



## The KDM Dairy Report - September 15<sup>th</sup>, 2006

### Bullish Fundamentals:

- NASS average prices for cheese were [sharply higher](#) this week. Blocks increased 5¢ to \$1.27/lb while barrels moved 6.4¢ higher to \$1.30/lb. Dry whey also continued its upward trend, gaining 0.4¢ to average 31.4¢/lb.
- For the first 11 days of September, weekly cold storage numbers are showing a 9% decrease in butter stocks and 1% [decrease in cheese stocks](#).
- Slaughter numbers [continue to be impressive](#). For the week ending 09/02, 49,700 dairy cows were culled vs. 43,300 during the same period last year.
- A net 4.93 million lbs of butter were [pulled out](#) of CME warehouses for the week ending 09/09, far greater than the 1.2 million lbs that were drawn out of storage a year ago at this time.
- Milk [supplies remain tight](#) in the Midwest, according to Fluid Milk & Cream Review. A reduction in shipments to the Southeast from the Southwest means more milk is being pulled from upper Midwest pools to meet Class I demand. As a result, there is less milk available for manufacturing needs, which is cutting cheese production.
- As reported above, milk production in the Southeast [continues to lag demand](#). Fluid Milk & Cream Review reports supplies are short in most areas, with bottlers having a tough time keeping school pipelines full.
- A combination of more cows being dried up, increased culling, fewer fresh cows and feed quality is keeping milk production in California [flat to lower](#), according to Fluid Milk & Cream Review. In NM, milk output is able to meet the needs of cheese plants and bottlers, but little is going to balancing plants.
- Dry whey [supplies are tight](#), and buyers are getting concerned about their ability to secure what they need, according to Dairy Market News. Some are buying ahead, but often suppliers are sold out or several weeks behind. In addition, export demand has been very strong.
- Dairy Market News reports cheese producers are having a [hard time finding nonfat dry milk](#) at prices they are willing to pay. Some are switching to condensed skim to improve yields.
- International: Domestic dairy [demand in Western Europe is strong](#), according to Dairy Market News. Manufacturing facilities would like more milk, but production is trailing last year. Dairy stocks available for export are limited.
- [Cheese originating in the Midwest remains tight](#), according to Dairy Market News. Producers are struggling to fill orders for low fat Mozzarella and provolone.
- World Ag Supply & Demand Report: [Strong demand for cheese](#) is helping support dairy prices, according to USDA. As a result, they increased their 2006 Class III price forecast to \$11.70/cwt, up from \$11.60 last month.
- Economy: Crude oil traded at its lowest level of the year, before bouncing slightly higher at the market close today. Those lower energy costs kept [inflation in check](#), as the U.S. Labor Department reported prices rose just 0.2% in August. After being above \$3/gal, the national average for gasoline was down to \$2.62, boosting consumer confidence.

Futures Month	Friday 09/15 Close	Friday 09/08 Close	Change	10-yr Average	Top 3rd Price
Sep-06	\$12.22	\$12.18	\$0.04	\$13.78	\$14.67
Oct-06	\$12.37	\$12.29	\$0.08	\$13.21	\$14.00
Nov-06	\$12.47	\$12.28	\$0.19	\$12.32	\$13.34
Dec-06	\$12.45	\$12.34	\$0.11	\$12.44	\$13.53
Jan-07	\$12.45	\$12.31	\$0.14	\$12.27	\$13.11
Feb-07	\$12.35	\$12.25	\$0.10	\$11.68	\$12.37
Mar-07	\$12.34	\$12.25	\$0.09	\$11.82	\$12.54
Apr-07	\$12.40	\$12.46	(\$0.06)	\$12.30	\$13.51
May-07	\$12.40	\$12.48	(\$0.08)	\$12.32	\$13.67
Jun-07	\$12.60	\$12.63	(\$0.03)	\$12.39	\$13.49
Jul-07	\$13.25	\$13.30	(\$0.05)	\$12.82	\$13.74
Aug-07	\$13.54	\$13.40	\$0.14	\$13.23	\$14.17
Sep-07	\$13.55	\$13.52	\$0.03	\$13.78	\$14.67
Oct-07	\$13.31	\$13.23	\$0.08	\$13.21	\$14.00
Nov-07	\$13.14	\$13.10	\$0.04	\$12.32	\$13.34
Dec-07	\$12.95	\$12.93	\$0.02	\$12.44	\$13.53
<b>2007 Avg</b>	<b>\$12.86</b>	<b>\$12.82</b>	<b>\$0.03</b>		

