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The KDM Dairy Report – December 21st, 2007

Bullish Fundamentals:

Futures Month	Friday 12/21 Close	Friday 12/14 Close	Change	5-yr Average	Top 3rd Price
Dec-07	$20.49	$20.38	$0.11	$12.92	$14.01
Jan-08	$18.25	$18.17	$0.08	$12.50	$13.33
Feb-08	$17.35	$17.32	$0.03	$12.53	$13.21
Mar-08	$16.95	$16.87	$0.08	$12.78	$13.50
Apr-08	$16.37	$16.35	$0.02	$14.14	$15.36
May-08	$16.30	$16.25	$0.05	$14.50	$15.85
Jun-08	$16.25	$16.23	$0.02	$14.54	$15.63
Jul-08	$16.34	$16.33	$0.01	$14.66	$15.57
Aug-08	$16.49	$16.45	$0.04	$14.47	$15.40
Sep-08	$16.57	$16.57	$0.00	$15.14	$16.02
Oct-08	$16.35	$16.32	$0.03	$14.78	$15.58
Nov-08	$16.20	$16.17	$0.03	$14.75	$15.73
Dec-08	$16.15	$16.06	$0.09	$12.92	$14.01
Jan-09	$15.55	$15.58	($0.03)	$12.50	$13.33
Feb-09	$15.47	$15.43	$0.04	$12.53	$13.21
Mar-09	$15.40	$15.38	$0.02	$12.78	$13.50
Apr-09	$15.58	$15.48	$0.10	$14.14	$15.36
May-09	$15.55	$15.45	$0.10	$14.50	$15.85
Jun-09	$15.59	$15.50	$0.09	$14.54	$15.63
2008 Avg	**$16.63**	**$16.59**	**$0.04**		
Jan-Jun 2009	**$15.52**	**$15.47**	**$0.05**		

- Cash Market: After reaching a low of $1.80½/lb yesterday, blocks raced back 14¼¢ to settle at $1.95/lb, up 2¢ for the week. Barrels jumped 10¢ during today's cash session, but were still 9¾¢ lower than last Friday. 11 loads of blocks and 6 loads of barrels exchanged hands as buyers re-entered the market. Butter lost 1¼¢ for the week to close at $1.32¼/lb on heavy volume of 31 cars.
- Cold Storage Report: American cheese stocks in November were down 2% vs. a year ago and down an identical 2% vs. October. Total cheese stocks were unchanged vs. last year and down 1% from October. Butter stocks were 33% higher than last year, but 27% lower than in October.
- Livestock, Dairy and Poultry Outlook Report: USDA's monthly look at the domestic ag sectors forecasts sharply higher feed costs in 2008, which could dampen milk production expansion. They expect the milk-feed ratio to be lower in 2008 compared to this year with the higher costs cutting into dairy producer profits. Also cited was the potential for higher exports and firm domestic demand providing support for Class III prices. As a result, they increased their Class III price forecast 35¢ from last month and now expect 2008 to average $16.55/cwt. Cheddar cheese is expected to average $1.68/lb, up 3¢ from last month.
- Weekly dairy cow slaughter for the week ending 12/08 totaled 53,300 head. It wasn't much higher than a year ago, but anything over 50k per week is considered fairly strong.
- NASS surveyed numbers showed yet another increase in cheese prices as they lag the cash market by about two weeks. 40-lb blocks were up 1.1¢ to average $2.14/lb and 500-lb barrels increased 4.1¢ to $2.12/lb. Butter and dry whey gained 0.3¢ to average $1.32/lb and 45.8¢/lb respectively, while nonfat dry milk continued to lose ground, falling 1.5¢ to $1.82/lb.
- Weekly cold storage numbers continue to show solid seasonal demand. For the period 12/01 through 12/17, cheese stocks were down 4% and butter stocks fell 1%.
- Butter stocks at CME-approved warehouses fell nearly 2 million lbs for the week ending 12/15. While total stocks are still much higher than a year ago (65 million lbs vs. 43 million lbs), weekly draw downs are starting to outpace the prior year and could help bring the surplus under control. Some contacts think strong exports are what's helping.
- In the Pacific Northwest, some hay growers are contemplating switching to wheat next crop year because of tight water supplies and better returns possible with wheat. Feed and hay prices continue to be a real concern for dairy producers, according to Fluid Milk & Cream Review.
- International: Despite higher milk producer prices, farmers in Europe have not responded with a boost in output. Dairy Market News reports milk production remains light.
- International: Milk receipts in New Zealand are about 2% higher than a year ago, but still less than forecast, according to Dairy Market News. Part of both the North and South Islands are dry and could affect pasture quality soon. In Australia, milk output for the first 4 months of the season is down 8.5%, with the latest month down over 9%. Some rain has fallen, but too late for the crops.
- International: Cheese is being imported to Australia from the U.S. to supplement local supplies and help fill contracts, according to Dairy Market News. Cheese demand remains solid.

