



## The KDM Dairy Report - January 27<sup>th</sup>, 2006

### On the bright side:

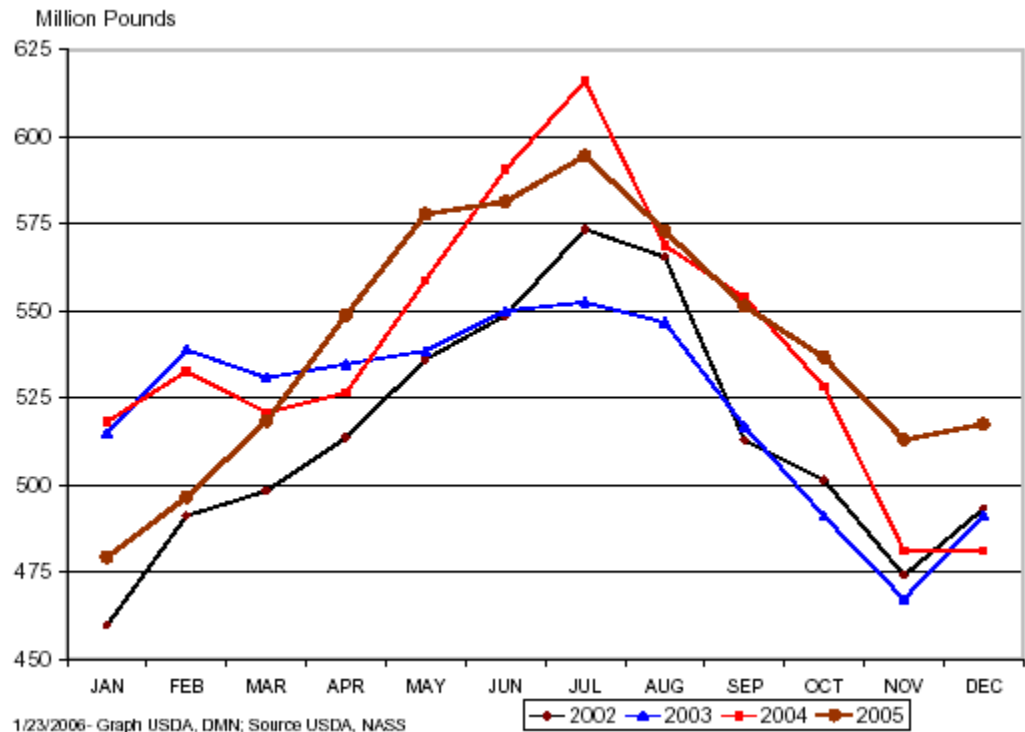
- Florida has imported Grade A milk the past two weeks, according to Fluid Milk & Cream Review. 61 loads entered the state, vs. 130 loads that were exported during the same period a year ago. [Fluid sales are brisk](#), perhaps due to the return of winter "snowbirds" from the North.
- Wet conditions continue to hamper milk production in the Pacific Northwest, according to Fluid Milk & Cream Review. In addition, it's taking longer to dry out operations due to heavy fog.
- Dry whey moved 0.4¢ higher to 34.8¢/lb in this week's NASS prices, and NDM was up 0.1¢ to 97.5¢/lb, despite recent drops in the cash price.
- Lower prices will eventually cure lower prices!

### however....

- Cold Storage Report: More milk yields more product. Commercial holdings of American cheese in December were up [a strong 9.5%](#) vs. a year ago. Monday's [Daily Dairy Report](#) said the 517.3 million lbs on hand was the 2<sup>nd</sup> highest level ever for the end of the year, and that stocks grew during the last ten months of the year, which is a rarity. Butter stocks were up an even stronger 27% vs. 2004.
- On a more micro level, weekly cold storage numbers paint no better a picture. For the period 01/01 through 01/23, [cheese stocks are up 3%](#) and butter holdings are up 84%.
- Cattle Inventory Report: The number of milk cows in the U.S. as of January 1<sup>st</sup>, 2006, was 9.06 million head, up 1% from January 1<sup>st</sup>, 2005, according to USDA's semi-annual report released today. More telling, the number of [milk replacement heifers was up 4%](#) to 4.28 million head. Among states with milk cows that have calved, ID had the largest annual increase with 38,000 head added to their milking herd, quite a feat in one year. They were followed by CA with 30,000 more head and NM with 22,000 added.
- The [cash markets plunged](#) again this week. Blocks dropped 11¼¢ from last Friday to close at \$1.23¾ today. Barrels lost a dime to settle at \$1.21, while butter fell 7½¢ to \$1.26½. Buyers stayed on the sidelines as only 2 loads of blocks and no barrels exchanged hands all week.
- NASS cheese and butter prices [continue to trend lower](#) in light of recent cash declines. U.S. 40-lb blocks averaged \$1.37/lb, down 1.2¢ from the previous week, and 500 lb barrels fell 0.2¢ to \$1.35/lb. Butter gave up 0.8¢ to \$1.35/lb.
- Dairy cow slaughter for the week ending 01/14 was [50,000 head vs. 58,800](#) head during the same period a year ago.
- Excess butter is being put in storage at a faster rate. For the week ending 01/21, [7.4 million lbs of butter were added](#) to CME-approved warehouses. That compares to only 3.5 million lbs during the same week a year ago. There are now 49.3 million lbs of butter on hand, vs. 32.6 million last year.

