



The KDM Dairy Report - January 13th, 2006

On the bright side:

- Fluid Milk & Cream Review reports Midwest [Class I demand has improved](#) to levels seen just before the early November holiday rush.
- Florida bottlers had to import 88 loads of milk this week (vs. 20 exported last week) as [demand rebounded significantly](#) after the holiday period, according to Fluid Milk & Cream Review.
- There has been no drying for three weeks in the Pacific Northwest as wet and rainy conditions persist for what could be a record number of days, reports Fluid Milk & Cream Review. Herd stress is building, and even free stall operations are being impacted as high winds are blowing moisture into facilities. Feed lots remain muddy.
- Exports of dry whey [continue to be strong](#). The November production was up 5% from last year, stocks are not building.

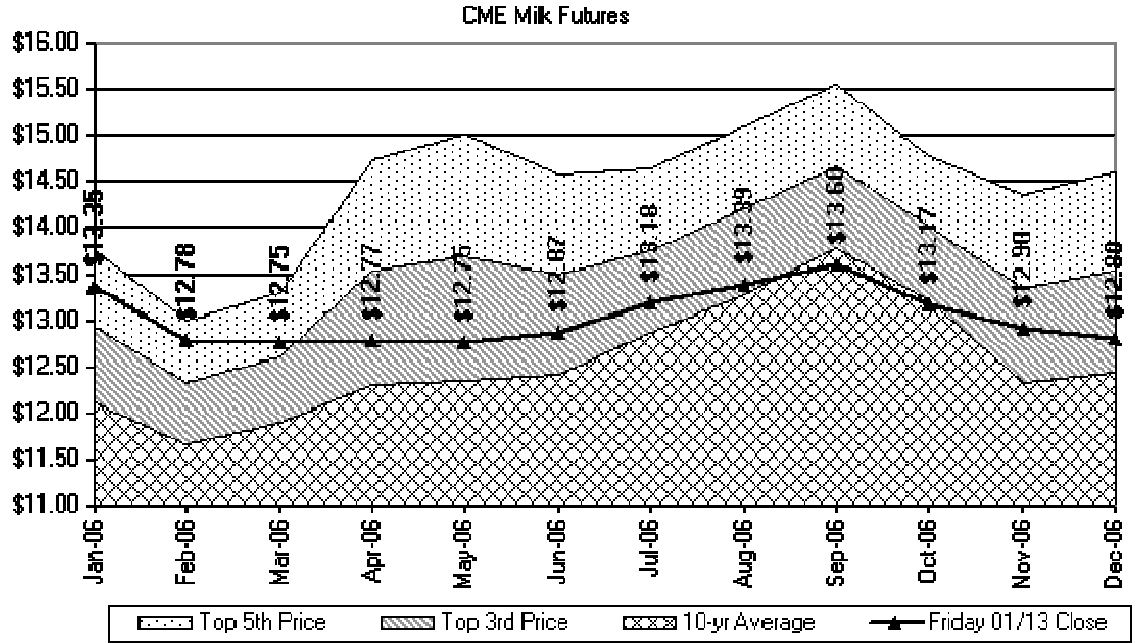
| Futures Month | Friday 01/13 Close | Friday 01/06 Close | Change | 10-yr Average | Top 3rd Price | Top 5th Price |
|---------------|--------------------|--------------------|----------|---------------|---------------|---------------|
| Jan-06 | \$13.35 | \$13.37 | (\$0.02) | \$12.10 | \$12.93 | \$13.74 |
| Feb-06 | \$12.78 | \$13.05 | (\$0.27) | \$11.64 | \$12.33 | \$13.00 |
| Mar-06 | \$12.75 | \$13.00 | (\$0.25) | \$11.88 | \$12.60 | \$13.30 |
| Apr-06 | \$12.77 | \$12.88 | (\$0.11) | \$12.31 | \$13.52 | \$14.71 |
| May-06 | \$12.75 | \$12.80 | (\$0.05) | \$12.35 | \$13.69 | \$15.01 |
| Jun-06 | \$12.87 | \$12.83 | \$0.04 | \$12.41 | \$13.50 | \$14.56 |
| Jul-06 | \$13.18 | \$13.19 | (\$0.01) | \$12.85 | \$13.75 | \$14.64 |
| Aug-06 | \$13.39 | \$13.42 | (\$0.03) | \$13.28 | \$14.19 | \$15.09 |
| Sep-06 | \$13.60 | \$13.61 | (\$0.01) | \$13.78 | \$14.67 | \$15.54 |
| Oct-06 | \$13.17 | \$13.19 | (\$0.02) | \$13.21 | \$14.00 | \$14.77 |
| Nov-06 | \$12.90 | \$12.88 | \$0.02 | \$12.32 | \$13.34 | \$14.35 |
| Dec-06 | \$12.80 | \$12.77 | \$0.03 | \$12.44 | \$13.53 | \$14.60 |

however....

