

The KDM Dairy Report – November 16th, 2007

Bullish Fundamentals:

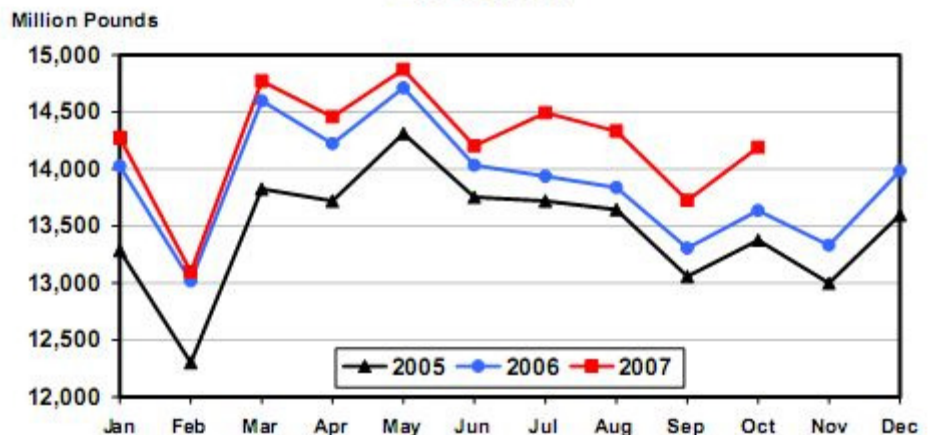
- Cash Market: Cheddar blocks raced 9½¢ higher on only one trade while barrels tried to keep up but only increased 2¾¢ on nine trades. Blocks settled within a few cents of the high for the year at \$2.15/lb while barrels finished at \$2.03/lb. Butter lost a penny, closing at \$1.37½/lb in heavy trading as 30 cars exchanged hands.
- NASS surveyed cheese prices have [started to jump](#) in response to the cash market. This week 40-lb blocks were up 5.8¢ to average \$1.92/lb, while 500-lb barrels were up 1.7¢ to \$1.93/lb. Butter increased 1.9¢ to average \$1.29/lb and dry whey reversed course from last week and came back up, gaining 1.8¢ to 43.9¢/lb. Nonfat dry milk was the lone loser, plummeting 14.5¢ to \$1.92/lb.
- Weekly cold storage stats are showing a [1% seasonal drawdown](#) in cheese stocks for the period 11/01 through 11/12. Impressive considering the high price of cheese during this time.
- Despite rising prices, Western cheese buyers are still looking for product to cover holiday needs, according to Dairy Market News. Inventories at minimal levels and new export demand has some rethinking what their purchasing strategies will be going forward. The Foreign Ag Service this week reported that cheese and curd [exports were up 67%](#) during September vs. a year ago.
- Dairy Market News reports exports of cheddar cheese for the period Jan-Sep 2007 were [up 196%](#) compared to last year. Leading destinations were Mexico, the Netherlands, Korea and Egypt.
- Butter and milkfat exports for the first nine months of the year were [up 145%](#), according to Dairy Market News. Cream supplies have tightened in the West as holiday item processing has been heavy.
- Current cheese stocks in the Midwest are limited, according to Dairy Market News. Cheese makers remain [reluctant to make spec loads](#) at current prices. Some late holiday orders are being prepared and shipped, with interest in aged cheddar seasonally strong.
- Western whey [supplies are tight](#) and prices are firming, according to Dairy Market News. Offerings are not sufficient to meet demand, with both domestic and export users looking for more product. Whey exports for the first nine months of the year were up 18.9%.

Futures Month	Friday 11/16 Close	Friday 11/09 Close	Change	5-yr Average	Top 3rd Price
Nov-07	\$19.20	\$19.20	\$0.00	\$12.88	\$13.86
Dec-07	\$19.55	\$18.45	\$1.10	\$12.92	\$14.01
Jan-08	\$18.52	\$17.39	\$1.13	\$12.50	\$13.33
Feb-08	\$17.48	\$16.59	\$0.89	\$12.53	\$13.21
Mar-08	\$16.95	\$16.38	\$0.57	\$12.78	\$13.50
Apr-08	\$16.32	\$15.95	\$0.37	\$14.14	\$15.36
May-08	\$16.19	\$15.88	\$0.31	\$14.50	\$15.85
Jun-08	\$16.18	\$15.95	\$0.23	\$14.54	\$15.63
Jul-08	\$16.26	\$16.09	\$0.17	\$14.66	\$15.57
Aug-08	\$16.35	\$16.26	\$0.09	\$14.47	\$15.40
Sep-08	\$16.41	\$16.40	\$0.01	\$15.14	\$16.02
Oct-08	\$15.99	\$16.10	(\$0.11)	\$14.78	\$15.58
Nov-08	\$15.76	\$15.80	(\$0.04)	\$12.88	\$13.86
Dec-08	\$15.68	\$15.71	(\$0.03)	\$12.92	\$14.01
Nov-Dec Avg	\$19.38	\$18.83	\$0.55		
2008 Avg	\$16.51	\$16.21	\$0.30		

