



The KDM Dairy Report – May 11th, 2007

Bullish Fundamentals:

- World Ag Supply & Demand Report: USDA increased both their remaining 2007 and 2008 Class III milk price forecasts in numbers released today. Continued international and domestic demand for nonfat dry milk and dry whey is expected to keep prices strong for those products well in to 2008. With commercial stocks predicted to stay tight, USDA [raised their Class III price forecast by \\$1.40/cwt](#) from last month; quite a big jump! They now project Class III to average \$16.30 for 2007, and took at first stab at estimating 2008 with a predicted average of \$16/cwt.
- NASS surveyed [cheese prices were up](#) this week. 40-lb blocks averaged \$1.47/lb, up 5.1¢ from the previous week, and 500-lb barrels gained 4.2¢ to reach \$1.49/lb. Butter increased 2.2¢ to average \$1.39/lb while nonfat dry milk rose 4¢ to \$1.56/lb.
- Cash Market: Blocks lost ground from last week, but we still include it as a bullish fundamental due to the limited correction and the willingness of buyers to continue to purchase large quantities of product. Blocks were as low as \$1.67 earlier in the week, but came back to \$1.69½/lb today, just ¾¢ lower than last Friday. Barrels traded down to \$1.60 on Wednesday, but rallied back to \$1.65¼/lb, closing today 1¾¢ higher than last Friday. Butter may be in for further gains, showing a strong move this week up 3½¢ to settle at \$1.49/lb. 8 loads of blocks, 29 of barrel and just 2 cars of butter exchanged hands.
- USDA weekly cold storage stats for the first week in May indicate a [1% drop in cheese stocks](#), and butter inventory virtually unchanged.
- Dairy producers continue to aggressively cull their herds. For the week ending 04/28, 50,500 head went to slaughter vs. only 43,700 during the same period last year. Year-to-date the [2007 cull is up 15.7%](#) vs. last year.
- Butter stocks at CME-approved warehouses increased 3.4 million lbs for the week ending May 5th; but that's 3.3 million lbs less than the gain last year at this time, and total stocks on hand are [10 million lbs below 2006 levels](#).
- Fluid Milk & Cream Review reports [improved utilization of milk](#) in the Central region this week. Class I sales are steady to slightly stronger and Class II interest has increased as ice cream producers use more milk rather than whey or nonfat dry milk in their formulations. Class III interest is up as well, primarily from specialty cheese makers.
- Milk is in balance in the Northeast, but strong Class I sales in the Mid-Atlantic region are [limiting milk receipts](#) to less than anticipated levels for manufacturing purposes, according to Fluid Milk & Cream Review.
- A combination of higher feed costs, freshening problems from last summer's heat and early season record highs has California milk receipts heading lower, according to Fluid Milk & Cream Review. Previously stressed milk processors now have a little extra capacity to handle the milk more efficiently. [Cream demand has surged](#), as the heavy offerings from just 10 days ago have changed rapidly now that milk production is starting to slide and heat is affecting components. Ice cream manufacturers are scrambling for cream supplies as they ramp up production for summer, and some cream brokers had to make numerous calls to meet their orders.
- Dairy Market News reports Western nonfat dry milk prices were up sharply again this week as supplies remain short of both domestic and international interest. At the end of March, stocks were down 38.9% vs. last year. Buyers are aggressively looking to find product and higher prices are usually not a problem. Those in the trade won't predict how high prices could go, but [don't think we are near the top](#) yet.
- Exports continue to drive the Western whey market, even though buyers are trying to resist higher prices. European whey [prices increased sharply](#) this week, so traders are watching if that will have any impact on U.S. prices.
- The Central butter market continues to firm as prices rise in the cash market. Though butter production is still outpacing demand, Dairy Market News reports some plants [are a little uncomfortable](#) with their inventory levels

Futures Month	Friday 05/11 Close	Friday 05/04 Close	Change	5-yr Average	Top 3rd Price
May-07	\$17.45	\$17.45	\$0.00	\$13.14	\$14.49
Jun-07	\$18.75	\$18.45	\$0.30	\$12.54	\$13.63
Jul-07	\$18.80	\$18.58	\$0.22	\$12.25	\$13.16
Aug-07	\$18.85	\$18.45	\$0.40	\$12.41	\$13.34
Sep-07	\$18.85	\$18.55	\$0.30	\$13.11	\$13.99
Oct-07	\$18.40	\$18.15	\$0.25	\$13.19	\$13.98
Nov-07	\$17.75	\$17.75	\$0.00	\$12.88	\$13.86
Dec-07	\$17.70	\$17.48	\$0.22	\$12.92	\$14.01
Jan-08	\$16.90	\$16.88	\$0.02	\$12.50	\$13.33
Feb-08	\$15.85	\$16.30	(\$0.45)	\$12.53	\$13.21
Mar-08	\$15.98	\$16.18	(\$0.20)	\$12.78	\$13.50
Apr-08	\$15.98	\$16.07	(\$0.09)	\$13.09	\$14.31
May-08	\$15.74	\$15.90	(\$0.16)	\$13.14	\$14.49
Jun-08	\$15.83	\$15.90	(\$0.07)	\$12.54	\$13.63
Jul-08	\$15.75	\$15.91	(\$0.16)	\$12.25	\$13.16
Aug-08	\$15.94	\$16.09	(\$0.15)	\$12.41	\$13.34
Sep-08	\$16.08	\$16.25	(\$0.17)	\$13.11	\$13.99
Oct-08	\$15.55	\$15.72	(\$0.17)	\$13.19	\$13.98
Nov-08	\$15.39	\$15.50	(\$0.11)	\$12.88	\$13.86
Dec-08	\$15.19	\$15.30	(\$0.11)	\$12.92	\$14.01
Apr-Dec Avg	\$18.32	\$18.11	\$0.21		
2008 Avg	\$15.85	\$16.00	(\$0.15)		

