The KDM Dairy Report - November 10th, 2006

Bullish Fundamentals:

Futures Month	Friday 11/10 Close	Friday 11/03 Close	Change	10-yr Average	Top 3rd Price
Nov-06	$12.75	$12.72	$0.03	$12.32	$13.34
Dec-06	$13.87	$13.32	$0.55	$12.44	$13.53
Jan-07	$14.02	$13.42	$0.60	$12.27	$13.11
Feb-07	$14.02	$13.41	$0.61	$11.68	$12.37
Mar-07	$14.02	$13.55	$0.47	$11.82	$12.54
Apr-07	$14.10	$13.66	$0.44	$12.30	$13.51
May-07	$14.20	$13.77	$0.43	$12.32	$13.67
Jun-07	$14.30	$13.86	$0.44	$12.39	$13.49
Jul-07	$14.60	$14.28	$0.32	$12.82	$13.74
Aug-07	$14.75	$14.35	$0.40	$13.23	$14.17
Sep-07	$14.80	$14.40	$0.40	$13.79	$14.68
Oct-07	$14.34	$14.05	$0.29	$13.19	$13.98
Nov-07	$14.25	$13.83	$0.42	$12.32	$13.34
Dec-07	$13.99	$13.63	$0.36	$12.44	$13.53
Jan-08	$13.60	$13.60	$0.00	$12.27	$13.11
Feb-08	$13.45	$13.45	$0.00	$11.68	$12.37
Mar-08	$13.45	$13.45	$0.00	$11.82	$12.54
Apr-08	$13.45	$13.45	$0.00	$12.30	$13.51
May-08	$13.22	$13.20	$0.02	$12.32	$13.67
Jun-08	$13.30	$13.30	$0.00	$12.39	$13.49
2007 Avg	**$14.28**	**$13.85**	**$0.43**		
Jan-Jun '08	**$13.41**	**$13.41**	**$0.00**		

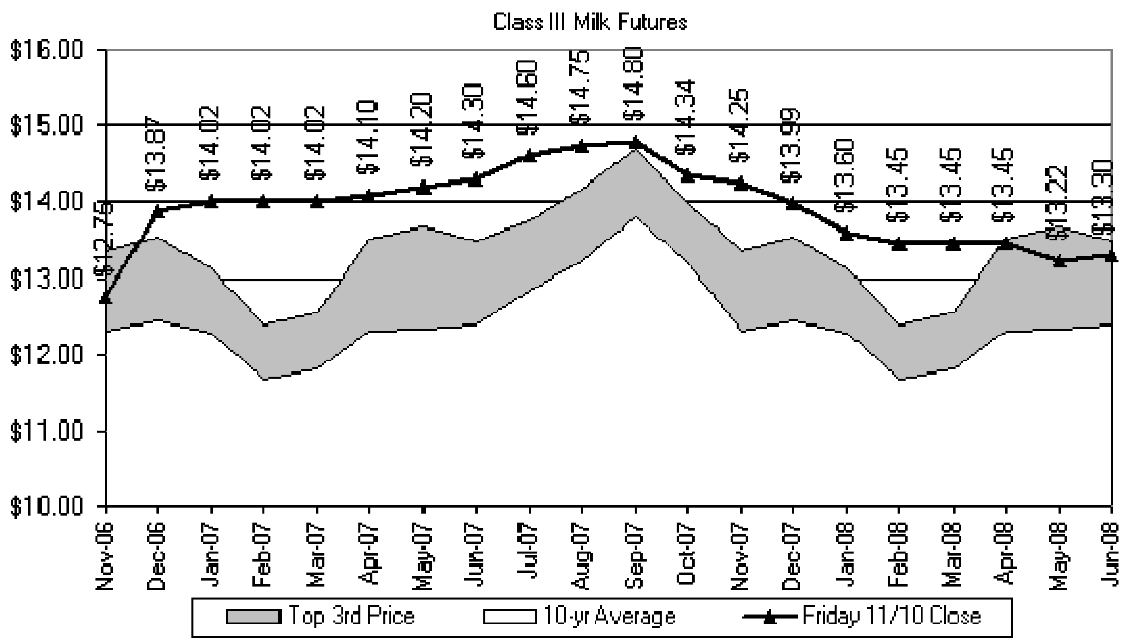
- Cash market: Blocks gained 8¼¢ this week, settling at $1.40/lb, while barrels shot 8¾¢ higher to also finish at $1.40/lb. Butter moved up 5½¢ to settle at $1.33/lb and Extra Grade nonfat dry milk was bid 15¢ higher in one session to stand at $1.20/lb. Grade A remains at $1.65/lb. 7 loads of blocks, 8 of barrel and 51 cars of butter exchanged hands.
- World Ag Supply & Demand Report: USDA lowered their 2007 milk production forecast in numbers released this week, due to increased feed costs and a projected "rapid" decline in cow numbers as a result. USDA increased the price forecast for cheese, nonfat dry milk and whey, reflecting strong demand. Finally, the Class III price forecast for 2007 was raised by 30¢/cwt from last month, and is now expected to average $12.85. Demand for dairy products is expected to remain firm.
- September fluid milk sales were about flat vs. last year, but YTD they are still running 1% higher, according to Dairy Market News. Sales of 2%, 1%, skim and flavored low fat milk were up from last year, but sales of whole milk, flavored whole milk and buttermilk decreased.
- NASS cheese prices started to climb in line with recent cash gains. Blocks increased 1.4¢ to $1.23/lb while barrels gained 2.7¢ to $1.26/lb. Nonfat dry milk climbed toward $1, moving up 1.7¢ to 95.9¢/lb. But, dry whey decreased 0.1¢ to 36.5¢/lb and butter fell 4.4¢ to $1.26/lb.
- Milk shifted from cheese production to butterfat/skim production in other areas of the country could affect short term cheddar offerings, according to Dairy Market News. Delayed and shorted orders for mozzarella and provolone are common and there is some tightness in both Colby/jack and pepper jack blocks.
- Western cheese plants have the capacity to make more cheese, but are struggling to come up with the milk to make it. Any barrel and block offerings are being quickly absorbed by buyers.
- November is starting like October. Despite high cheese output in September as reported in last week's Dairy Products Report, both butter and cheese holdings fell. For the first week in November, butter stocks at USDA selected storage centers were down 3% and cheese stocks were down 1%.
- Weekly cow slaughter numbers indicate the dairy cull remains robust. For the week ending 10/28, 50,600 head exited the herd, vs. 48,500 head during the same period last year.
- In the Midwest, strong Class I demand for fluid and specialty products such as eggnog is keeping the milk supply very tight, according to Fluid Milk & Cream Review. Milk shipments from Minnesota, Wisconsin and Michigan continue to head to southern locations. Churning is light due to tight cream supplies and many cheese plants are running on light schedules. Increased consumer demand for rBST-free milk as an alternative to higher cost organic milk could also be playing a role in reducing supplies.
- Fluid Milk & Cream Review reports milk handlers in the Northeast and Mid-Atlantic region say they have not seen milk supplies remain this tight this late into the fall. Most expect the shortage to last at least to the end of the year.
- Massive rainfalls in Washington and Oregon are causing bulk tanks to fill as some hauling routes have been disrupted by regional flooding, reports Fluid Milk & Cream Review. Of more concern, however, is the rising cost of feed and hay. Many producers did not lock in their grain costs during September lows and are now facing high winter feed bills.
- Nonfat dry milk supplies remain insufficient to satisfy current demand, despite extra milk being directed toward drying facilities instead of cheese plants, according to Dairy Market News. Some end-users out East, such as bakeries, are on the verge of shutting down their plants without needed nonfat dry milk they have contracted through brokers.

