



The KDM Dairy Report - July 7th, 2006

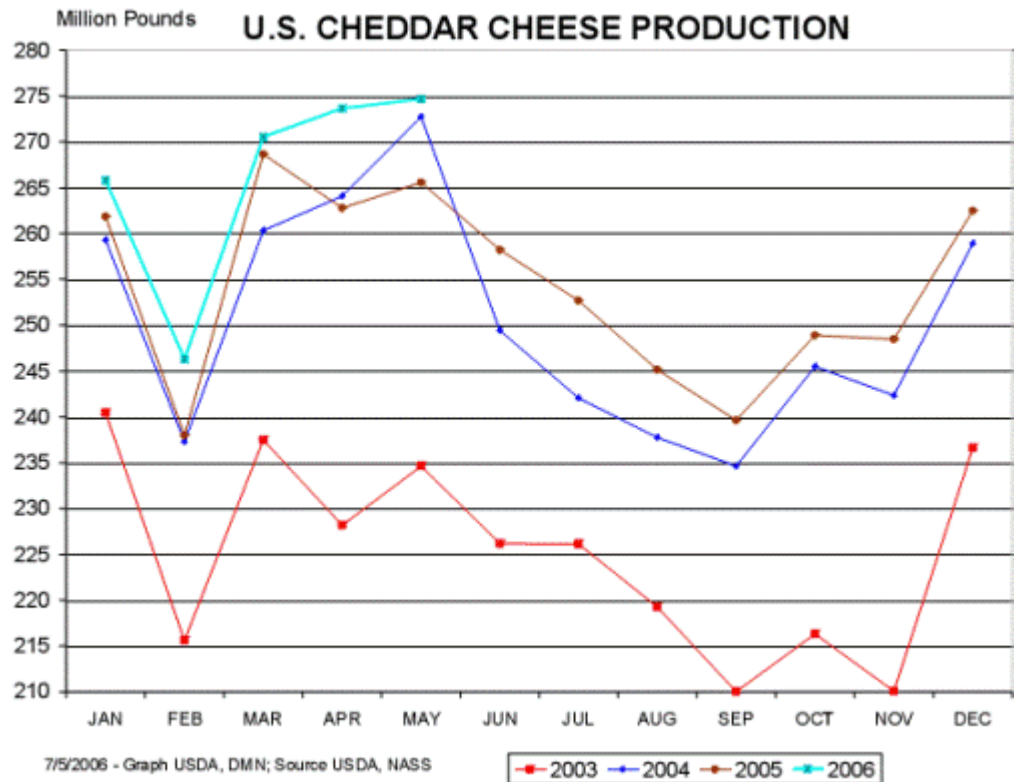
On the bright side:

- Weekly slaughter numbers continue their recent trend of [outpacing last year's levels](#). For the week ending 06/24, 41,200 dairy cows exited the herd, compared to 36,400 during the same period a year ago.
- In the Northeast, recent heavy rainfall continues to impact milk production and logistics, while in the Southeast, seasonal heat and humidity are [taking their toll on production](#). Only 6 loads of milk left the state of Florida this week, vs. 33 last week and 150 during the same period last year.
- While California has cooled some, Arizona is now hot and humid and [production is declining](#). Seasonal warmth in the Pacific Northwest is also affecting receipts, while the lack of dairy quality hay persists. Lower milk prices are making alternative grain and protein options costly.
- With less milk to dry, the nonfat dry milk market is [firming up](#), according to Dairy Market News. In addition, there were no CCC purchases this week.
- Dry whey production is also trending lower, while foreign buyers are still finding excellent quality and price value in U.S. stocks, making it easy to move product.

Futures Month	Friday 07/07 Close	Friday 06/30 Close	Change	10-yr Average	Top 3rd Price
Ju1-06	\$11.05	\$11.15	(\$0.10)	\$12.85	\$13.75
Aug-06	\$11.45	\$11.59	(\$0.14)	\$13.28	\$14.19
Sep-06	\$12.08	\$12.17	(\$0.09)	\$13.78	\$14.67
Oct-06	\$12.20	\$12.20	\$0.00	\$13.21	\$14.00
Nov-06	\$12.18	\$12.18	\$0.00	\$12.32	\$13.34
Dec-06	\$12.11	\$12.08	\$0.03	\$12.44	\$13.53
Jan-07	\$12.30	\$12.22	\$0.08	\$12.27	\$13.08
Feb-07	\$12.18	\$12.09	\$0.09	\$11.68	\$12.34
Mar-07	\$12.20	\$12.17	\$0.03	\$11.82	\$12.51
Apr-07	\$12.40	\$12.35	\$0.05	\$12.19	\$13.36
May-07	\$12.42	\$12.40	\$0.02	\$12.22	\$13.51
Jun-07	\$12.60	\$12.56	\$0.04	\$12.31	\$13.36
Ju1-07	\$12.95	\$12.87	\$0.08	\$12.85	\$13.75
Aug-07	\$13.10	\$13.02	\$0.08	\$13.28	\$14.19
Sep-07	\$13.25	\$13.12	\$0.13	\$13.78	\$14.67
Oct-07	\$13.03	\$12.97	\$0.06	\$13.21	\$14.00
Nov-07	\$12.85	\$12.77	\$0.08	\$12.32	\$13.34
Dec-07	\$12.62	\$12.62	\$0.00	\$12.44	\$13.53

however....

