



## The KDM Dairy Report - February 3<sup>rd</sup>, 2006

### On the bright side:

- The settlement price for January Class III milk was announced today at \$13.39, well above its historical average since 1995 of \$12.10, and even above its top-third price of \$12.93.
- It's been a while since a bullet on the cash markets has made it to the "bright side", but it does appear cheese has made a short-term bottom. Blocks actually gained ¼¢ this week to settle at \$1.24, while barrels were unchanged at \$1.21. More telling is the fact that only 1 load of blocks and no barrels traded the entire week, which could be an indication that sellers aren't interested in pushing things lower. There was 1 unfilled bid for blocks during today's cash session.
- January rainfall in Seattle was the third highest on record, according to Fluid Milk & Cream Review. Feed lots remain in bad shape and the mud has continues to stress the cows and tire them out. Cull rates are increasing while hay supplies are tight, as hay producers report being close to sold out.
- After the Super Bowl, it's likely buyers will need to [replenish depleted cheese stocks](#), reports Dairy Market News. And the current low prices may generate increased feature activity at retail outlets. Demand is strong for hard Italian varieties, and handlers are putting product into aging programs.
- The NASS dry whey price climbed to 35.1¢/lb, up 0.3¢ from the prior week.
- Economy: The U.S. unemployment rate fell to 4.7%, its [lowest level in 4½ years](#), according to the Labor Department.

### however....

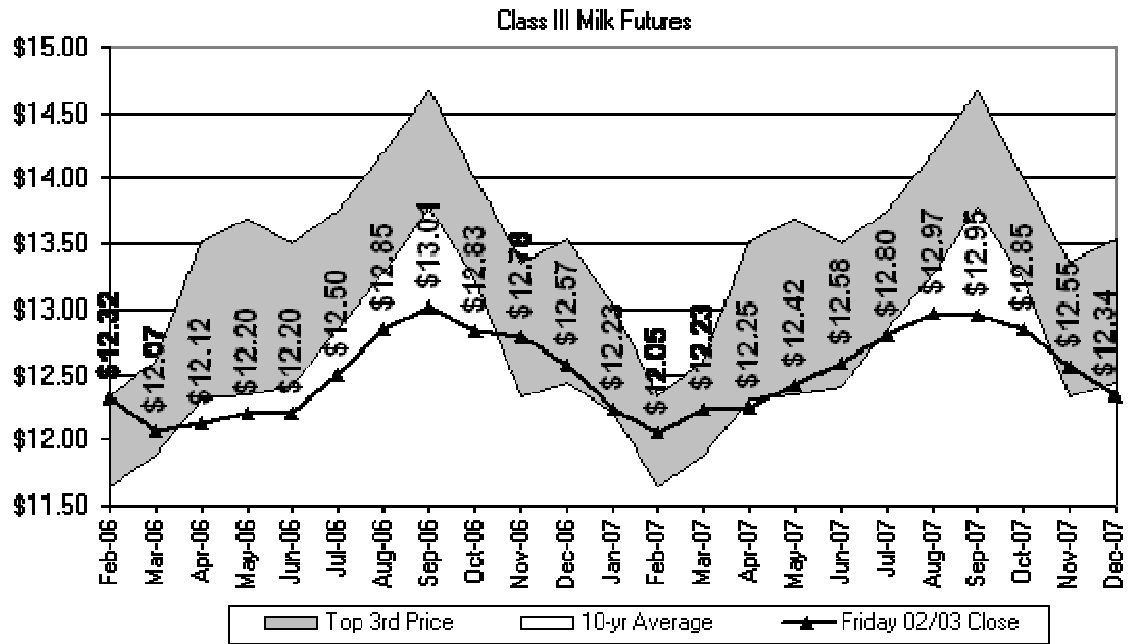
- Dairy Products Report: American cheese output in December was 0.3% higher than a year ago, and 4.9% higher than the prior month. Total [cheese output was up 2.2%](#) and 3.9%, respectively. One surprise, cheddar production was down 0.1% in December, likely due to cheese makers trying to limit production. Butter output was 5.9% higher than last December, and 13.3% higher than November.
- Commercial Disappearance: Use of milk in all products was up 0.8% in November (vs. the prior year), but down 11.7% in NDF and down 1.7% in butter, according to USDA numbers released this week. [American cheese use was off 4.5%](#), while all other cheese use was off 0.8%.
- Weekly cold storage numbers show a 3% increase in cheese stocks and a huge [92% gain in butter stocks](#) for the month of January.
- "Print butter sales are slow, production is heavy and prices are moving lower", so says the headline in this week's Dairy Market News. Manufacturing plants have switched to producing bulk butter for storage because they can't get rid of the prints fast enough.
- Dairy cow slaughter for the week ending 01/21 was [47,200 head vs. 49,600](#) head during the same period a year ago.
- Manufacturing milk demand in the Midwest is slow, with [supply far exceeding needs](#), according to Fluid Milk & Cream Review. Plant managers remain concerned about how they will handle spring flush levels, and at least one Wisconsin operation has stopped soliciting new patrons.
- NASS [cheese prices continued to fall](#), with blocks falling 1.3¢ to average \$1.35/lb, and barrels down 2¢ to \$1.33/lb. Butter dropped as well, decreasing 3.6¢ to \$1.32/lb, while NDM fell 5.5¢ to 92¢/lb.
- A local cheese plant we visited this week said sales were slow and predicted dry whey could drop to around 30¢/lb over the next few months. That would cut 24¢ out of the Class III price.
- Dairy Market News reports the dry whey price as steady to lower. But, they point out that stocks are beginning to build, and they see some [weakness developing](#) in the market.
- Fluid Milk & Cream Review reports milk production is steadily increasing in the Southeast. Florida went back to a [milk surplus](#), exporting 30 loads of Grade A milk this week, after importing 61 loads last week. Bottlers are long on milk, to the excess is being forced to clear to manufacturing operations.
- California milk output is strong, starting 2006 [several percentage points higher](#) than last year, according to Fluid Milk & Cream Review. Our own monitoring pegs it close to 8% higher.

