



## The KDM Dairy Report - April 6<sup>th</sup>, 2006

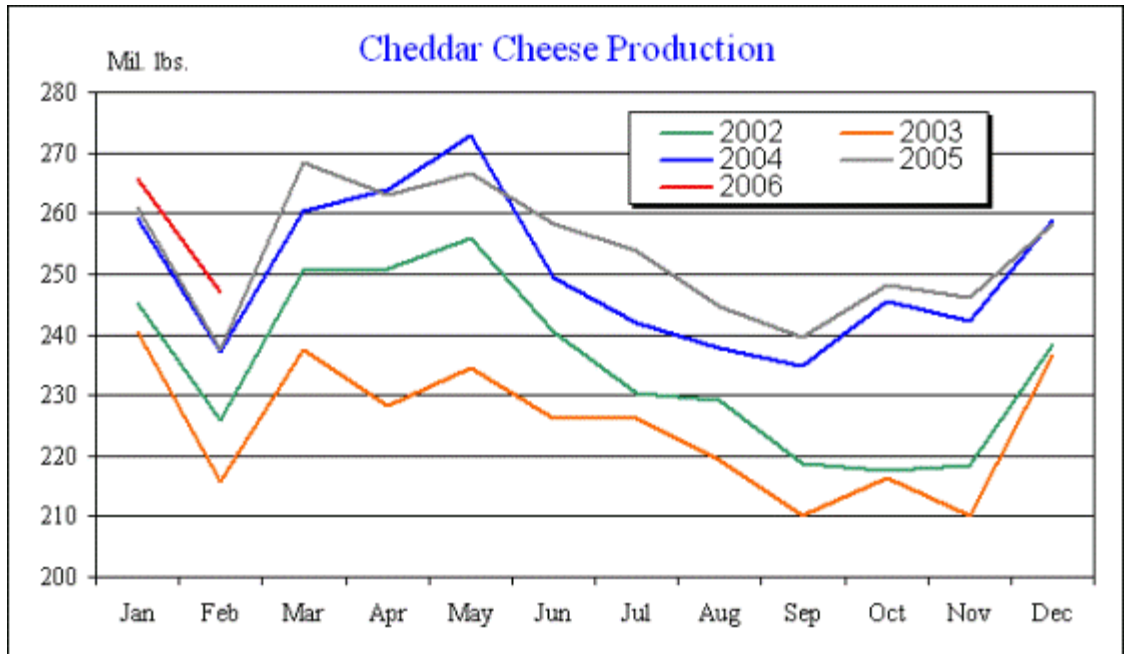
### On the bright side:

- Fluid Milk & Cream Review reports improved sales and feature activity have [helped ease the cream surplus](#) in the Southeast. Fewer loads are clearing to out-of-region plants and ice cream production is picking up. 106 loads of milk were exported out of Florida last week vs. 158 the week before.
- NASS surveyed cheese prices continue to move gingerly higher. U.S. 40-lb blocks were up 1.2¢ to \$1.17/lb, while 500-lb barrels were up 0.4¢ to \$1.14/lb.
- Dairy Market News indicates the nonfat dry milk market is steady, with increased demand offsetting increased production. Some buyers are re-entering the market as they perceive a [bottom has been made](#).
- The Midwest cheese market is [firm for the short term](#), according to Dairy Market News. Some buyers are having difficulty procuring current American varieties, as well as mozzarella. Process interest is picking up and spot loads of current barrels are hard to find. Plants have been limiting production to committed sales.
- Out West, buyers are hopping off the fence and making purchases. Dairy Market News reports that [demand from processors is excellent](#). Number one blocks are clearing well along with any barrel cheese.
- Economy: The unemployment rate dropped to 4.7% in March, its [lowest level in 4½ years](#), according to data released by the Labor Department today. Employers added 211,000 new jobs, well ahead of the forecast of 190,000.

