



The KDM Dairy Report - February 17th, 2006

On the bright side:

- Though milk supplies in the Midwest remain heavy, Fluid Milk & Cream Review reports that they are [better in balance](#) than a week ago. Class I demand is steady, and ice cream production is picking up slightly, while fat and protein levels have declined seasonally.

however....

- Milk Production Report: January milk production was up a [very strong 5.4%](#) in the 23 major states. The number of milk cows on farms was 103,000 head more than a year ago, and 11,000 more than December. Increases were led by NM up 15.8%, TX up 14.1% and ID up 10.3%.
- The cash market continued to collapse as blocks shed another 6¾¢ for the week to settle at \$1.16½/lb. Barrels followed suit, declining 5¾¢ to \$1.14½/lb. The lower price did attract a few buyers as 5 loads of blocks exchanged hands. There were no barrel trades. Cash butter declined 3¢ to settle at \$1.17/lb today.
- Fluid Milk & Cream Review reports milk [output in California is very strong](#). There is concern about how all the milk will be handled this spring, and some cheese plants are choosing not to take in milk for periods due to growing cheese inventories.
- Prices for [all Class III components fell](#) in the most recent weekly NASS survey. 40-lb blocks declined 3.9¢ to average \$1.28/lb, 500-lb barrels dropped 4.4¢ to \$1.24/lb and butter slipped 3.9¢ to \$1.24/lb. After recently testing \$1, nonfat dry milk has come under pressure, and was down to 88.7¢/lb in this week's survey, falling 3.6¢. And dry whey, after reaching record highs and providing much of the support for Class III, saw its first decline in several weeks, dropping 0.3¢ to 35.2¢/lb. Further declines in dry whey could really hurt the market.
- Weekly cold storage numbers continue to show a [big build in](#)

Futures Month	Friday 02/17 Close	Friday 02/10 Close	Change	10-yr Average	Top 3rd Price
Feb-06	\$12.10	\$12.26	(\$0.16)	\$11.64	\$12.33
Mar-06	\$11.12	\$11.69	(\$0.57)	\$11.88	\$12.60
Apr-06	\$11.10	\$11.71	(\$0.61)	\$12.31	\$13.52
May-06	\$11.00	\$11.85	(\$0.85)	\$12.35	\$13.69
Jun-06	\$11.27	\$11.72	(\$0.45)	\$12.41	\$13.50
Jul-06	\$11.46	\$12.03	(\$0.57)	\$12.85	\$13.75
Aug-06	\$11.90	\$12.35	(\$0.45)	\$13.28	\$14.19
Sep-06	\$11.90	\$12.55	(\$0.65)	\$13.78	\$14.67
Oct-06	\$11.95	\$12.45	(\$0.50)	\$13.21	\$14.00
Nov-06	\$11.91	\$12.43	(\$0.52)	\$12.32	\$13.34
Dec-06	\$11.80	\$12.22	(\$0.42)	\$12.44	\$13.53
Jan-07	\$11.30	\$11.87	(\$0.57)	\$12.20	\$13.01
Feb-07	\$11.25	\$11.80	(\$0.55)	\$11.64	\$12.33
Mar-07	\$11.25	\$11.81	(\$0.56)	\$11.88	\$12.60
Apr-07	\$11.50	\$11.95	(\$0.45)	\$12.31	\$13.52
May-07	\$11.80	\$12.11	(\$0.31)	\$12.35	\$13.69
Jun-07	\$11.70	\$12.33	(\$0.63)	\$12.41	\$13.50
Jul-07	\$12.00	\$12.67	(\$0.67)	\$12.85	\$13.75
Aug-07	\$12.15	\$12.87	(\$0.72)	\$13.28	\$14.19
Sep-07	\$12.15	\$12.93	(\$0.78)	\$13.78	\$14.67
Oct-07	\$12.15	\$12.83	(\$0.68)	\$13.21	\$14.00
Nov-07	\$11.80	\$12.55	(\$0.75)	\$12.32	\$13.34
Dec-07	\$11.50	\$12.30	(\$0.80)	\$12.44	\$13.53

[butter holdings](#), while cheese levels increased as well. Butter inventory increased 11% for the period Feb 1-13, while cheese stocks grew 2%.