Futures Month	Friday 02/03 Close	Friday 01/27 Close	Change	10-yr Average	Top 3rd Price
Feb-06	\$12.32	\$12.39	(\$0.07)	\$11.64	\$12.33
Mar-06	\$12.07	\$12.16	(\$0.09)	\$11.88	\$12.60
Apr-06	\$12.12	\$12.16	(\$0.04)	\$12.31	\$13.52
May-06	\$12.20	\$12.35	(\$0.15)	\$12.35	\$13.69
Jun-06	\$12.20	\$12.47	(\$0.27)	\$12.41	\$13.50
Jul-06	\$12.50	\$12.75	(\$0.25)	\$12.85	\$13.75
Aug-06	\$12.85	\$12.95	(\$0.10)	\$13.28	\$14.19
Sep-06	\$13.01	\$13.14	(\$0.13)	\$13.78	\$14.67
Oct-06	\$12.83	\$12.95	(\$0.12)	\$13.21	\$14.00
Nov-06	\$12.78	\$12.80	(\$0.02)	\$12.32	\$13.34
Dec-06	\$12.57	\$12.61	(\$0.04)	\$12.44	\$13.53
Jan-07	\$12.23	\$12.30	(\$0.07)	\$12.20	\$13.01
Feb-07	\$12.05	\$12.10	(\$0.05)	\$11.64	\$12.33
Mar-07	\$12.23	\$12.26	(\$0.03)	\$11.88	\$12.60
Apr-07	\$12.25	\$12.29	(\$0.04)	\$12.31	\$13.52
May-07	\$12.42	\$12.54	(\$0.12)	\$12.35	\$13.69
Jun-07	\$12.58	\$12.63	(\$0.05)	\$12.41	\$13.50
Jul-07	\$12.80	\$12.88	(\$0.08)	\$12.85	\$13.75
Aug-07	\$12.97	\$13.02	(\$0.05)	\$13.28	\$14.19
Sep-07	\$12.95	\$12.93	\$0.02	\$13.78	\$14.67
Oct-07	\$12.85	\$12.78	\$0.07	\$13.21	\$14.00
Nov-07	\$12.55	\$12.53	\$0.02	\$12.32	\$13.34
Dec-07	\$12.34	\$12.30	\$0.04	\$12.44	\$13.53

- NDM prices are sharply lower, according to Dairy Market News. [Excess milk](#) is going into NDM production, while at the same time demand is light.
- The [MILC program was renewed](#) on Wednesday by the House of Representatives, and if signed by the President, will extend the program to September 2007. The program will pay out 34% of the difference on the first 2.4 million lbs of production when the Class I price falls below \$13.69, and is retroactive back to October 1<sup>st</sup>, 2005. Already, payouts will be 4¢ for December and 10.5¢ for January and February. While this certainly helps the small producer, in our opinion it encourages overproduction and disrupts natural market signals, and ultimately prolongs lower prices.

**Recommendation:**

Though we finished lower for the week in nearly every Class III contract, Friday's trade was encouraging with 3-6 cent gains across the board. The lack of cash cheese sales and an unfilled bid gave hope to the bulls who pushed the market slightly higher by day's end. While fundamentals have not changed, there is some indication that cheese buyers may return to replenish pipelines after the Super Bowl and in preparation for Easter/Passover celebrations. We could see cheese move a few



cents higher before resuming its downward spiral. We'd recommend holding off any further milk sales March-July as it appears downside risk from here is minimal. Instead, wait for a 30-50¢ rally in Class III in a response to a push higher in the cash cheese market, and sell at those levels. Have your orders in AHEAD of time if you want to catch this. We would continue to recommend selling Aug-Dec which averaged \$12.81 on Friday's close. November at \$12.78 appears to be an especially good price in light of fundamentals as it is well above its 10-yr average (see chart). Looking even further into the future, we make our first 2007 recommendation. Considering we have had 23 consecutive months of \$13+ milk, lower prices are likely to be with us well into 2007. But because this is so far out and we don't know what's in store for us this summer, we would look at selling up to 25% of your milk Jan-Jun '07 at a \$12.30 average (currently \$12.29), which is 17¢ higher than the 10-yr average of \$12.13 for these months.

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

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