Futures Month	Friday 01/27 Close	Friday 01/20 Close	Change	10-yr Average	Top 3rd Price	Top 5th Price
Jan-06	\$13.42	\$13.38	\$0.04	\$12.10	\$12.93	\$13.74
Feb-06	\$12.39	\$12.67	(\$0.28)	\$11.64	\$12.33	\$13.00
Mar-06	\$12.16	\$12.48	(\$0.32)	\$11.88	\$12.60	\$13.30
Apr-06	\$12.16	\$12.48	(\$0.32)	\$12.31	\$13.52	\$14.71
May-06	\$12.35	\$12.56	(\$0.21)	\$12.35	\$13.69	\$15.01
Jun-06	\$12.47	\$12.71	(\$0.24)	\$12.41	\$13.50	\$14.56
Jul-06	\$12.75	\$12.94	(\$0.19)	\$12.85	\$13.75	\$14.64
Aug-06	\$12.95	\$13.22	(\$0.27)	\$13.28	\$14.19	\$15.09
Sep-06	\$13.14	\$13.42	(\$0.28)	\$13.78	\$14.67	\$15.54
Oct-06	\$12.95	\$13.09	(\$0.14)	\$13.21	\$14.00	\$14.77
Nov-06	\$12.80	\$12.84	(\$0.04)	\$12.32	\$13.34	\$14.35
Dec-06	\$12.61	\$12.71	(\$0.10)	\$12.44	\$13.53	\$14.60

### U.S. AMERICAN CHEESE COLD STORAGE HOLDINGS

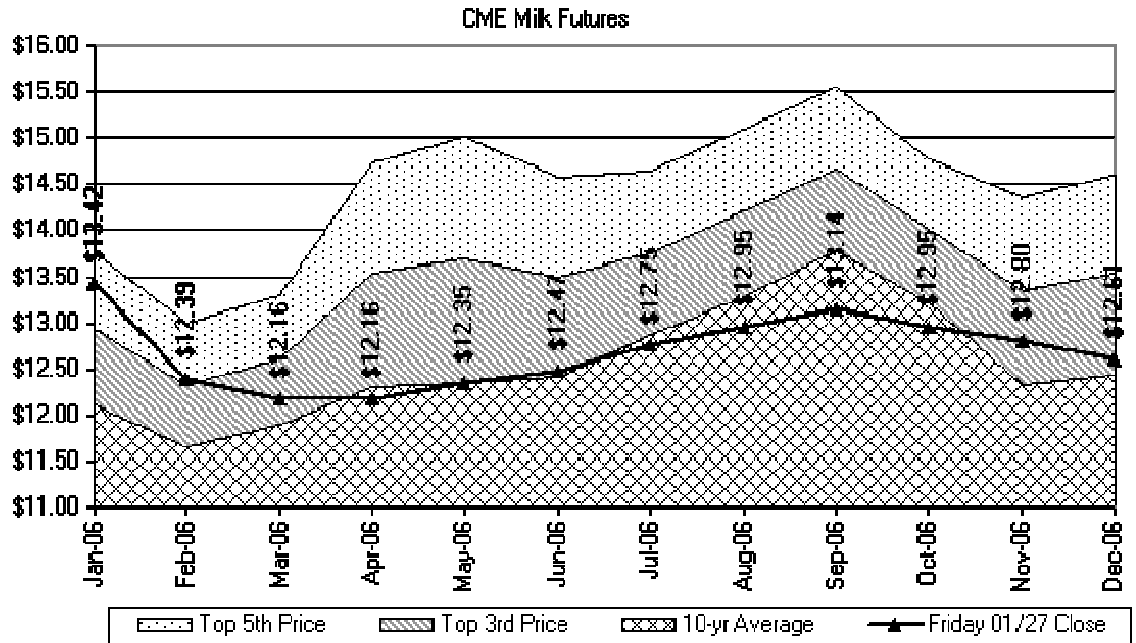


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- Production of dips and sour cream is unusually sluggish and manufacturing milk interest is slow, according to Fluid Milk & Cream Review. Midwest plant operators are trying to reduce current production, but a few have said milk receipts have put their schedules [near spring peak capacity](#). Above average temperatures in January and minimal snow cover are contributing to the excellent milking conditions.
- Dairy Market News reports Midwest churning operations are receiving surplus cream from Eastern and Western sources. Butter production is running at near capacity levels and [surpassing demand](#), forcing excess product to move to inventory.

**Recommendation:**

Monday's Cold Storage Report was bearish to the market, showing big increases in cheese and butter stocks, but by far, the story of the week was the continued crash in the cash market. Block cheese broke through the important \$1.30 barrier, reaching levels not seen since June, 2003. The question asked all week - When will we hit bottom? According to commercial sources we spoke to this week, there doesn't appear to be the will to push it much lower; perhaps a few more cents. So we don't think



we're headed to government support prices (\$1.13 for blocks), but we could for butter and nonfat dry milk. So, what's a hedger to do in light of current conditions? Continue to target the last half of the year near \$13.00. Currently, July-Dec averages \$12.87, but be patient. During times of sharply lower prices, the market will many times overdo it to the downside. In fact, it may have already done so in the short term. While there is about a 2-week delay between the NASS prices and the cash market, the current block spread of \$1.37 (NASS) to \$1.23<sup>3</sup>/<sub>4</sub> (cash) is quite wide. The great majority of cheese is bought and sold "off-exchange", and may never get as low as the current cash price (then again, it might). In the near term, then, we would continue to target buying cheap out-of-the-money call options Mar-May, and sell into them once they are purchased. For example, buy the March 12.50 call for 7¢, then enter a standing order to sell your March milk at \$12.40 or higher. If successful, you would have a 12.40 floor with upside covered over 12.50.

Give us a call and we'll help you put together a risk-management plan for your operation!

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