



The KDM Dairy Report - January 12th, 2007

Bullish Fundamentals:

- Grains: USDA's annual summary report on crop production contained a large downward revision for corn, estimating the total crop at 10.5 billion bushels, which was down 2% from their November forecast and [5% lower than 2005](#). Yield at 149.1 bu/acre was down 2.1 bu/acre than previously thought. Ending stocks are now forecast at 752 million bushels, down 183 million bushels from the previous forecast and 62% less than last year's carry-over. 20% of the 2006 crop is expected to be used for ethanol production. Finally, USDA's quarterly Grain Stocks report had corn stored in all positions on Dec 1, 2006 at 8.93 billion bushels, [down 9%](#) from a year ago.
- U.S. exports of dairy products for the period Jan-Nov 2006 is [up 12% vs. last year](#), according to USDA figures in this month's U.S. Ag Trade Update report. And in a market related to milk, corn exports are up a very strong 45% for the same period.
- NASS surveyed prices for most Class III components were up this week, with a [strong surge in powders](#). Nonfat dry milk increased 4¢ to average \$1.05/lb and dry whey was up 2.1¢ to 43.7¢/lb. Cheddar blocks reversed direction, increasing 1¢ to \$1.32/lb, but barrels were still lower, losing 0.2¢ to \$1.30/lb. Butter remains the weakest link, shedding 1.8¢ to average \$1.19/lb.
- Fluid milk sales in November were [up 1.8%](#) vs. last year, according to Dairy Market News. Gains in consumption were seen in 2%, 1%, skim and low-fat flavored varieties. YTD fluid milk sales are up 1.1%.
- World Ag Supply & Demand Report: USDA's monthly look at agriculture correctly anticipated today's grain run-up, saying, "Gains in [milk prices are expected to lag increased feed costs](#) through much of 2007...". They also pointed out that in the absence of other international sources, U.S. prices for nonfat dry milk and dry whey are expected to remain high. However, due to the increase in the make allowance, the adjusted their 2007 milk price forecast 25¢/cwt lower.
- Dairy cow [slaughter remains strong](#), as the last weekly stats for 2006 were 10% higher than the same period in 2005. For the week ending 12/30/06, 40,600 head were culled compared to only 36,900 head last year.
- Milk prices are [not covering the cost of production](#) for many producers in California, according to Fluid Milk & Cream Review. Feed costs and quality are limiting factors in feeding plans. Milk production in New Mexico is trending lower due to recent wet weather and financial stress as producers face increased prices on corn and hay. The same appears to be true in the Pacific Northwest where milk production is steady, but financial hardship at the farm level is increasing as both grain and hay prices firm.
- Dairy Market News reports dry whey prices continue to firm. Most plants [have nothing to offer](#) on a spot basis, despite increased production over the holidays.
- The Western whey powder market remains firm with [prices continuing to increase](#), according to Dairy Market News. Demand from both domestic users and foreign buyers is aggressive, and supplies are tight to short of needs.

Futures Month	Friday 01/12 Close	Friday 01/07 Close	Change	5-yr Average	Top 3rd Price
Jan-07	\$13.40	\$13.33	\$0.07	\$12.16	\$13.00
Feb-07	\$13.63	\$13.41	\$0.22	\$12.02	\$12.70
Mar-07	\$13.80	\$13.53	\$0.27	\$11.89	\$12.61
Apr-07	\$14.02	\$13.74	\$0.28	\$13.09	\$14.31
May-07	\$14.40	\$14.05	\$0.35	\$13.14	\$14.49
Jun-07	\$14.50	\$14.11	\$0.39	\$12.54	\$13.63
Jul-07	\$14.70	\$14.45	\$0.25	\$12.25	\$13.16
Aug-07	\$14.99	\$14.65	\$0.34	\$12.41	\$13.34
Sep-07	\$15.15	\$14.80	\$0.35	\$13.11	\$13.99
Oct-07	\$14.75	\$14.49	\$0.26	\$13.19	\$13.98
Nov-07	\$14.60	\$14.28	\$0.32	\$12.88	\$13.86
Dec-07	\$14.35	\$14.10	\$0.25	\$12.92	\$14.01
Jan-08	\$14.25	\$14.05	\$0.20	\$12.16	\$13.00
Feb-08	\$14.08	\$13.90	\$0.18	\$12.02	\$12.70
Mar-08	\$14.08	\$13.85	\$0.23	\$11.89	\$12.61
Apr-08	\$14.08	\$13.85	\$0.23	\$13.09	\$14.31
May-08	\$14.18	\$13.85	\$0.33	\$13.14	\$14.49
Jun-08	\$14.18	\$14.00	\$0.18	\$12.54	\$13.63
2007 Avg	\$14.36	\$14.08	\$0.28		
Jan-Jun '08	\$14.14	\$13.92	\$0.23		

