was 47,200 head, vs. 54,400 during the same week a year ago, a drop of 13%.
- Florida exported 44 loads of milk this week with milk supplies described as excessive and burdensome, according to Fluid Milk & Cream Review. Milk handlers have had problems finding a home for all the milk during the holiday weekend as manufacturing capacity is stretched, and conditions aren't expected to get any better until sometime next week.



- Milk production in the Southwest continues to trend higher, according to Fluid Milk & Cream Review (This corresponds with our own monitoring of co-op intakes, which has steadily risen since mid-November). In addition, Western cream markets are weaker, with some of the lowest prices of the year.
- Dairy Market News reports butter stocks are building due to slowing demand. With the exception of a few fill-in orders, holiday needs have been filled, and traders foresee any significant increase in butter demand for early 2006.
- The cheese market is weak, writes Dairy Market News this week. New orders are light and processing operations are running on reduced schedules.
- The recent 9 cent drop in the CME cash cheese market is attributed to a general lack of demand, according to Dairy Market News. Buyers are going hand-to-mouth for current needs.

- Northeast cheese handlers expect the market tone will remain weak and cheese prices may continue to ease lower as more milk is available going into 2006. Food service demand has been good, but current cheese offerings have been more than ample.
- Economy: Sales of existing homes fell 1.7% in November, and homes for sale hit their highest point in 19 years, according to the National Realtor's Association.

Recommendation:



It's the end of the year and a time for reflection. Where have we been and where are we headed? The dairy industry has benefited from unusually high prices for an extended amount of time. As mentioned above, at $14.05, 2005 goes in the books with the third highest average of all time. And since August 2003, prices have averaged $14.52, nearly $2/cwt higher than the 10-yr historical average of $12.55! Despite higher milk production this year, solid demand has done a great job consuming the extra output and provided support for the market. But there are, we feel, inevitable consequences to this 29-month reign of profitable prices, and that leads us to where we may be headed. Though the border with Canada remains closed to replacement animals, we have still managed to grow the herd from within, despite a CWT herd retirement program that got rid of nearly 70,000 animals. The profit motive promotes ingenuity, and the American farmer has responded. With higher cow numbers, production has been up over 4% vs. a year ago for the last six consecutive months, and looks likely to continue into 2006. Energy and fertilizer costs will be up, while feed costs will be lower. What will you need per cwt to make money in 2006? Economy? The stock market finished lower for the year for the first time since 2002, and the housing market looks weak. Equity gains in homes have helped propel the economy as consumers refinanced and spent their money, but that could come to an end if home prices head lower. We honestly don't know what the economy will do next year, but our point is that we wouldn't be willing to literally "bet the farm" that the economy, and increased demand, will bail us out of ever increasing milk production. We remain bearish on milk prices for 2006, as we have been since early summer. Trade volume the past few weeks has concentrated on the July-December months, indicating producers are getting covered and that these months have the most downside potential. We agree. While the front months were up this week, the deferred were down (see graph above). July-December was averaging $13.22 just a couple weeks ago, but is now down to $13.13 today. We would continue to sell at $13.15 average or higher. Continue to target $12.80 or higher March-June. If you have nothing hedged yet, the 2006 annual average is $13.00. Take a good hard look at these numbers. We just experienced two of the three highest annual averages in consecutive years. Is that trend likely to continue? We wish all of you a happy and prosperous new year!

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, January 2nd in observance of New Year's Day. Dairy markets will be closed.