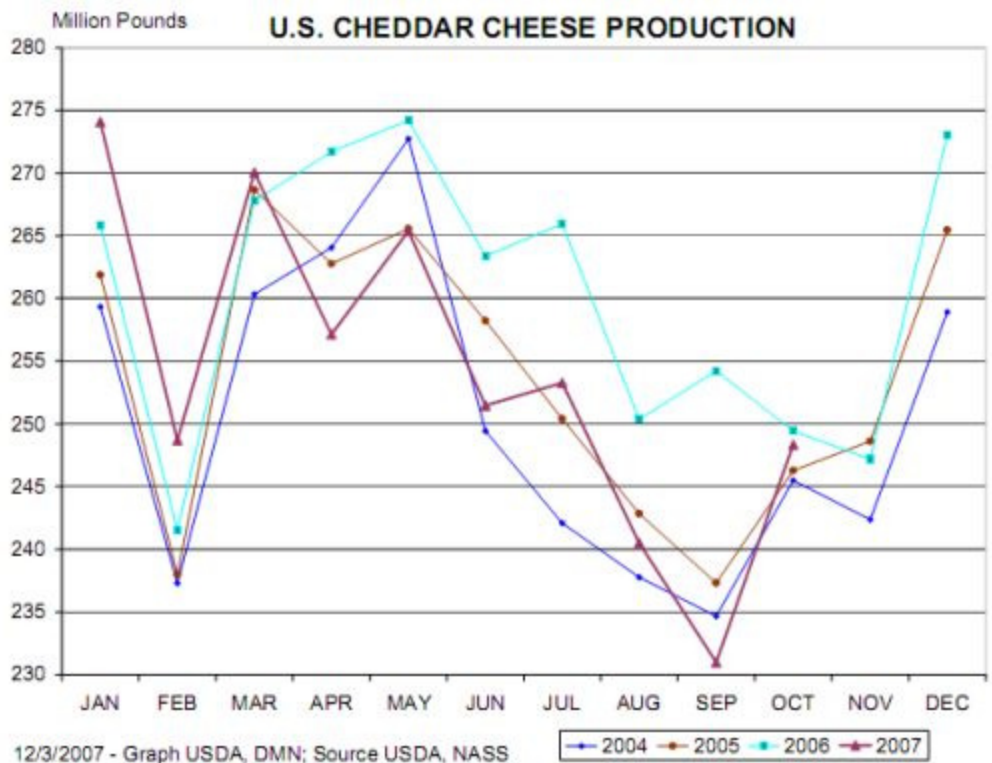


The KDM Dairy Report – December 7th, 2007

Bullish Fundamentals:

- Cash Market: Wow! Blocks lost 19¢ last week, but gained most of it back this week as bidders ripped the price 18¼¢ higher, coming within a penny of the all-time record established last week. Blocks settled at \$2.19¼/lb, causing barrels to follow suit with a 14¼¢ gain of their own, to close at \$2.16/lb. Buyers had to purchase only 4 loads of blocks and 1 barrel to achieve the result. Butter showed signs of life as buyers took on 20 cars for the week, and in the process bid the price a penny higher. Butter settled at \$1.33/lb.
- Dairy Products Report: Cheddar cheese output in October was [down 0.4%](#) vs. October 2006, according to USDA figures published Monday. American cheese output was up 1.2% and Total cheese up 1.6% over the same period; however, demand was strong over this period and likely consumed available supplies.
- NASS surveyed cheese and whey prices continued to [grind higher](#) this week. 40-lb cheddar blocks increased 6.3¢ to average \$2.10/lb, while barrels were up 3.5¢ to \$2.04/lb. Dry whey was up a penny to reach 45.6¢/lb. But, butter gave up 0.9¢ to average \$1.32/lb and nonfat dry milk fell 3.4¢ to \$1.85/lb.
- Weekly dairy cow slaughter during the holiday shortened week ending 11/24 was 40,600 head, [up 1,100 head](#) from last year.
- Midwestern cheese plants are continuing efforts to avoid building inventory at current cheese prices. But demand for natural cheeses is steady to higher as holiday ordering continues, and this is [driving inventories lower](#) at many manufacturers, according to Dairy Market News.
- Western cheese buyers still need cheese to finish off orders and [time is running out](#) before the holidays. They are paying up to get cheese on time, according to Dairy Market News. Blocks are tighter than barrels and export interest continues to play a factor in overall demand. Mozzarella stocks are being depleted via the pizza industry.
- Class I interest has picked up since Thanksgiving in the Northeast and Mid Atlantic regions of the country, according to Fluid Milk & Cream Review. Most milk bottled during the holiday has cleared through retail outlets and [new supplies are needed](#) to fill pipelines, so less milk is moving into manufacturing classes. In the Southeast and Florida, fluid sales are higher as population increases with winter residents returning from northern states.
- Grains: Soybeans over \$11/bu and meal over \$300/ton through Aug 2008. Corn over \$4.25/bu Mar-forever. Wheat over \$9/bu Dec-May and over \$8/bu July-Mar '09. Alfalfa selling for over \$250/ton. Enough said.