- NASS cheese prices took a [big drop](#) this week. Blocks lost 3.6¢ to average \$1.39/lb, while barrels fell 3.2¢ to \$1.38/lb. Nonfat dry milk lost 1.7¢ to average 98.4¢/lb, but dry whey increased 0.4¢ to 33.4¢/lb.
- Cash blocks remained steady at \$1.36¾ this week, but barrels fell 1¼¢ to close at \$1.32¾ today. There were no trades the entire week. Cash butter dropped 7¢ to settle at \$1.33, with 13 trades for the week.
- Are we seeing the first cracks in the nonfat dry milk market? The Grade A cash price fell 2.5¢ this week, and Dairy Market News reports [demand is weak](#) as buyers have backed off in light of the lower cash prices and heavier production during the holidays. Some contacts believe there will even be offerings to the CCC sometime during first quarter to ease growing commercial stocks. Exports have resumed at lower prices, but volumes have not recovered after slowing at year end.
- Recent rains did little to slow milk production in California, according to Fluid Milk & Cream Review. [Output has been increasing](#) and processing plants are active, but retail orders have been fair at best. Growth in herd size and milk per cow has Central Valley output at a brisk pace above a year ago.
- Butter inventories at USDA selected storage centers [increased 53%](#) during the first nine days of January, according to the Weekly Cold Storage report. Cheese stocks increased 1%.
- Dairy cow slaughter for the week ending 12/31 was only [36,900 head vs. 42,700](#) during the same period a year ago.
- Expansions. Local freestall installer with national presence reports big backlog of orders.
- Midwestern churns are cranking out butter as they continue to process heavy volumes of Eastern and Western cream, according to Dairy Market News. Stocks of butter are increasing as [production outpaces demand](#).
- Dairy Market News reports cheese buyers are adopting a "just-in-time" approach, only ordering to replace stocks that have sold. With the increased milk production, there is [little fear of price strength](#) in the cheese market or availability of product in the near term.
- Feed prices look to stay under wraps as Thursday's Crop Production Report confirmed large carry-overs in the grain market.

Recommendation:

Here today, gone tomorrow. Last week's fund buying appeared to be a one-time affair, and with increasingly bearish fundamentals and no strong buyer, the market quickly gave back its gains, and then some. This is yet another example of why it's so important to have a plan, get orders in place, and remain stubbornly emotionless as it executes. Last week was a gift. Our reports appear to be



adding more and more bullet points under the "however" section, and fewer and fewer in the "bright side" section, and rightfully so. Fundamentals are turning decidedly bearish. Commercial contacts we talked to this week expect another nickel drop in the cheese price over the next several weeks. And our strong export market for dry products is showing its first signs that price pressure is under way, not necessarily due to weak demand, but the sheer volume of milk that is available to make product. We can't help but wonder if we are starting to see the "beginning of the end" for 2006 milk prices. Milk prices seem to be moving in 18-24 month cycles as of late. Our 18 months of \$9 prices were cured by over 20 months of \$13+ prices. Are we now heading for 18-24 months of lower prices? If so, one should possibly even consider 2007 futures prices if they are at profitable levels. Also bear in mind that the December Milk Production Report will be out next Wednesday, and will most certainly show another 4% or more increase in production and higher cow numbers. The previous six production reports have basically been ignored, but we're not so certain about this one. It may be the catalyst that finally triggers stronger selling.

But have hope! Even if you missed out on last week's rally, the July-December average only lost a penny from last week and at \$13.17, should be sold. Or, if you need further coverage, sell April – December at \$13.05. We would get coverage on 75% of your milk. The front months have gone below our longstanding \$12.80 target, so it's time to switch strategies. Consider buying the February and March 13.00 calls for 5¢ and 10¢ respectively. Current cash prices work out to about \$13.08 Class III, so at \$12.78 and \$12.75, Feb and Mar are trading at a discount to cash. Once the calls are bought, enter orders to sell your milk at \$12.98 to \$13.00. If successful, you'll have an effective floor of about \$12.90 (sold at \$13 less cost of the call) with your upside covered in case we head higher. Sell April and May at \$12.90 or higher, and June at \$13.00 or higher.

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