

The KDM Dairy Report – October 5th, 2007

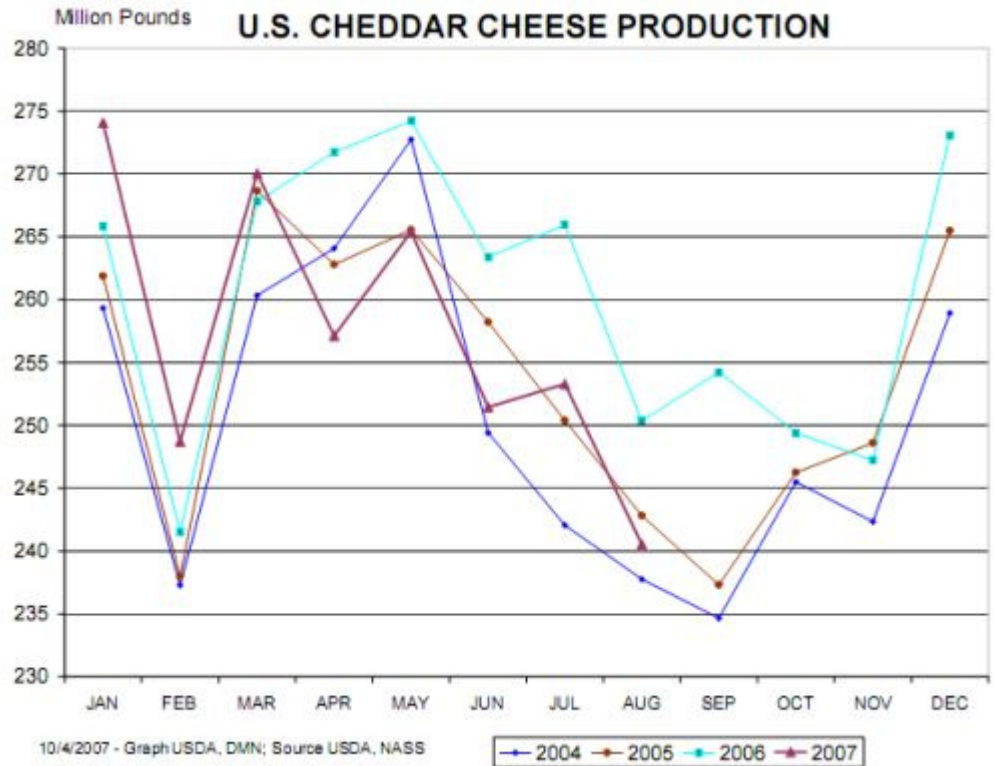
Bullish Fundamentals:

- September Class III settlement was announced at \$20.03/cwt, a new all-time record for this month.
- Dairy Products Report: Cheddar cheese output in August was [3.9% below August 2006 and 5.0% below July 2007](#). Total cheese output was down 0.1% for both time periods, but butter output was up 23.6% vs. a year ago.
- Weekly cold storage numbers from USDA show that during the month of September, cheese stocks at selected storage centers [fell by 5.2 million lbs, or 4%](#), and butter stocks fell by 2 million lbs, or 7%.
- Dairy Market News reports some Western butter producers state that they are [booked through the end of the year](#) making 82% butterfat product for export channels.
- Finally! The dry whey market seems to have found a bottom. Western dry whey prices were actually UP slightly from last week, with Dairy Market News reporting improved export and domestic interest. Inventories, which were burdensome, are [now in much better shape](#).
- Cheese plant [inventories in the Midwest have cleared](#), according to Dairy Market News, and regular lead times are now required on new orders. Large holiday orders need to be placed soon. Barrels appear to be ample, but mozzarella is tight. Cheese plants are receiving interest in rBST-free cheese.
- Cheese buyers in the Western region of the country are not yet covered and will [have to enter the market soon](#) for additional volumes, according to Dairy Market News. They have been waiting on the sidelines for lower prices, but many are still hoping for further declines before making any decisions.

Futures Month	Friday 10/05 Close	Friday 09/28 Close	Change	5-yr Average	Top 3rd Price
Oct-07	\$18.30	\$18.26	\$0.04	\$13.19	\$13.98
Nov-07	\$17.20	\$17.21	(\$0.01)	\$12.88	\$13.86
Dec-07	\$16.72	\$16.83	(\$0.11)	\$12.92	\$14.01
Jan-08	\$16.25	\$16.13	\$0.12	\$12.50	\$13.33
Feb-08	\$15.80	\$15.66	\$0.14	\$12.53	\$13.21
Mar-08	\$15.79	\$15.73	\$0.06	\$12.78	\$13.50
Apr-08	\$15.54	\$15.61	(\$0.07)	\$14.14	\$15.36
May-08	\$15.51	\$15.64	(\$0.13)	\$14.50	\$15.85
Jun-08	\$15.66	\$15.83	(\$0.17)	\$14.54	\$15.63
Jul-08	\$15.88	\$16.05	(\$0.17)	\$14.66	\$15.57
Aug-08	\$15.98	\$16.09	(\$0.11)	\$14.47	\$15.40
Sep-08	\$16.16	\$16.24	(\$0.08)	\$15.14	\$16.02
Oct-08	\$15.75	\$15.82	(\$0.07)	\$13.19	\$13.98
Nov-08	\$15.65	\$15.62	\$0.03	\$12.88	\$13.86
Dec-08	\$15.55	\$15.51	\$0.04	\$12.92	\$14.01
Oct-Dec Avg	\$17.41	\$17.43	(\$0.03)		
2008 Avg	\$15.79	\$15.83	(\$0.03)		