Futures Month	Friday 12/07 Close	Friday 11/30 Close	Change	5-yr Average	Top 3rd Price
Dec-07	\$20.40	\$19.85	\$0.55	\$12.92	\$14.01
Jan-08	\$18.41	\$18.19	\$0.22	\$12.50	\$13.33
Feb-08	\$17.39	\$17.25	\$0.14	\$12.53	\$13.21
Mar-08	\$16.80	\$16.69	\$0.11	\$12.78	\$13.50
Apr-08	\$16.26	\$16.20	\$0.06	\$14.14	\$15.36
May-08	\$16.15	\$16.06	\$0.09	\$14.50	\$15.85
Jun-08	\$16.11	\$16.09	\$0.02	\$14.54	\$15.63
Jul-08	\$16.18	\$16.15	\$0.03	\$14.66	\$15.57
Aug-08	\$16.30	\$16.24	\$0.06	\$14.47	\$15.40
Sep-08	\$16.37	\$16.33	\$0.04	\$15.14	\$16.02
Oct-08	\$16.15	\$16.08	\$0.07	\$14.78	\$15.58
Nov-08	\$16.09	\$15.94	\$0.15	\$14.75	\$15.73
Dec-08	\$15.96	\$15.84	\$0.12	\$12.92	\$14.01
2008 Avg	\$16.51	\$16.42	\$0.09		



- International: While New Zealand milk production is up 2.5% over last year, Australian production is [down 8.6%](#) due to little relief from drought conditions, according to Dairy Market News. Dairy stocks are low and being directed toward the domestic market with little available for export.
- International: Dairy Market News reports [demand for cheese in Oceania is strong](#) as international buyers negotiate contracts for the first half of 2008. Suppliers are working with the increased interest but are being careful not to over commit.

Bearish Fundamentals:

- This week the U.S. Ag Department made changes to the WIC (Women, Infants & Children) program for the first time in 30 years. The program for low income families serves 8 million people and the changes increase the amount of fruits, whole grains and vegetables, but lowers the amount of milk, cheese, eggs and juice in the program. The changes are expected to result in a [reduction in annual milk and cheese sales of \\$400 million](#).
- Fluid Milk sales in October were down 1% vs. October 2006, according to Dairy Market News.
- California milk output is well above last year's levels, according to Fluid Milk & Cream Review. Cows are being added to the milking herd and producers are keeping cows in milk longer as high milk prices provide incentive. The extra milk is [stressing processor capacity again](#), forcing some to ship excess volumes out of state. Plants in Arizona and New Mexico are running full to process available milk from both local and regional accounts.
- Western dry supplies are more available than they were a few weeks ago, according to Dairy Market News. [Production is high](#) and some producers are reporting difficulty in moving additional product.
- Nonfat dry milk prices were sharply lower this week as Western producers were forced to trade at a discount in order to clear some [building inventory](#). The heavy milk production in the region is contributing to the problem as processors look for a home for the excess supply.
- International: European dry whey prices are slipping and the market is weak, according to Dairy Market News. Stocks are building as late season milk volumes are being [directed toward cheese output](#). Buyers are standing on the sidelines to see where the bottom is.

Recommendation:

We have too much milk but not enough cheese! No, it doesn't sound logical, but it appears to be true. Here's why. As we've stated before and is noted above, cheese manufacturers have been very careful to limit production in this era of \$2 cheese, wanting to avoid sitting on high-priced inventory, especially at year end. Most are making cheese only on firm orders. At the same time, both domestic and international demand has been strong. Cheese buyers have been supplying out of their inventory, but reports we're hearing from contacts are that the cupboards are bare! Holiday buying is going on to replenish supply and to handle holiday customer orders, even at this late date in the year! While milk hasn't been going to cheese, it's been going everywhere else, which is why buttery, dry whey and nonfat dry milk prices have all been under pressure. So with that as background, after last week's freefall in the cash cheese market, bidders were able to move prices right back up with very little sell pressure. If there's someone out there with a warehouse of blocks to sell, they're keeping it a secret. We do believe, however, that \$2.20 cheese is not sustainable. When we and the rest of the world are done celebrating Christmas, New Years and various sporting events, a pullback is to be expected, and the buying could stop at any time. We're also growing more concerned about dry whey prices. They're holding steady above 40¢/lb now, but what if we're 30¢ in January? It could easily happen, and 30¢ whey with \$1.90 cheese equates to about \$17.80/cwt. January settled today at \$18.41. Or, what if we're at \$1.65 cheese and 25¢ whey in June? That works out to \$15.10/cwt and June settled at \$16.11. We're not changing our opinion on 2008 yet. With no relief in sight on input costs, making milk in 2008 will be very expensive. Producers we work with are working on their 2008 budgets and coming up with some big break-even numbers. For now, we would continue to stay on the sidelines, with the exception of January 2008. That month is worth trying to protect should another break come in the cash market. Place orders to buy the 17.75 PUT for 25¢, or the 18.00 PUT for 30¢. It's a decent floor, yet leaves your upside open. If cheese hangs on longer than expected, you will see the January contract rocket higher due to its current \$3/cwt discount to cash.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.