Bearish Fundamentals:

- Milk Production Report: October milk production was up a stronger-than-expected 4.1% in the 23 top states, according to USDA, and production per cow increased 47 lbs. The number of milk cows increased 13,000 head from Sep to Oct. For all 50 states, production was up 3.5% and with cow numbers up 8,000 head. Individual states with the largest percentage increases were AZ up 13%, MI up 7.6%, CO up 7.4%, ID up 6.2% and CA up 5.8%. WI was up 4.3%.
- The milk supply is still adequate to heavy in the Southwest, according to Fluid Milk & Cream Review.

**Monthly Milk Production
23 States**



Production is trending higher and CA milk is still moving out of state. In the Pacific Northwest, manufacturing plants are taking calls to process outside milk, but most is [being rejected](#).

- Dairy cow slaughter for the week ending 11/03 [fell below](#) last year's levels. 51,200 head were culled vs. 53,400 during the same week a year ago.
- Butter stocks at CME-approved warehouses continue to be far higher than last year. For the week ending 11/10, 86.4 million lbs were on hand, compared to 55.4 million lbs in 2006, [an increase of 56%](#).
- Milk movement into the Southeast dropped again this week, with only 63 loads making the trip. 154 went in last week and 240 a year ago at this time. Milk production is [trending higher](#), resulting in the drop in imports.
- After staying above \$2/lb for an extended period, nonfat dry milk prices are making a rapid retreat. Western nonfat dry milk priced between \$1.85 to \$1.90 per pound, and [inventories are building](#) as buyers step away.
- Very scary, volatile market while whipsaw on the least bit of perceived weakness. Trading not for the faint of heart!

Recommendation:

This week's bearish Milk Production Report will most likely be forgotten within the first hour of trade Monday. Last week we were urging folks to get some coverage Dec-Mar, even sending out a Trade Alert via email. We're still not ruling out a short-term correction; we're at \$2.15 cheese! But this market may be stronger than we realized. There's a good possibility that those who put on min-max or fence strategies this week could see their milk price caps become a reality. From a trading perspective, that's no fun, but we have to remember that hedging is managing risk, and the capped price is very

profitable. Beyond that, we were very careful to limit the percentage of monthly milk volume committed to this strategy. That said, we could have been very wrong on our short-term prediction. Why the sudden change in outlook? If you're a regular reader, you know the "export factor", ie. the weak dollar leading to strong dairy exports, has been discussed at length here for months. The problem was, we saw very little evidence of actual international sales, and some butter plants in particular, were even resistant to converting from 80% to 82% butterfat despite burgeoning demand for it. That seems to have changed, particularly with cheese. As noted above, cheese exports were incredibly strong in Sep and appear to be growing. While most of the trade had discounted the "export factor", it now appears to be gaining momentum. The dollar was weakened further still, and cheese plants we work with are saying orders are flooding in and they can't keep up. Phrases like, "people we've never heard from before", and, "lots of international interest", are being repeated often. One went so far as to say they could double in size and still sell everything. All this new interest is happening at a time when domestic buyers, who have held off due to high cheese prices, are now trying to get last-minute holiday orders filled. And cheese plants all along have intentionally limited production to keep \$2 cheese inventory low. Finally, commercial hedgers may be drawn back into the 2008 contracts as the long awaited correction seems to be slipping away. At a new record annual high of \$16.51, it could attract even more buying from these firms as they try to get covered. How long this will last, no one knows, but at this point, we would switch to a PUT option only strategy on the front months to keep your upside open. Target to buy the Dec 19.00 PUT for 20¢, the Jan 17.25 PUT for 20¢ and the Feb 16.00 PUT for 20¢.

Note: KDM Trading will close at noon on Wednesday and will be closed on Thursday and Friday in observance of Thanksgiving. There will be no KDM report next week. Have a wonderful weekend and holiday, and remember to count your many blessings!

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**Monthly Milk Cows
23 States**