Bearish Fundamentals:

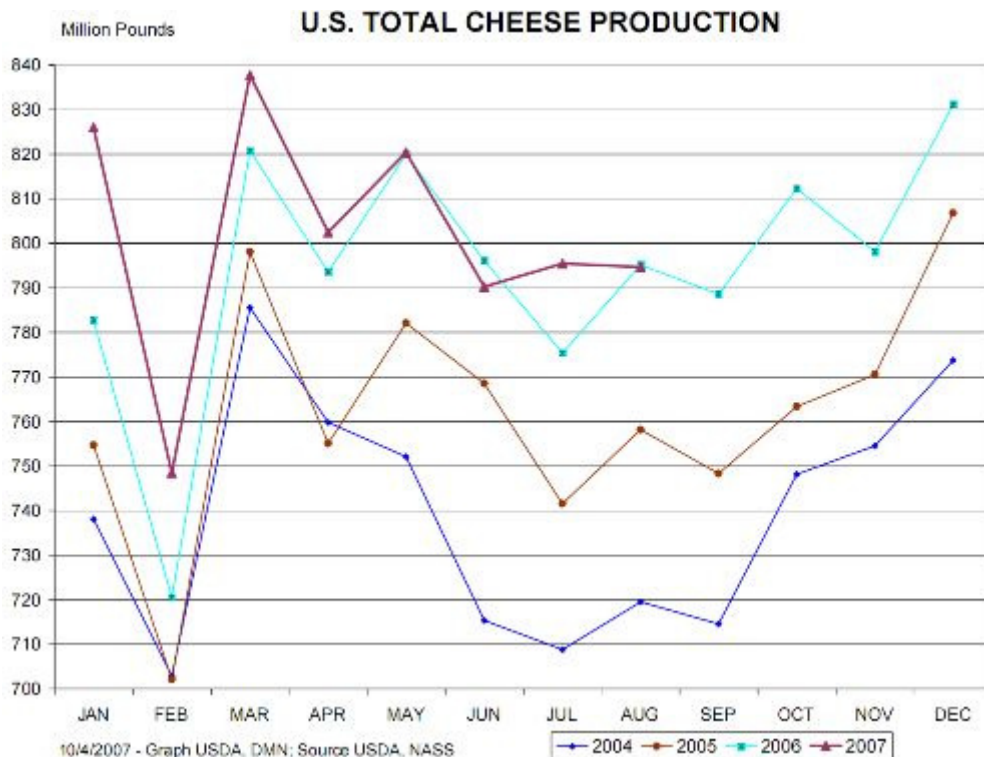
- It was inevitable. NASS surveyed [cheese prices took a hit](#) this week, following recent weakness in the cash market. Blocks shed 7.5¢ to average \$2.01/lb and barrels fell 5.2¢ to \$2.02/lb. Expect further losses in the weeks to come. Butter was down 0.7¢ to \$1.35/lb and dry whey decreased 1.9¢ to 42.3¢/lb, but nonfat dry milk was up 0.7¢ to \$2.06/lb.
- Cooler fall weather is improving cow comfort over much of the Eastern region of the country, according to Fluid Milk & Cream Review. Milk production in the Northeast is steady to gradually rising, and [more milk is available](#) for manufacturing use. 378 loads of Grade A milk were imported during the week, down from 408 last week.
- Milk output in California remains high, with some milk at the end of the month unsuccessfully finding a home, according to Fluid Milk & Cream Review. Weather conditions are ideal for strong milk production and there is very



limited excess plant capacity. Class I demand is increasing, but not enough to clear the [excess milk being offered](#), so churning activity is up.

Recommendation:

It was an interesting week in the cheese pit. On Tuesday we saw 16 bids come into the pit and blocks and barrels move up to \$1.93 for blocks and \$1.89 for barrels. The futures market did not move significantly higher even with the aggressive cheese trade. On Wednesday, only one bid was made at \$1.90 for blocks, 3¢ under the market, and no activity for barrels. On Thursday, bids were placed at unchanged and milk futures moved higher on news the Western whey price had gone up. Finally, on Friday, offers from a large player pushed blocks 4½¢ lower, leaving blocks below barrels by ½ cent, at \$1.88½/lb and \$1.89/lb respectively. Class III futures are best described as sloppy right now, with a lack a certainty, leaving a tendency to drift lower. Get ready for more uncertainty. International



demand, Australian drought, Canada increasing milk production quota levels 10%, low dollar value, and a strong domestic economy will all battle to determine prices going forward. Seasonal buying for cheese could be completed by the end of the month, so as the buyers get pre-holiday orders filled, there could be that one load that nobody wants to buy that sends the cheese market down and Class III futures with it. Options seem the best way to protect your milk price in this uncertain market. On market rally days, buy puts. Currently the 15.50 puts January to March are trading at an average price of 50¢ each. Bid to buy them at 45¢. Or, another alternative would be to buy 14.00 puts January to June, currently trading 18¢. Bid 16¢ and use it as a cheap safety net, just in case the market moves significantly lower. Use this on 50% or more of your milk production and hold out buying more puts until the market makes a significant move higher.

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