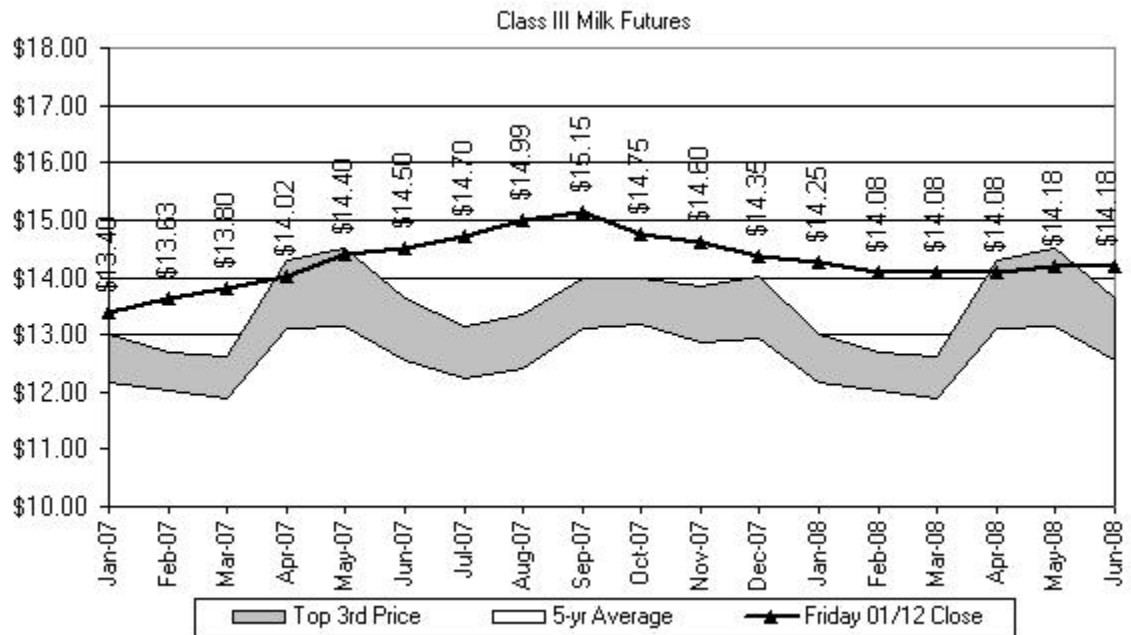
Bearish Fundamentals:

- Cash market: You wouldn't know it from Class III futures, but both blocks and barrels lost ground this week. Sellers pushed blocks 3¼¢ lower than last Friday, settling today at \$1.30¾/lb while barrels closed at \$1.33/lb, down 1½¢. Butter was the surprising bright spot, up 3¢ to settle at \$1.23/lb. Cheese buyers did become more aggressive at these lower prices, with 10 loads of blocks, 9 of barrel and 11 cars of butter exchanging hands.
- Butter stocks continue to [climb more rapidly](#) than last year at this time. For the week ending January 6th, 8.8 million lbs of butter were added to CME-approved warehouses, compared to only 1.65 million lbs during the same period last year.

- Though surplus milk volumes have declined some since the holidays, manufacturing milk [interest remains sluggish](#), according to Fluid Milk & Cream Review. Cream offerings are heavy with large volumes headed to the churn.
- Butter demand is slow and unaggressive, according to Dairy Market News. [Offerings often surpass need](#) and sales are slow, which is typical for this period following the holidays.
- Interest in current cheddar blocks is light with [some inventory building](#), according to Dairy Market News. Buyers have come back in to the market after assessing holiday sales, but trading activity remains light.

Recommendation:

In our opinion, the milk market is undergoing a paradigm shift as global forces play a stronger role in domestic milk prices. Some of our competitors continue to insist we are in the midst of a bear market due to rising cow numbers, milk production and the fact that prices weren't low enough long enough to force farm liquidation. While these are bearish fundamentals, we feel other market forces are changing the way the game is played. Today's



crop production report erased losses in the grain markets of the past few days as corn finished limit up in nearly every contract month while beans were up about 40¢/bu across the board. We expect grain prices to move higher when trading resumes Tuesday. And we're sounding like a broken record, but world dairy stocks are tight. One analyst pegged the world whey price at 60¢/lb, which helps explain the strong move in today's NASS numbers as foreign buyers still see a bargain. Could NASS dry whey hit 50¢/lb? It sure could. The mostly price for Western whey this week was between 46½ to 50¢ per pound, according to Dairy Market News. Feed costs (grains), global dairy supply and the devaluation of the U.S. dollar (making our exports cheaper) are, we believe, the main driving forces in today's market. Analysts typically tell us that U.S. milk production needs to increase 1.5 to 2% each year to handle domestic population growth. But what happens to that % increase number when international demand rises sharply as we're seeing now? On Thursday the next Milk Production Report will be released, but it may not matter a whole lot if cow numbers continue to go up (slightly!) or production is up – we may need everything we can get next year. With grain prices sharply higher, profitability will still be a challenge to those operations that buy the bulk of their feed. While this sounds rosy, we caution everyone not to get too bullish. And consider this. If you sold all your milk at today's annual average of \$14.36, you would have locked in the second highest annual average of all time! You should do something to protect that price! We are glad that we have stuck to recommending our producers sell no more than 25% of their production, but at this point, we would recommend going to an all PUT option strategy to get a floor price on any unsold milk, leaving it open to higher prices. Premiums look likely to fall further next week, but even so, the 13.25 PUT Jan-Dec settled today at 20¢ each. That would give you a \$13.05 floor with all the upside. If prices keep moving higher, target the 13.50 PUT Jan-Dec.

NOTE: There will be no trading on Monday, January 15th, in observance of Martin Luther King Day. Our office will reopen on Tuesday.

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