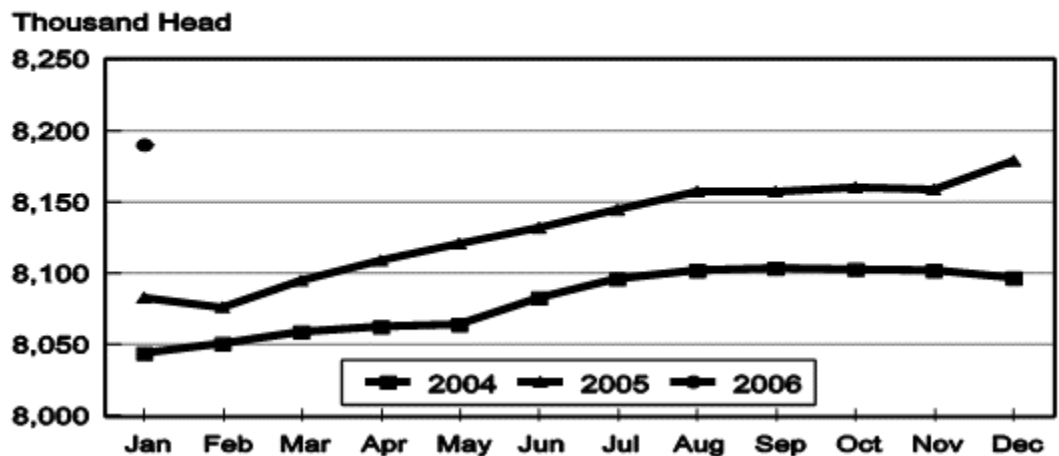
- A net movement of 11.3 million lbs of butter went into CME-approved warehouses this week, [more than double](#) the 5 million lbs during the same week a year ago.

- Dairy Market News reports the butter market is weak, with prices not seen since October 2003. In the past two weeks, butter stocks at CME warehouses have grown 21.8 million lbs, the [largest two-week increase on record](#).

Buyers are standing on the sidelines, procuring product only when needed.

- Dairy cow slaughter for the week ending 02/04 was [44,700 head vs. 49,100](#) head during the same week a year ago.
- Florida exported 96 loads of Grade A milk this week vs. 55 last week, according to Fluid Milk & Cream Review. Some contacts think the [flush is coming early](#) this year.
- The cheese market is weak, according to Dairy Market News. Buyers are content with their inventories and [don't see any shortage of cheese](#) in the near future due to the current milk supply situation.
- The dry whey market is steady, according to Dairy Market News. But demand is not as aggressive as it was a few weeks ago, and some sellers are starting to [build light inventories](#).

