



## The KDM Dairy Report - March 9<sup>th</sup>, 2007

### Bullish Fundamentals:

- World Ag Supply & Demand Report: USDA increased their Class III price forecast this month by a strong 85¢/cwt, expecting it to now average \$14.40/cwt. As reasons for the increase, they cite a drop in output per cow, a weak milk-feed ratio and a gradual decline in cow numbers through much of the year. Despite higher beginning dairy stocks, they expect demand to absorb the additional quantities. Finally, strong international demand for nonfat dry milk and dry whey is [expected to keep supplies tight the entire year](#). As a result, USDA also increased their price forecast for dry whey by 14¢/lb, expecting it to now average 61¢/lb for the year. Wow!
- Cash Market: Buyers continue to be aggressive as they successfully acquired 21 loads of barrels, 8 of blocks and 9 cars of butter. Blocks gained 5¢ for the week, closing today at \$1.39½/lb, while barrels increased 4¢ to \$1.39/lb. Butter saw less activity, but still managed to gain ¾¢ to close at \$1.32¼/lb.
- This week's Dairy Market News reported the mostly price for dry whey in the Central region [up again](#), ranging from 73¼ to 76¾ cents. Export buyers are so far undeterred by the price, but domestic buyers are resisting. In the West, prices ranged from 61 to 69 cents, with export sales driving the market. Supply remains short of needs, and little competition is noted [from anywhere else in the world](#).
- Fluid milk sales in January were an estimated 2.9% higher than in 2006, according to Dairy Market News. Sales of flavored milk, 2%, 1%, skim and buttermilk were all higher, while non-flavored whole milk sales were down.
- Nonfat dry milk production is down in the Central region due to reduced milk intakes, according to Dairy Market News. But demand is strong and [supplies are tight](#). End users are anxious to sign forward contracts, but producers are only interested in going month-to-month due to price volatility.
- Dairy cow slaughter for the week ending 02/24 [topped 50,000](#). Last year during this period 41,900 head were culled, but in 2007, 51,300 head were removed from the herd, up 22%.
- Increases in butter stocks at CME warehouses have seen a [dramatic slowdown](#) in the last couple weeks. Only 308,000 lbs were added to inventory for the week ending March 3<sup>rd</sup>, vs. an increase of 6.5 million lbs during the same week last year. Stocks on hand are now only 8.1 million lbs more than in 2006.
- Class I demand and [sales are strong](#) in the Northeast and Mid Atlantic states, according to Fluid Milk & Cream Review. The milk supply appears to be in balance in the region, with little surplus left for balancing plants.
- Cheese buyers in the Western region are [looking for additional cheese](#) supplies to satisfy long-range planning, according to Dairy Market News. Barrels are noted as being tighter than blocks.

Futures Month	Friday 03/09 Close	Friday 03/02 Close	Change	5-yr Average	Top 3rd Price
Mar-07	\$14.87	\$14.54	\$0.33	\$11.89	\$12.61
Apr-07	\$15.01	\$14.35	\$0.66	\$13.09	\$14.31
May-07	\$15.00	\$14.50	\$0.50	\$13.14	\$14.49
Jun-07	\$14.97	\$14.50	\$0.47	\$12.54	\$13.63
Jul-07	\$15.37	\$15.00	\$0.37	\$12.25	\$13.16
Aug-07	\$15.73	\$15.31	\$0.42	\$12.41	\$13.34
Sep-07	\$15.83	\$15.52	\$0.31	\$13.11	\$13.99
Oct-07	\$15.63	\$15.40	\$0.23	\$13.19	\$13.98
Nov-07	\$15.27	\$15.05	\$0.22	\$12.88	\$13.86
Dec-07	\$15.00	\$14.82	\$0.18	\$12.92	\$14.01
Jan-08	\$14.87	\$14.80	\$0.07	\$12.50	\$13.33
Feb-08	\$14.85	\$14.78	\$0.07	\$12.53	\$13.21
Mar-08	\$14.85	\$14.77	\$0.08	\$11.89	\$12.61
Apr-08	\$14.85	\$14.82	\$0.03	\$13.09	\$14.31
May-08	\$14.90	\$14.78	\$0.12	\$13.14	\$14.49
Jun-08	\$14.93	\$14.89	\$0.04	\$12.54	\$13.63
Jul-08	\$15.09	\$15.05	\$0.04	\$12.25	\$13.16
Aug-08	\$15.11	\$15.10	\$0.01	\$12.41	\$13.34
Sep-08	\$15.20	\$15.15	\$0.05	\$13.11	\$13.99
Oct-08	\$14.95	\$14.95	\$0.00	\$13.19	\$13.98
Nov-08	\$14.66	\$14.66	\$0.00	\$12.88	\$13.86
Dec-08	\$14.55	\$14.55	\$0.00	\$12.92	\$14.01
<b>Mar-Dec Avg</b>	<b>\$15.27</b>	<b>\$14.90</b>	<b>\$0.37</b>		
<b>2008 Avg</b>	<b>\$14.90</b>	<b>\$14.86</b>	<b>\$0.04</b>		

