



The KDM Dairy Report - May 12th, 2006

On the bright side:

- The cash cheese market sprang to life this week, as barrel cheese, usually a price follower of blocks, became the price leader with a [5½¢ gain](#) to close at \$1.18/lb today. Blocks managed to pick up a penny to settle at \$1.17/lb. Regional tightness in barrels (see below) could be responsible to what most think is a temporary situation, as inverted cheese prices (barrels higher than blocks) rarely last very long.
- Dairy Market News reports the [barrel supply remains tight](#) in the Midwest, and the cheese market as a whole is in balance.
- Barrels are also in short supply out West, according to Dairy Market News. And while small orders of current block cheese are available, orders for 5-10 loads are [looking at mid-June for delivery](#). Demand for both Mozzarella and Swiss cheese is very strong.
- For the first week of May, [cheese stocks were down 1%](#), according to weekly cold storage numbers.
- Dairy cow [slaughter is trending higher](#). For the week ending 04/26, 43,700 head were culled vs. 39,300 during the same period a year ago.
- International: Milk production in Oceania will most likely trail last year, according to Dairy Market News. As a result, traders indicate they will [not have any surplus dairy end-products](#) available for spot buyers in the near future.
- World Ag Supply & Demand Report: USDA's first estimate for 2007 milk prices is about \$1.00/cwt higher than in 2006. They expect higher feed costs and weaker milk prices in 2006 will lead to a reduction in dairy cow numbers, limiting production increases.

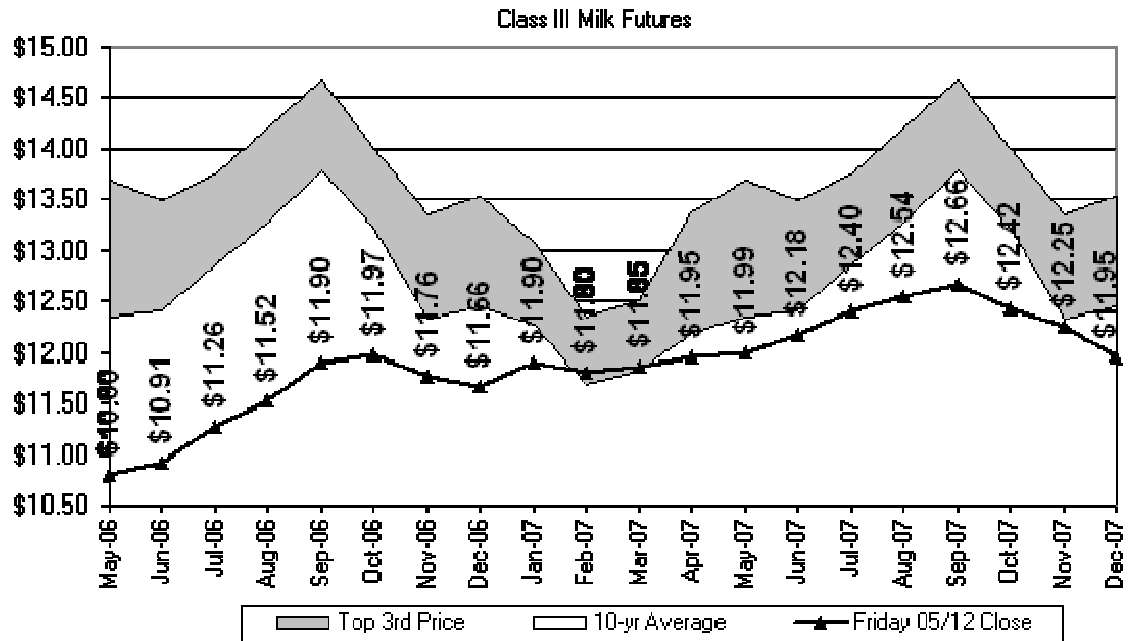
Futures Month	Friday 05/12 Close	Friday 05/05 Close	Change	10-yr Average	Top 3rd Price
May-06	\$10.80	\$10.81	(\$0.01)	\$12.35	\$13.69
Jun-06	\$10.91	\$10.89	\$0.02	\$12.41	\$13.50
Jul-06	\$11.26	\$11.27	(\$0.01)	\$12.85	\$13.75
Aug-06	\$11.52	\$11.60	(\$0.08)	\$13.28	\$14.19
Sep-06	\$11.90	\$11.90	\$0.00	\$13.78	\$14.67
Oct-06	\$11.97	\$11.90	\$0.07	\$13.21	\$14.00
Nov-06	\$11.76	\$11.70	\$0.06	\$12.32	\$13.34
Dec-06	\$11.66	\$11.69	(\$0.03)	\$12.44	\$13.53
Jan-07	\$11.90	\$11.77	\$0.13	\$12.27	\$13.08
Feb-07	\$11.80	\$11.77	\$0.03	\$11.68	\$12.34
Mar-07	\$11.85	\$11.77	\$0.08	\$11.82	\$12.51
Apr-07	\$11.95	\$11.95	\$0.00	\$12.19	\$13.36
May-07	\$11.99	\$11.99	\$0.00	\$12.35	\$13.69
Jun-07	\$12.18	\$12.15	\$0.03	\$12.41	\$13.50
Jul-07	\$12.40	\$12.40	\$0.00	\$12.85	\$13.75
Aug-07	\$12.54	\$12.53	\$0.01	\$13.28	\$14.19
Sep-07	\$12.66	\$12.64	\$0.02	\$13.78	\$14.67
Oct-07	\$12.42	\$12.40	\$0.02	\$13.21	\$14.00
Nov-07	\$12.25	\$12.24	\$0.01	\$12.32	\$13.34
Dec-07	\$11.95	\$11.95	\$0.00	\$12.44	\$13.53