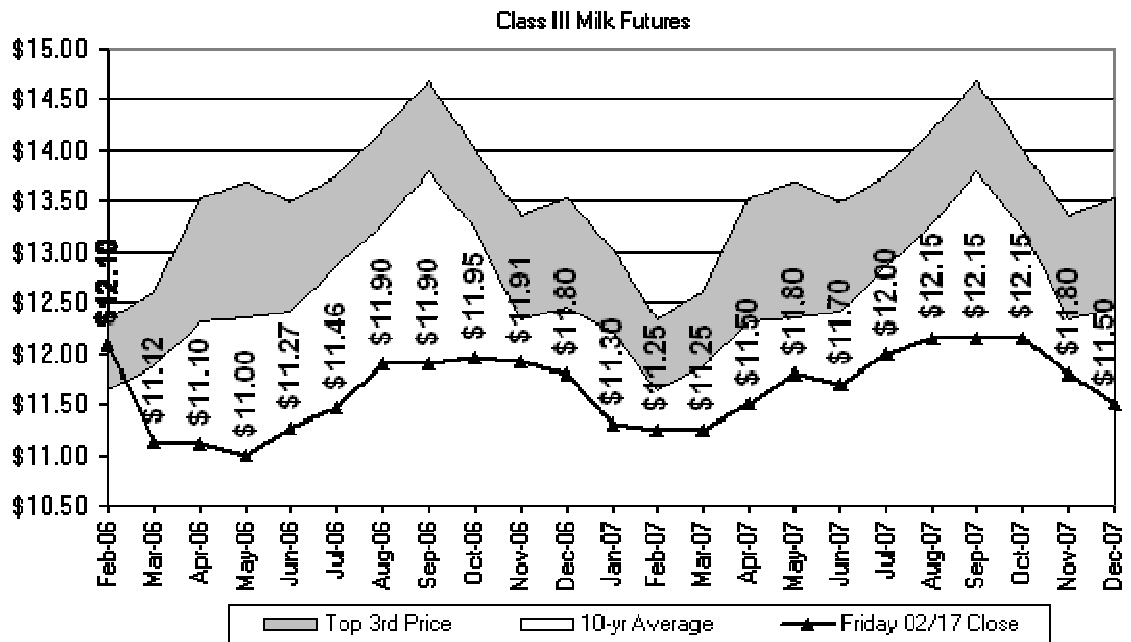
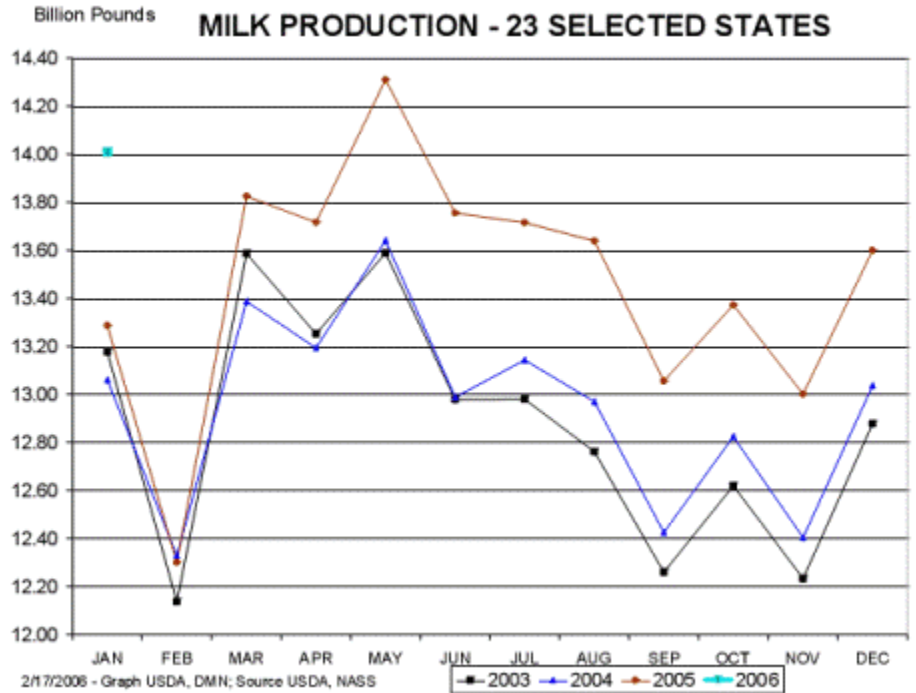
Monthly Milk Cows 23 States



- Livestock, Dairy & Poultry Outlook Report: 2.9 million heifers are expected to calve and join the milking herd in 2006, [up 3% from a year earlier](#), according to USDA. They also revised their 2006 forecast on milk cows up 10,000 head to 9.115 million and lowered their Class III forecast from \$12.45 to \$12.20.

Recommendation:

The blood-letting continued this week as anticipation for a big production report proved accurate and producer panic kicked in. Sellers outnumbered buyers all week, with markets typically opening 5-10¢ lower each morning and never recovering. The cash markets didn't help, with steady declines in both cheese and butter. It looks like we're headed to support (\$1.1314 blocks and \$1.1014 barrels) or below. The last time we were this low, prices actually needed to go below support to induce sellers to ship to the government due to the extra hassle factors (paperwork, packaging) involved. The slip in the dry whey price is worrisome too. Were we to go to support and dry whey to drop a nickel, we'd be looking at \$10.50 milk. Looking at the production and milk cow charts above, we are starting 2006 at levels significantly higher than the previous 2-3 years (look for the "dots" above January). The week ended with major declines in all contract months, with 2007 contracts finally coming under the pressure of fundamentals. I can't help but look back even just two weeks, when the Feb-Dec '06 average was \$12.50. Now it's \$11.48. And the 2007 average on 02/03 was \$12.52 but we closed today at \$11.71. Is there any silver lining in this? It's sure hard to find, but if prices do go to support, we could see a significant amount of product taken off the market and put in to government warehouses. That might allow a potential move higher after spring flush is over and we head into seasonal buying during late summer. Until then, it looks like we'll have plenty of milk. It's hard to recommend selling at current prices, especially on the front months. You have to decide for yourself if the downside risk from here is worth it. We would sell anything over \$12 for the last half of the year, and hold off selling 2007 now until this summer or fall. For those with sold positions, look to cover your upside risk July-Dec by purchasing call options, but wait until cheese moves lower and premiums come down further.



Note: We will be closed Monday, February 20th in observance of President's Day. Milk markets will not trade at the CME.

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