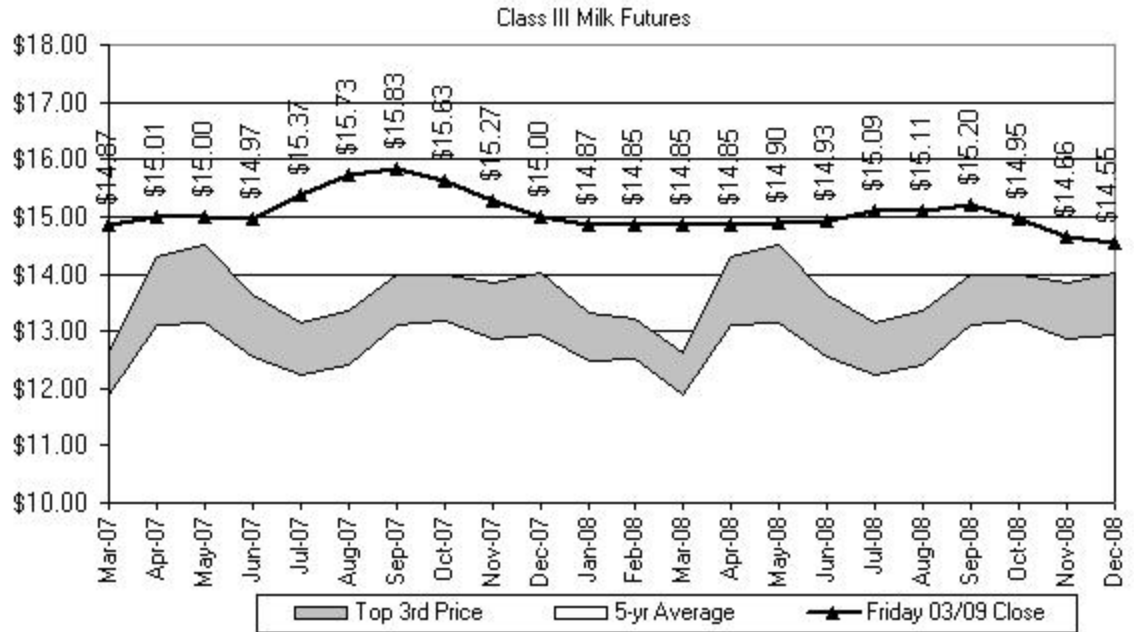
### Bearish Fundamentals:

- NASS surveyed prices for Class III components all went up, but by [less than expected levels](#). 40-lb blocks increased 0.6¢ to average \$1.32/lb while 500-lb barrels were up by the same margin to \$1.34/lb. Butter was up 0.1¢ to \$1.20/lb and nonfat dry milk gained 0.8¢ to \$1.14/lb. Finally, dry whey only moved up 0.3¢ to reach 65.2¢/lb, despite recent multi-cent gains in weekly USDA bulletins, causing some to question whether a top is being made.
- High prices for whey, nonfat dry milk and buttermilk are impacting ice cream makers' production decisions, according to Fluid Milk & Cream Review. [Sales have been sluggish](#) so far in 2007, and ice cream producers are wondering how consumers will react to price changes affected by their input costs.

- Current cheddar cheese supplies in both barrels and blocks are adequate in the Central region, according to Dairy Market News. Industry exports [don't expect that to change](#) until after spring flush.
- California continues to crank out the milk, with big gains in the Central Valley and southern locations, according to Fluid Milk & Cream Review. Milk [receipts are above projected levels](#), keeping plants full and necessitating some strategic balancing. In Arizona, production is nearing the spring peak due to ideal weather. Processing plants are running on higher schedules, and cream supplies are long. Finally, despite wet conditions, cows are responding in the Pacific Northwest and are milking well. Despite a shortage of dairy quality hay, there is some concern in the area about being able to handle the upcoming spring flush efficiently.

### Recommendation:

As news of the big jump in the Central whey price hit the dairy pit on Thursday, traders began buying Class III futures in the front months in earnest. After another gain in the cash cheese session at 10:45am, buying continued the rest of the afternoon, lifting most front-month contracts 25-30¢. Today's session was more subdued, but even disappointing NASS numbers, which opened the market lower, could only keep the March contract in negative territory by the end of the day.



When all the dust settled, the March-December average increased an amazing 37¢ for the week, while the 2008 contracts continue to creep higher. Little else has changed from one week to the next. We still believe it wise to sell April and May on rallies, and to stick with PUT options on the deferred months. This week, we would raise the strike price on the floor, and bid for 14.50 PUTs, April-December at an average of 25¢ premium. They are currently trading at 32¢, so the market will need to work higher next week to get filled. But if successful, it would yield an effective floor of 14.25 base price for the remainder of the year. Several producers called this week asking what to do with 2008, given the solid prices currently offered. Looking at the graph above, I don't know if we've ever seen 22 consecutive months all trading above their Top 3<sup>rd</sup> historical price average. Amazing! But despite that, we would hold off. Unfortunately, PUT options that far out command quite a premium, so they aren't a viable strategy at this point. But we also believe prices in 2008 are not going to collapse overnight, and it would be better to stay on the sidelines for now. We'll keep you posted as our opinion changes. All eyes will be on next week's milk production report.

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