Futures Month	Friday 04/07 Close	Friday 03/31 Close	Change	10-yr Average	Top 3rd Price
Apr-06	\$10.92	\$10.96	(\$0.04)	\$12.31	\$13.52
May-06	\$10.90	\$10.88	\$0.02	\$12.35	\$13.69
Jun-06	\$10.91	\$10.97	(\$0.06)	\$12.41	\$13.50
Jul-06	\$11.25	\$11.28	(\$0.03)	\$12.85	\$13.75
Aug-06	\$11.64	\$11.74	(\$0.10)	\$13.28	\$14.19
Sep-06	\$11.79	\$11.83	(\$0.04)	\$13.78	\$14.67
Oct-06	\$11.73	\$11.86	(\$0.13)	\$13.21	\$14.00
Nov-06	\$11.70	\$11.77	(\$0.07)	\$12.32	\$13.34
Dec-06	\$11.64	\$11.67	(\$0.03)	\$12.44	\$13.53
Jan-07	\$11.67	\$11.67	\$0.00	\$12.27	\$13.08
Feb-07	\$11.67	\$11.71	(\$0.04)	\$11.68	\$12.34
Mar-07	\$11.67	\$11.69	(\$0.02)	\$11.82	\$12.51
Apr-07	\$11.95	\$11.97	(\$0.02)	\$12.31	\$13.52
May-07	\$11.98	\$11.95	\$0.03	\$12.35	\$13.69
Jun-07	\$12.05	\$12.15	(\$0.10)	\$12.41	\$13.50
Jul-07	\$12.25	\$12.25	\$0.00	\$12.85	\$13.75
Aug-07	\$12.50	\$12.35	\$0.15	\$13.28	\$14.19
Sep-07	\$12.45	\$12.35	\$0.10	\$13.78	\$14.67
Oct-07	\$12.30	\$12.20	\$0.10	\$13.21	\$14.00
Nov-07	\$12.10	\$12.00	\$0.10	\$12.32	\$13.34
Dec-07	\$11.75	\$11.65	\$0.10	\$12.44	\$13.53

### however....

- Dairy Products Report: Despite cheese makers' efforts to limit production, February [cheddar output was 4% higher](#) than a year ago, a record high, while total cheese output was up 1.6%. Butter production was up an even stronger 18.1%, also an all-time record. In powder products, dry whey for human consumption was up 9.1% and nonfat dry milk was up 24.1%. Finally, January numbers were revised higher, with USDA finding 1.8 million additional lbs of butter and 8.1 million lbs of cheese.
- In the cash cheese market, the recent block rally was brought back to reality as it fell 4½¢ from its mid-week high of \$1.20. For the week blocks were down ¾¢ to settle at \$1.16. Barrels also finished ¾¢ lower for the week to close at \$1.12¾. Five loads of blocks and four barrels exchanged hands.