Bearish Fundamentals:

- Milk Production Report: Milk output in November was up 3.8% vs. last year in the 23 major states and up 3.2% for all 50 states. Production per cow was up 40 lbs and the number of milk cows reached 9.175 million head, up 64,000 head from last year and up 6,000 head vs. October. Largest percentage gainers were AZ up 10.8%, TX up 7.9%, CO up 7.1% and MI up 6.3%. CA was up a very strong 5.5% and WI was up 3.3%.

- Livestock Slaughter Report: Dairy cow slaughter in November was down 0.5% compared to last November, the first decline we've seen all year. 217,400 animals were culled vs. 219,000 last year. YTD, however, the cull rate is still 7% higher than in 2006.
- The cheese is market is weak in the Midwest, according to Dairy Market News. Last week's spectacular fall may have been triggered by the desire to minimize inventories by companies prior to yearend and thus minimize the inventory write downs. Bulk cheese needs are lighter while production remains seasonally active.
- The Western cheese market is also week as holiday orders are completed and neither producers nor end users want to own any extra cheese at this time. Dairy Market News reports buyers will only purchase if they have a sale in hand and offerings of surplus milk over the next few weeks are expected to be heavy.
- Shortened production schedules over the Christmas and New Year's holidays is already resulting in offers of extra loads of milk in much of the Eastern region of the country. Fluid Milk & Cream Review reports more milk is moving into manufacturing to clear holdings before the weekend, and some plants are curtailing production of ice cream and other holiday items as many retail outlets are already well stocked.
- Fluid Milk & Cream Review reports Class I demand in the Central region is showing signs of slowing as schools begin to close until 2008. Handlers report steep discounts of up to $5/cwt on spot loads of milk.
- Milk supplies in California are heavy as production builds week to week, according to Fluid Milk & Cream Review. The amount of the increase over last year is significant, as processors continue to struggle to handle all the incoming milk. There are more reports of milk not being processed. Milk production is also heavier than anticipated in Utah and Idaho and some processors are expected to struggle handling the loads. They're receiving offers of surplus milk from out of state, but few loads are being accepted.
- The dry whey market is weak and prices dropping, according to Dairy Market News. Inventories have been building as the end of the year approaches and buyer interest at this time is historically low. At the same time, production is expected to be heavy over the next couple weeks to process all the surplus milk during the holiday period.
- The same holds true for nonfat dry milk. Dairy Market News reports recent sharp declines in price are keeping buyers at the sidelines. Production is heavy and inventories are building, giving buyers the confidence to use only the spot market to procure needs vs. entering into long-term contracts.

Recommendation:

T'was the week before Christmas and volatility reined
The markets went down then shot up like a flame
A week full of reports to digest and surmise
Is likely to keep 2008 a surprise

Ok, we couldn't resist a little prose this week. Confusion is king at the moment, with both bulls and bears having points to lean on. Bears point to cow numbers, milk production, the powder market, recent weakness in cheese prices and the end of holiday buying. Bulls point to the resilience in the cash market, exports, grain prices and cheese stocks. Our long term view remains mostly unchanged, and that is it's still too early to sell significant percentages of your production for the entire year. But, looking at the action in the front months makes us nervous. The gain in both cheese and futures prices today could be just a last minute burst to try and catch market participants off guard. With the trend established the past couple weeks being lower cheese and powder prices, has the market suddenly decided that's wrong? Maybe prices did get pushed to low. A local plant we work with mentioned that when cheese hit $1.80 this week, the phones started ringing again, with foreign interest part of the make up. But, on the other hand, most of the Western world will be in slow-motion for the next week or two, and one can't think orders will be that strong. The point we're trying to make is that we really don't know where the market is headed near term. We do, however, know that the downside risk to the front months is significant. Traders who never thought we'd breach $1.80 cheese saw blocks nearly hit the mark and barrels go through to $1.77. At that point, everyone was reassessing and thinking $1.60 was the new floor. How quickly things change! Because that's a real possibility though, we're putting out a **TRADE ALERT**. Markets are closed Monday and Tuesday, so on Wednesday, buy the Jan 17.75 PUT option for 25¢ as we did for several customers today. It will give you an effective floor of 17.50 with 100% upside if we're wrong.

Finally, on behalf of KDM Trading, Inc., we want to sincerely thank you for your business in 2007. We wish all of you a very merry and blessed Christmas!

"For unto you is born this day in the city of David a Savior, who is Christ the Lord"