- Dry whey on the resale market is going for as high as 50¢/lb, according to Dairy Market News. Supplies are being rationed and producers are unable to satisfy demand.
- Butter movement out of CME-approved warehouses was very strong this week. 7 million lbs were pulled out of storage vs. 4 million during the same week last year.
- Dairy Market News reports butter orders are still surprisingly strong given how close we are to Thanksgiving. Many butter handlers thought most Thanksgiving needs had been filled but current short-term delivery orders are proving them wrong.

Bearish Fundamentals:

- Milk output in Florida, the Carolinas and Texas is increasing, according to Fluid Milk & Cream Review. Haulers state load sizes are getting heavier and extra routes will need to be added soon. Florida imported 62 fewer loads of milk this week vs. last as a result of the increased production and leftover milk from last week's imports.
- Weather has been near ideal for milking in California, Arizona and New Mexico. Cheese plants are working towards resuming full production and milk appears to be in balance with needs.
- The amount of butter produced in September was the most in 35 years, according to Dairy Market News. The Western region produced 49% of total U.S. butter production during the month.

Recommendation:



This week's cash market saw buyers become much more aggressive over worries of a tight current cheese supply. Barrels appear to be leading the way but blocks are sticking close by. Word is there's cheese out there, but sellers are reluctant to release product off exchange, so buyers are being forced to bid for cheese on the cash market to shake a few loads loose from suppliers. Bids remained unfilled in today's session. Class III futures responded sharply higher in a combination of spec buying, commercial long hedging and producer short covering. At $1.40/lb, cheese has reached its highest price since Dec. 2005, and current prices work out to about $13.80 Class III. December settled at $13.87 today, in line with cash. Further increases in the cash market will move the front months higher, but a sudden drop will have things going the other way. The market continues to trade with a lot of emotion, so expect more violent up and down swings in the weeks ahead. However, repeating what we've said the past several weeks, long-term fundamentals will provide much support for the market. Grains have begun to drop but look to be well supported into the New Year on strong exports. Holiday item production, strong fluid demand, interest in rBST-free milk and a tight global powder supply continue to be the main drivers of the market. Unless feed costs drop dramatically, higher milk prices in 2007 look justified.

If you've been following us for a while, you know we have recommended selling only up to 25% of your 2007 production. If you have sold nothing yet, congratulations! However, at the current annual average of $14.28, it might not be a bad idea to market some milk. Producer optimism is improving, and the higher prices rise now, the more probable it is we'll be back in an expansion mode sooner than later. Switch to PUT options for the front months on any unsold milk. PUT options provide floor price protection for your milk while allowing participation in rising prices. Enter orders to buy the Jan 13.50 PUT for 20¢, Feb 13.50 PUT for 30¢ and the Mar 13.50 PUT for 35¢. This will provide an excellent floor while giving you unlimited upside potential should prices continue higher. Expect continued volatility in the weeks ahead.