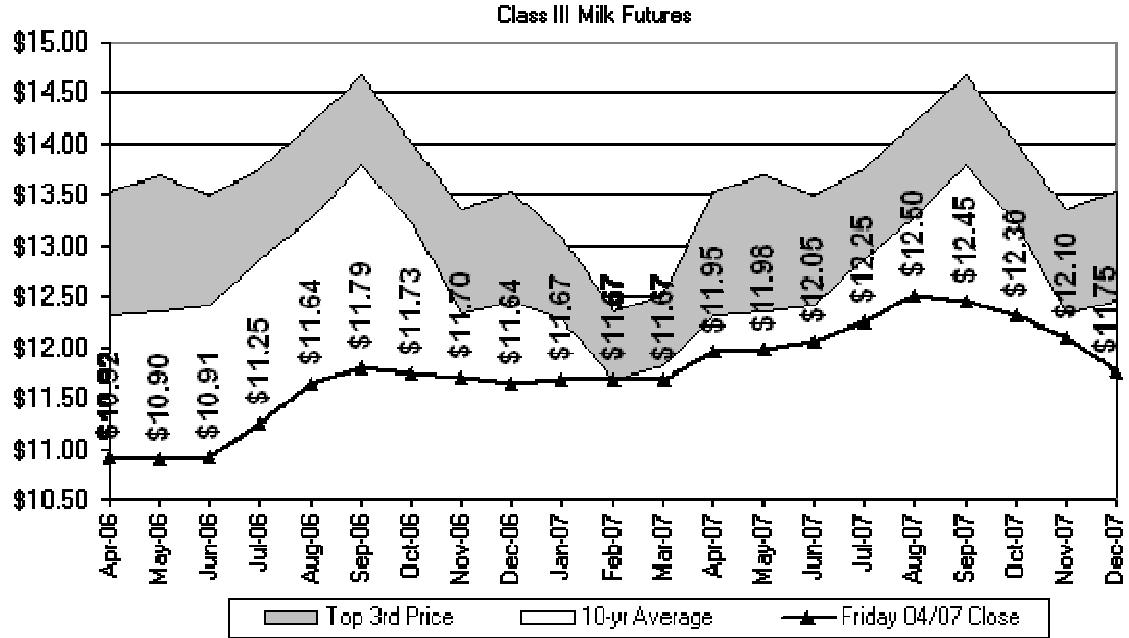


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- Butter inventories at CME-approved warehouses climbed to 114.7 million lbs, their [highest level for this date](#) with the exception of 2003.
- Midwest processors are finding [abundant milk supplies locally](#) as well as supplemental volumes from further south, according to Fluid Milk & Cream Review. Spot loads are still available for 50¢ under class.

- Fluid Milk & Cream Review reports milk output in the West and Southwest remains at high levels despite some recent rain in Northern California and the Central Valley. More dairies are under cover so the impact has been minimal. There is continued concern over processing abilities over Easter as some smaller plants take down days.
- Western dry whey prices continue to weaken as lower prices are needed to move offerings in a timely fashion, according to Dairy Market News. [Production is heavier](#) as more whey solids are leaving other processing facilities and going into dryers.
- Dry whey stocks are building out East as well, reports Dairy Market News. Price [discounts below cost](#) are commonplace.
- Related to the above weakness in dry whey, the NASS survey this week reported a [1.2¢ drop](#) to 31.8¢/lb. If declines continue at this pace, the Class III market will react lower. Each penny move down in dry whey equates to a 6¢ loss in Class III. Butter was also lower, down 0.9¢ to \$1.14/lb, as well as nonfat dry milk down 1.8¢ to 84.2¢/lb.

**Recommendation:**

The market remains confined to a trading range as Class III futures refused to rally with cash cheese. Although there are more positive comments in this week's report about improved demand for both blocks and barrels, and recent bidding for blocks in the cash market, it appears that this is more short-term demand as end-users pick up a few extra loads for Easter next week. From what we are hearing from our sources, cheese sales are good for the moment, and product is moving. Mozzarella is especially



strong as pizzerias out East are aggressively looking to procure for their needs. The economy continues to chug along with low unemployment and the stock market reaching a new 5-year high today before a profit-taking sell off. A strong economy doesn't automatically mean higher use of dairy end-products, but over time, the more disposable income we have, the more we eat out, which benefits those pizzerias (as well as the entire food service industry). That said, a 3-4% increase in demand will still not offset the 6% increase in production we're currently experiencing, and so far all signs point toward sustained high output into May/June. The fall months will not crash immediately (and may not ever) but will retain a weather "premium" until more is known about production levels going into the heart of summer. However, with today's emphasis on cow comfort and modern heat abatement systems (mistifiers, fans, etc.), it's less likely heat will have as big an impact on production as in years past, unless we also have very high humidity. So we believe the fall months still need protecting at current levels. Consider the following strategy: Buy Aug-Dec 11.50 put options for an average 52¢ each. That's expensive, but after buying them, enter orders to sell Aug-Dec 10.75 puts for an average of 42¢ each. Those 10.75 puts currently average 24¢ each, but if prices continue to trend lower, you have a good shot at getting them filled. So what does it buy you in the end? You recoup 42 of the 52 cents you paid for the 11.50 put options, leaving you with a net cost of 10¢ each. You'll also have an 11.50 floor price for your milk that will protect you all the way down to \$10.33/cwt. If prices were to go below \$10.33, you would receive the market price for your milk. And if prices recover from where they are today, you have unlimited upside. This strategy could also be used by short hedgers sitting on large futures gains. Basically, you lock in a certain gain by lifting your futures hedge, replacing them with put options, but you still gain if prices weaken, and you participate in higher prices if we move the other way.

Have a great weekend! Call us if you'd like us to come out and visit your operation in person!

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