however....

- World Ag Supply & Demand Report: While USDA had some good news for 2007, they [lowered their 2006 price forecast yet again](#) on weaker demand and lower cheese and whey prices. They now expect Class III to average \$11.50 for the year, down 10¢ from last month's forecast.
- The NASS [dry whey price fell](#) another 0.8¢ to average 28.5¢/lb, according to today's report. Nonfat dry milk also fell 0.8¢ to 83.4¢/lb, and block cheese was down a penny to \$1.15/lb. Bucking the trend, both barrels and butter were slightly higher.
- Butter movement into storage [continues to outpace last year](#). 6.8 million lbs went into CME-approved warehouses last week vs. 5.8 million last year.
- The milk supply in the Midwest is still ample to burdensome, according to Fluid Milk & Cream Review. In what sounds like a month-long rerun, plant operators continue to be concerned about capacity issues going into the flush. Some bottlers have cut back as local colleges close for the summer, forcing [more milk into manufacturing channels](#). Spot loads of milk are readily available at below class prices.
- Milk exports out of Florida shot up by 109 loads from the prior week due to school closings having a negative affect on Class I sales. Milk supplies were called "[more than excessive](#)". In the Northeast, operations received heavy milk volumes over the weekend and were still trying to clear them at midweek.
- Near ideal milking conditions persist across the entire Pacific Northwest to Southwest parts of the country, according to Fluid Milk & Cream Review. Output is flat to slightly higher in California, and up in Arizona and New Mexico on increased cow numbers.
- Dairy Market News reports first quarter butter production was the [largest output ever recorded](#). Churning activity has been heavy all spring, and handlers feel there is little chance for prices to increase.
- Cheese output remains heavy out East, according to Dairy Market News. Supplies are more than adequate to cover needs.

Recommendation:

The week began in quiet fashion, but picked up pace as the cash cheese market came to life. A tight barrel situation has inverted the cheese market, but one has to ask, "For how long?" Locals (floor traders) and commercial hedgers were quick to push Class III prices higher on the cheese move, but it didn't appear there was a whole lot of conviction behind it. After moving some contract months up as much as



30¢ on the day, most settled single digits higher. Once again, this was a gift to producers looking to get hedged above \$12 and another example of the power of open orders (good until cancelled). Today we were able to sell October at its high of \$12.12 because our sell order was hit during the short surge higher. Some of these highs lasted only minutes, so if orders were not in ahead of the run-up, there was little chance to get anything done. November traded as high as \$12.00 before finishing the day at \$11.76. Despite what looks to be some short-term tightness in cheese, we have to remind ourselves we are still in a bearish market. There is PLENTY of milk flowing in the country. The market should get a healthy reminder of that on Wednesday when the next production report is released. By all accounts it should be bearish and show another increase in cow numbers. Combine that with school closings, and more milk will be diverted into manufacturing pipelines. Cheese continues to move well through food service and retail outlets, but much is going into aging programs as well. When those warehouses are full, the cheese will need to go somewhere.

We continue to recommend selling Aug-Dec at an 11.90 average or higher. The average now stands at 11.76, but had an order been in today, you would have been filled, as we hit 11.93 during the short price spike. Get those orders in place! The 2007 annual average increased another 3¢ over last week to stand at \$12.16, while Jan-Jun improved 4¢ to \$11.95. We feel that these are good prices to get a start on your hedging program for next year. Prices are unlikely to recover substantially until well into 2007.

Please feel free to call us for further insight into the markets or for help setting up a marketing plan!

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