

The KDM Dairy Report – December 28th, 2007

Bullish Fundamentals:

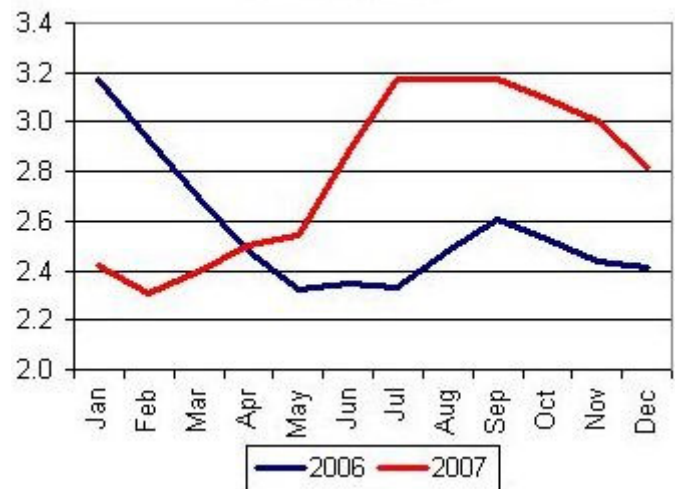
- Cash Market: The spot cheese market continued to show signs of life this week. Blocks gained 8¢ to settle at \$2.03/lb, all on uncontested bids. Barrels followed, increasing an identical 8¢ to reach \$1.98/lb on 5 loads traded. Butter fell 7¼¢, however, to close at \$1.25/lb with 14 cars exchanging hands.
- Ag Prices Report: USDA's monthly look at ag prices puts the December milk-feed ratio at 2.82, [back below 3.0](#) (see chart below). Despite very high milk prices, grains have been on a rocket ride in comparison, pushing the cost to produce milk higher, and the index lower.
- The cheese market is firm, according to Dairy Market News. Recent lower cash prices generated some extra orders for 2008 delivery, and [export interest](#) was part of the total.
- Weekly cold storage numbers continue to indicate a late seasonal [drawdown in cheese stocks](#). For the period 12/01 through 12/24, cheese held at selected USDA storage centers fell 3%, or 3.4 million lbs.
- Dairy cow slaughter for the week ending 12/15 was [strong at 53,500 head](#). 12 of the last 14 weeks has seen weekly slaughter numbers above 50k head.

Bearish Fundamentals:

- Fluid Milk & Cream Review reports bottler [demand fell sharply](#) last week due schools being out and a holiday-shortened week. As a result, 295 loads of milk were exported out of the Southeast region of the country, compared to only 70 last week and 140 a year ago. The excess milk is going to butter/powder operations as they try to keep supply balanced.
- The milk supply is [ample to burdensome](#) in the Midwest, according to Fluid Milk & Cream Review. Manufacturers are running heavy schedules to try to clear the extra volumes and price discounts are numerous on spot loads or milk.
- Milk output in California remains 3-6% above a year ago, according to Fluid Milk & Cream Review. The major challenge in the state has been finding processing homes for the [growing milk supply](#). With some plants down during Christmas break, there were reports of some milk being dumped, and next week, a cheese plant will stop taking milk (although that would be bullish for cheese).
- The butter market continues to weaken, reports Dairy Market News. Churning activity across the country [remains strong](#) as surplus milk and cream offerings are heavy.
- Nonfat dry milk [inventories are heavy](#), according to Dairy Market News. Production is steady to higher as plants process excess milk. Traders expect more price discovery to occur at the start of the New Year as there is a current lack of demand.
- Consumer Price Index: The U.S. government released the CPI for November. Food and beverage costs increased 4.7% since November 2006. The biggest gains came, not surprisingly, in dairy, where the cost to consumers has risen 14% in the last twelve months. Within dairy, fresh milk prices have [gone up 23.2%](#) since the first of the year. That can't be good for demand.

Futures Month	Friday 12/28 Close	Friday 12/21 Close	Change	5-yr Average	Top 3rd Price
Dec-07	\$20.49	\$20.49	\$0.00	\$12.92	\$14.01
Jan-08	\$18.88	\$18.25	\$0.63	\$12.50	\$13.33
Feb-08	\$17.87	\$17.35	\$0.52	\$12.53	\$13.21
Mar-08	\$17.44	\$16.95	\$0.49	\$12.78	\$13.50
Apr-08	\$16.75	\$16.37	\$0.38	\$14.14	\$15.36
May-08	\$16.54	\$16.30	\$0.24	\$14.50	\$15.85
Jun-08	\$16.59	\$16.25	\$0.34	\$14.54	\$15.63
Jul-08	\$16.60	\$16.34	\$0.26	\$14.66	\$15.57
Aug-08	\$16.75	\$16.49	\$0.26	\$14.47	\$15.40
Sep-08	\$16.89	\$16.57	\$0.32	\$15.14	\$16.02
Oct-08	\$16.45	\$16.35	\$0.10	\$14.78	\$15.58
Nov-08	\$16.26	\$16.20	\$0.06	\$14.75	\$15.73
Dec-08	\$16.20	\$16.15	\$0.05	\$12.92	\$14.01
Jan-09	\$15.65	\$15.55	\$0.10	\$12.50	\$13.33
Feb-09	\$15.50	\$15.47	\$0.03	\$12.53	\$13.21
Mar-09	\$15.46	\$15.40	\$0.06	\$12.78	\$13.50
Apr-09	\$15.70	\$15.58	\$0.12	\$14.14	\$15.36
May-09	\$15.60	\$15.55	\$0.05	\$14.50	\$15.85
Jun-09	\$15.59	\$15.59	\$0.00	\$14.54	\$15.63
2008 Avg	\$16.94	\$16.63	\$0.30		
Jan-Jun 2009	\$15.58	\$15.52	\$0.06		

