

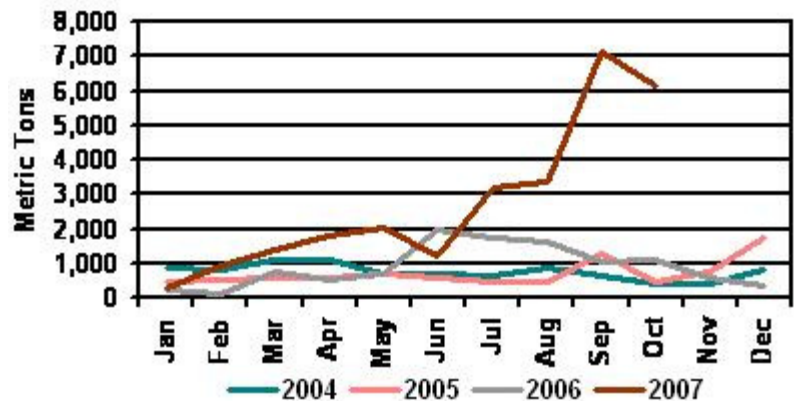
The KDM Dairy Report – December 14th, 2007

Bullish Fundamentals:

- World Ag Supply & Demand Report: USDA [upped their price forecasts](#) for both cheese and Class III milk in their monthly look at world Ag markets. Cheese is now expected to average \$1.68/lb, up 3¢ from last month's estimate, and Class III milk is expected to average \$16.55/cwt, up 35¢ from last month's report.
- 40-lb cheddar blocks [increased 2.9¢](#) to average \$2.13/lb in this week's NASS survey. 500-lb barrels averaged \$2.08/lb, up 3.9¢. Dry whey gained 0.3¢ to average 45.5¢/lb, but butter lost 0.4¢ to \$1.31/lb and nonfat dry milk decreased 1.3¢ to \$1.85/lb.
- Current supplies of blocks cheese and many natural varieties remain tight, according to Dairy Market News. Orders for natural shreds and slices are good, and many cutters are [running overtime](#) trying to fill last minute orders.
- Cheese exports for the first ten months of the year were [up 38.4%](#) vs. last year, and October exports were up an even stronger 44%, according to Dairy Market News. Exports to the Netherlands were up 294.5%.
- Exports of butter and milkfat for the first ten months of the year were [up 180.7%](#), according to Dairy Market News. The Netherlands was the top recipient, importing nearly 16 million lbs, compared to last year when they imported none.
- Weekly cold storage numbers for the first 10 days of December indicate a [continued seasonal drawdown](#). Cheese stocks were down 6%, or 6.7 million lbs, and butter stocks fell 2%, or 0.5 million lbs.
- For the week ending 12/08, butter stocks at CME-approved warehouses [fell 5.2 million lbs](#), compared to a 2.2 million lb increase during the same period a year ago. While total stocks on hand are still 23 million lbs higher than a year ago, increased export activity might be responsible for the drawdown, and could help alleviate the oversupply.
- Balancing plants from the Northeast to Southeast regions of the country are reporting lower intakes for the week, according to Fluid Milk & Cream Review. [Heavier Class I utilization](#) ahead of the holidays appears to be the source, leaving less milk available for manufacturing purposes. Ice storms in the middle part of the country hampered transportation of some milk, while Florida imported 25 loads for the week, after exporting 27 last week.
- Fluid Milk & Cream Review reports some producers using rBST may face sizable discounts going into the New Year as several bottlers and handlers are implementing new requirements at that time. There will be [fewer operations](#) in 2008 that will accept milk that has not been certified free of rBST.

Futures Month	Friday 12/14 Close	Friday 12/07 Close	Change	5-yr Average	Top 3rd Price
Dec-07	\$20.38	\$20.40	(\$0.02)	\$12.92	\$14.01
Jan-08	\$18.17	\$18.41	(\$0.24)	\$12.50	\$13.33
Feb-08	\$17.32	\$17.39	(\$0.07)	\$12.53	\$13.21
Mar-08	\$16.87	\$16.80	\$0.07	\$12.78	\$13.50
Apr-08	\$16.35	\$16.26	\$0.09	\$14.14	\$15.36
May-08	\$16.25	\$16.15	\$0.10	\$14.50	\$15.85
Jun-08	\$16.23	\$16.11	\$0.12	\$14.54	\$15.63
Jul-08	\$16.33	\$16.18	\$0.15	\$14.66	\$15.57
Aug-08	\$16.45	\$16.30	\$0.15	\$14.47	\$15.40
Sep-08	\$16.57	\$16.37	\$0.20	\$15.14	\$16.02
Oct-08	\$16.32	\$16.15	\$0.17	\$14.78	\$15.58
Nov-08	\$16.17	\$16.09	\$0.08	\$14.75	\$15.73
Dec-08	\$16.06	\$15.96	\$0.10	\$12.92	\$14.01
Jan-09	\$15.58	\$15.38	\$0.20	\$12.50	\$13.33
Feb-09	\$15.43	\$15.25	\$0.18	\$12.53	\$13.21
Mar-09	\$15.38	\$15.25	\$0.13	\$12.78	\$13.50
Apr-09	\$15.48	\$15.34	\$0.14	\$14.14	\$15.36
May-09	\$15.45	\$15.24	\$0.21	\$14.50	\$15.85
Jun-09	\$15.50	\$15.25	\$0.25	\$14.54	\$15.63
2008 Avg	\$16.59	\$16.51	\$0.08		
Jan-Jun 2009	\$15.47	\$15.29	\$0.19		