compared to other years at this time, and are expressing concern about milk and cream availability during summer and fall.

- Western butter contacts indicate that some do not have as much butter put away this year as last, according to Dairy Market News. Ice cream operations are starting to [take more cream away](#) from the churn causing supplies to tighten.
- International: Though milk production in Europe has rebounded due to improved grazing conditions, demand for manufactured dairy products continues to surpass supply, according to Dairy Market News. Strong domestic use is leaving little available for export, and handlers don't foresee a significant change to the situation in the coming months. Export subsidy levels were left unchanged at the last Dairy Management Committee on May 10th, but some speculate that [cheese subsidies will be reduced](#) in the near future.
- International: Milk production in Oceania (New Zealand and Australia) has held up better than anticipated in the face of a continuing drought, according to Dairy Market News, but [nearly one in two dairy farms operated at a loss](#) this year. Recent rainfalls have helped green pastures and milk output is responding, but the amount has done little to replenish water levels. Manufactured dairy supplies remain limited, and some traders may need to reach in to next season's production to fulfill current commitments.

Bearish Fundamentals:

- The NASS dry whey price continued to show near term weakness as it fell 1.5¢ to 76.7¢/lb in this week's survey.
- There continues to be a disparity between Central and Western dry whey. Dairy Market News reports that because Central whey is typically packaged in totes or 50 lb bags, it [makes it more difficult to clear](#) into export markets, which expect 25 Kg bags. Some traders think that the price spread between the Central and Western whey markets may need to expand to account for increased shipping costs to reach export markets from the middle of the country.
- Cheese [offerings in the Midwest are starting to increase](#) in response to higher prices, according to Dairy Market News. Buyers are backing off on new orders to wait for lower prices.
- Cheese output in March was up 6.7% in the Western region, according to Dairy Market News. Almost half of the increase is from New Mexico's new cheese-making facilities which has [output in the state up 11 million lbs](#) from last year.

Recommendation:

If you didn't know it by now, we are officially on the dairy roller coaster as predicted volatility finally arrived. After another price washout on Monday, prices stabilized, then made an impressive recovery over the remainder of the week. Jun-Jan futures actually finished with a gain for the week, while the majority of the 2008 contracts were slower to recover. The international picture looks little changed. Recent price increases to their powder complex should keep foreign buyers interested in our products, so we don't expect a large correction in our dry whey price, though the NASS surveyed price has now dropped two straight weeks. In fact, it may be taking a break before another run higher. Butter is starting to make some noise as more cream is diverted to ice cream manufacture for the summer. Commercial holders of butter would like to build more inventory, but have fewer stocks than last year at this time. This could leave them with less than desired stocks going into fall. From butter and cheese processors to fluid bottlers, it seems everyone is predicting milk to tighten up significantly this summer and the scramble is on to get covered. While our long-term outlook remains positive, the price action we saw to the downside last week should be a wake-up call for every producer to get some type of protection in place. We shed nearly \$2/cwt off of prices in 2 days. Our phones went nuts for awhile from producers trying to buy PUT options. Trying to buy PUTs in a down market is not ideal and hard to get done. Sellers, out of fear, demand much higher premiums to cover the added volatility and uncertainty. The time to buy your PUTs and get covered is when you don't think you need them and the market is heading higher. Don't miss this second chance because the market will eventually correct itself again. Place a working order to buy the July-Dec 16.50 PUTs for an average of 30¢ each (current close 38¢). If successful, it would give you an effective floor of 16.20 with all the upside.

Advanced Strategy: PUT options are still expensive, especially for the higher floors. Consider this example. Buy 2 October 17.00 PUT options for 50¢ each, AND buy one October futures at 18.40. Our bias is for higher prices, so target to sell the October at close to 19.40. The resulting gain of \$1/cwt would pay for your PUT options. If prices head substantially lower, say to \$15, you would lose \$3.40/cwt on your futures position, but gain a total of \$4/cwt from your PUT options. Call us if you'd like more info on this type of strategy.

Grain comment: As we've mentioned a few times earlier, we'd consider getting more of your soy complex booked for your feed needs. Meal is still hovering in the low 200's on the CBOT, but impressive gains in spring corn planting mean it's less likely any new acres will be diverted to beans. Today's Crop Production report showed less ending stocks than expected and grain prices rallied on the news. In addition, meal may need to rally later this year in order to start defending 2008 acres from a substantially reduced carry-over.

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