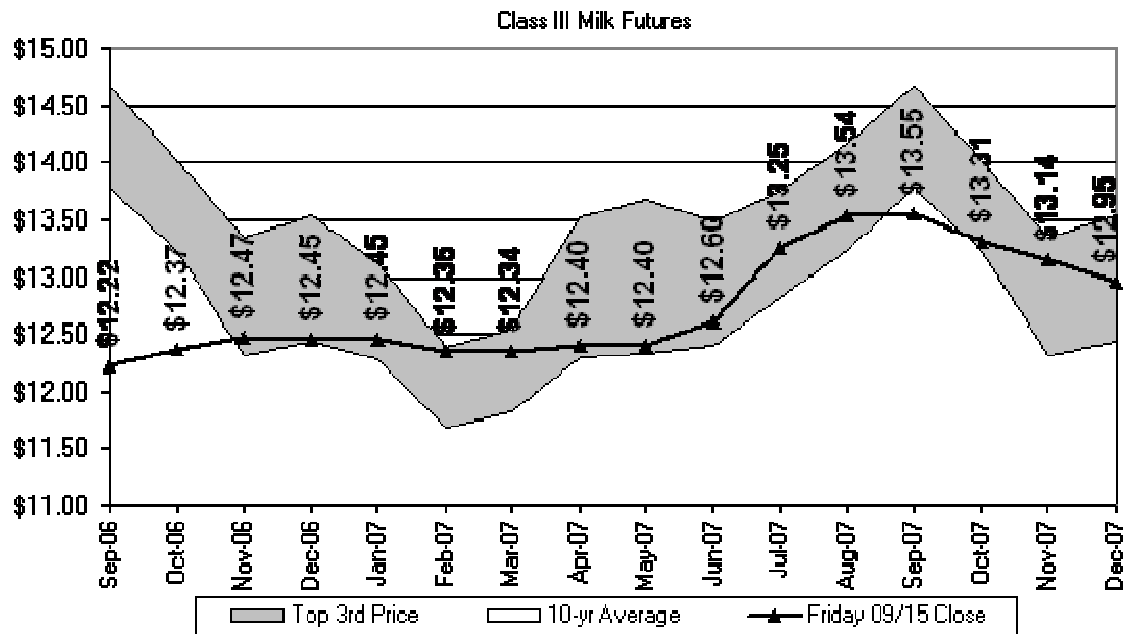
### Bearish Fundamentals:

- Cash market: Although coming off of mid-week lows, cash blocks still ended up lower than one week ago, losing 2¾¢ to close at \$1.27¼/lb today. Barrels did manage a small gain of ¾¢, settling at the same price as blocks, and butter gained a penny on the week to close at \$1.31. Block buyers needed to buy 12 loads to keep prices from falling further, while 3 loads of barrel and 33 cars of butter exchanged hands.
- World Ag Supply & Demand Report: USDA increased both their 2006 and 2007 milk production forecasts, primarily due to the less-than-expected impact from hot weather on milk per cow.
- Food service orders are [decent but not great](#), according to Dairy Market News. There is continued concern about the impact gas prices are having on the restaurant sector, and worry over an economic slowdown.

- There are plenty of cheddar blocks and barrels in Western states, according to Dairy Market News. Buyers state they no longer need to be aggressive purchasing product since their [inventory levels are now above](#) what they would normally have at this time of year.

**Recommendation:**

Class III continues to trade in a choppy, sideways market, not really knowing which way to go. After hitting a low mid-week of \$12.24, the block price managed to come back up to \$12.71¼. But it appeared more defensive in nature, as it tried to keep the block/barrel spread from getting too out of whack. Though there are clearly more bullish than bearish fundamentals in this report, the market



overall feels somewhat heavy. It's as if the big sellers in the cash market allow the price to go up some, before socking it to the buyers. Despite what appears to be a shortage of manufacturing milk in much of the country, ample availability of both blocks and barrels in the Western region of the nation should keep prices in check. Another observation: The 2007 average continues to range between 12.80-12.90, but there is a tilt going on. The front half of 2007 is dropping while the back half is going up. This could be a manifestation of the belief that prices have not been low long enough for a substantial recovery by 2007, but that by mid-2007, things could be quite different. Finally, it will be interesting to see where we are in 3-4 weeks. It seems dairies across the country are drying up cows, which may keep production a little tight going into the fall.

All eyes will be on Monday's milk production report for August. Our initial estimate is for about a 0.75% increase for all 50 states. Cow numbers will also be key, as a return to a growing herd will be bearish for the market.

Our trade recommendation remains unchanged this week. Keep trying to buy the 13.00 call in November and December for 15¢, with the idea of selling your milk later on a seasonal rally. Continue to be patient with 2007. Sell up to 25% at a 12.90 average or higher, with further sales above 13.00.

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