U.S. Butter Exports



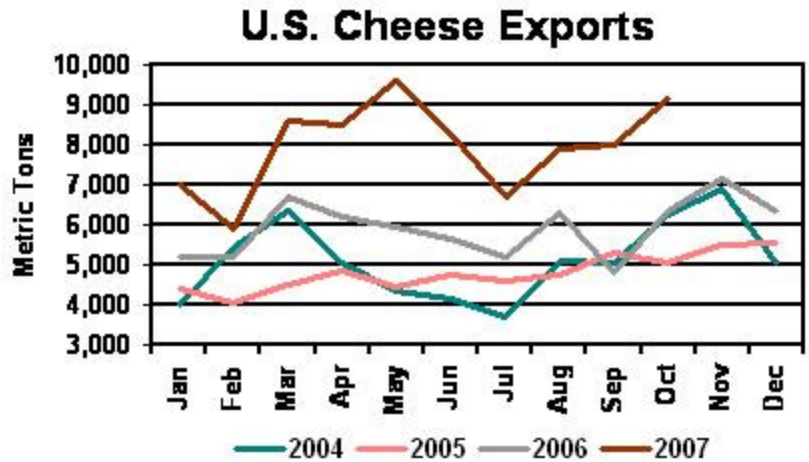
Bearish Fundamentals:

- Cash Market: Blocks fell off a cliff this week, losing a whopping 26¼¢ to settle at \$1.93/lb today. Barrels 16¼¢ to close at \$1.99¾/lb. Buyers were valiant, taking on 15 loads of blocks and 4 barrels, but sellers kept the pressure on with additional offers. Butter managed a small ½¢ gain to close at \$1.33½/lb on sales of 16 cars.

- California milk output is strong and well above levels of a year ago, according to Fluid Milk & Cream Review. Cow numbers are increasing while marginal cows are being kept in herds due to the high milk price, which is fueling a [3-7% growth in milk production](#). Processing capacity is being stressed, so some milk is still finding its way out of state.
- Nonfat dry milk supplies are [long and continue to build](#), according to Dairy Market News. Prices are lower on a weak market as buyers are aware of increasing inventories. Nonfat dry milk exports through the first ten months of the year are down 18.6% vs. a year ago.

Recommendation:

Cheese prices plummeted more than 26¢ in the cash market this week, yet most of the outlying months were up double digits for the week, and the January contract was down only 24¢. The market is getting more sophisticated, for it wasn't that long ago a move like that would have caused limit-down conditions across much of the complex; remember 2004? Futures has predicting for weeks that such a move was imminent, and now it's happened. Yawn. Trying to predict what's going to happen over the next week or two is pretty tough, but in our estimation, some follow through weakness is likely over the next week or two as holiday buying has literally run out of time. However, current cheese stocks are still tight and cheese makers have little interest in building inventory, so another burst of buying for New Year's / Super Bowl is possible. January is trading at \$1.85/lb cheese, so if a bottom is found in the cash market, it still has room to head back up. It's incredibly interesting observing the back month increases in the face of higher milk production and the recent cash decline. We think it's the tremendous respect the market has for input costs in the foreseeable future, the weak dollar and the potential for much greater exports. If cheese exports are up 38% this year and butter exports up 180%, what could they be next year and what affect will that have on prices? Even the 2009 contracts were up substantially albeit on light volume. Besides the front months, every contract beyond March is trading below \$16.50/cwt, with the exception of September 2008 at \$16.57, and it appears the market is telling us that's still too low to cover costs. We filled orders this week on last week's recommendation to get PUT coverage for January. The 17.75 PUT purchased for 25¢ is now at 31¢ and could gain more if we experience more pressure next week. We would remain essentially on the sidelines for the majority of 2008, but start looking for cheaper CALL options Jan-Apr if the market continues to head lower. You can then use them to sell in to on a recovery, leaving you 100% open to higher prices. Call us for specific recommendations.



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