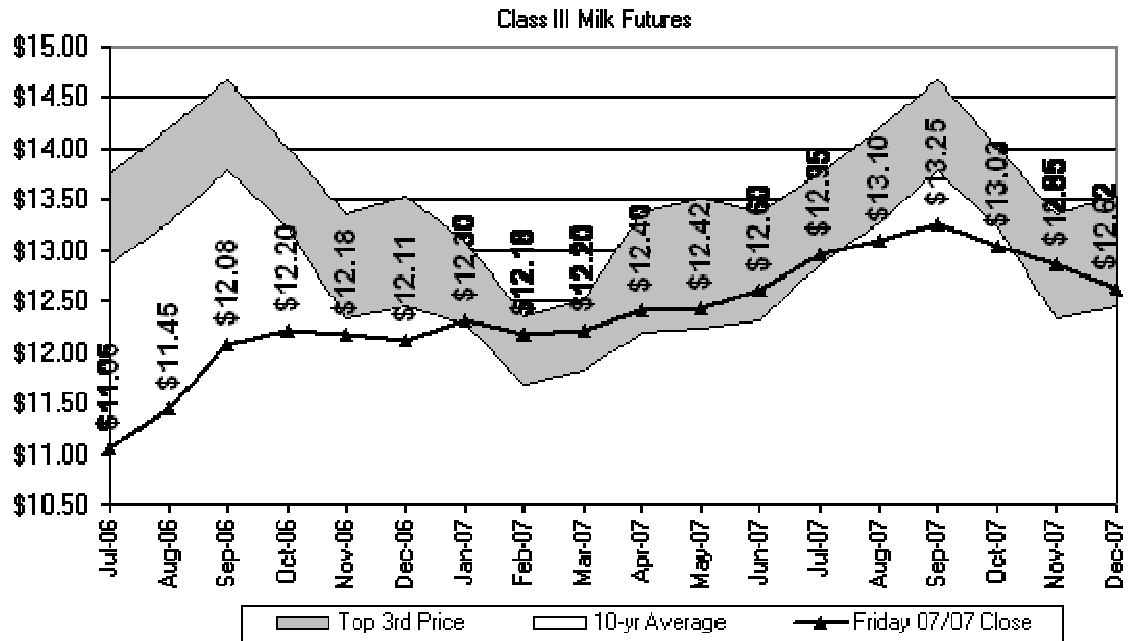
- Cash Markets: Sellers continued to arrive with blocks, getting rid of 8 loads during the holiday-shortened week. The price was pushed down 1¼¢ to settle at \$1.16/lb today. There were no trades in barrels, but a load was offered lower in response to the block price, falling 1½¢ during the week to finish at \$1.15/lb.
- Dairy Products Report: May cheddar cheese [output was 3.4% higher](#) than last year, while American cheese output was 4% higher than a year ago and 2.1% higher than April. Total cheese output was up 3% for the year and up 2.6% vs. April. May butter output was up 7.3% vs. last year and up 0.8% from the prior month.
- With some plants closed over the July 4th holiday, some handlers in the Midwest reported more [problems clearing surplus milk](#), while others just continued to receive milk and get by with full silos. Interest in manufacturing milk remains lackluster.



- Strong milk production is supporting active cheese output in the Midwest, according to Dairy Market News. But, current American supplies are meeting current needs as [less cheese is going into aging programs](#).
- NASS surveyed cheese and butter [prices fell](#) this week. U.S. 40-lb blocks averaged \$1.19/lb, down 1¢ from last week, while 500-lb barrels fell 1.4¢, also at \$1.19/lb. Butter decreased 2.3¢ to average \$1.13/lb.

Recommendation:

The headline this week should read "Inventory trumps Heat!" With a record level of cheese output the first half the year, supply remains plentiful despite some significant curbs in milk production due to heat in parts of the country. Heavy cheese inventories held by large commercial firms that were accumulated with the anticipation of slower milk production this summer are holding prices for cheese at lower levels.



It will be difficult for cheese to rally unless the hot weather is prolonged into late July. Cow and heifer prices have declined some, but not enough. \$1,700 springers and \$11 milk does not pencil out to profit. Dairy producers are getting discouraged after three months of low prices and the prospect for another month of below breakeven prices.

For short range protection on your existing sold positions, buy 3 August 12.00 calls at 14¢ and sell 1 January 13.00 call at 40¢ to finance them. This will protect you until the 10th of August against a cheese rally, while risking only 200,000 lbs of milk in January 2007. If successful, you would have a cap of \$13 on 200,000 lbs of January milk in the event prices are somehow strong in Q1 2007.

While nearby contracts are being pressured, 2007 contracts are finding support. The 2007 average increased 6¢ this week to stand at \$12.66. We continue to recommend getting up to 15% coverage if you can make money at these levels. We believe there may be opportunities to hedge 2007 at higher levels later this summer and into fall as commercial interest increases in these contracts.

Please feel free to call us any time if you have questions on the market or need help putting together a hedge program!

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