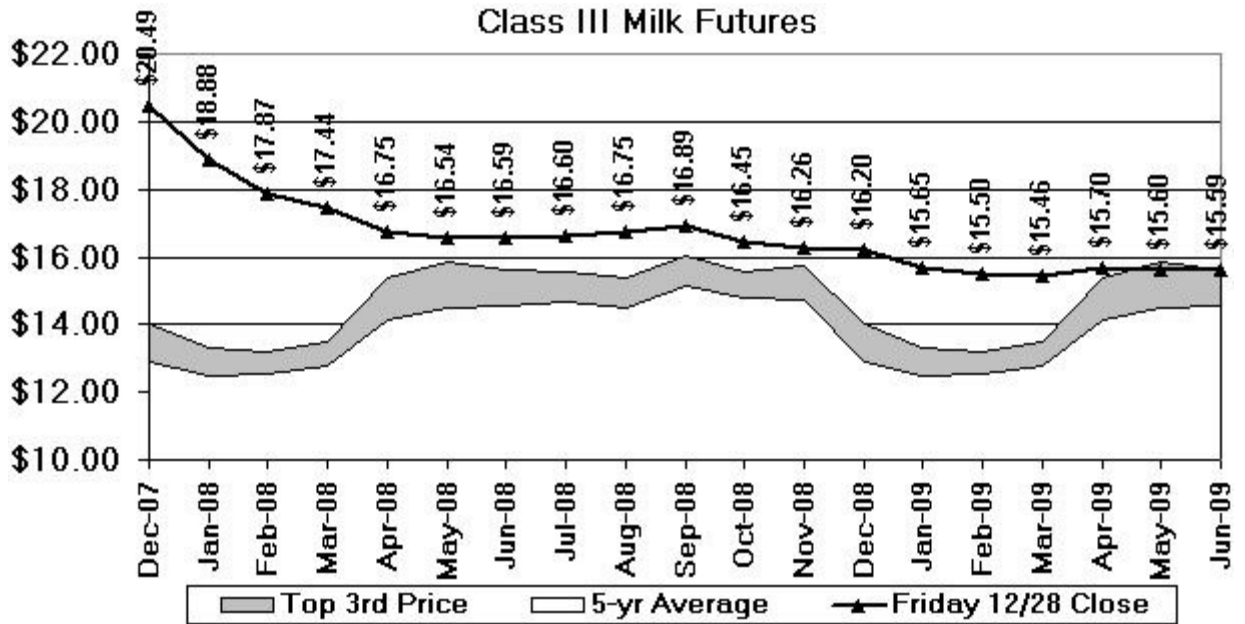
Milk-Feed Ratio



- NASS surveyed prices this week were [mostly negative](#). 40-lb blocks started to react to the cash market with a decline of 5.6¢ from last week to average \$2.08/lb, while 500-lb barrels fell 2.4¢ to \$2.10/lb. Butter increased a paltry 0.4¢ to average \$1.32/lb and nonfat dry milk managed a 2¢ gain to \$1.84/lb, but dry whey lost 1.2¢ to 44.6¢/lb.
- Commercial Disappearance: American cheese use in October was [down 4.5%](#) vs. a year ago, according to USDA statistics released this week. Total cheese use was up just 0.8%, after a 4.6% increase in the prior month. The low numbers could be a response to higher cheese prices. Commercial use of butter, however, was up 14% compared to last year, and nonfat dry milk use was up 30.6%. Finally, use of milk in all products was up 3.6%.

Recommendation:

What most thought would be a quiet 3-day trading week turned out anything but. Cheese bidders came back on Wednesday, catching most by surprise. By the end of the day, the January contract was trading limit up 75¢, settling at \$19.00. Much of the more than 600 contracts



traded was likely short covering as the market moved against sold positions. Wednesday's trade also saw us set a new 2008 annual settlement high of \$17.02/cwt. However, despite further gains in the cash cheese market on Thursday and Friday, follow through buying never materialized, and we settled January at \$18.88, with the 2008 annual average down to \$16.94 (but still up 30¢ for the week!). Going forward, we have another short 3-day trading week ahead of us as the dairy markets are closed again on both Monday and Tuesday. There is much speculation on the floor as to what happens next, but if cheese holds through next week, January will march higher. We continue to be concerned about the amount of milk we're starting to produce as a nation, but cheddar production appears limited by manufacturing capacity as this week another cheese plant in CA closes. Midwest plants continue to focus on varieties higher up the value chain, such as hard Italian and mozzarella types. So, as we've said before, we may have too much milk and not enough cheese. But we're also concerned about the powder market, as both nonfat dry milk and dry whey were early leaders in the bull market of 2007. Both look like they will stay far under 2007 highs, with nonfat dry milk particularly vulnerable to further price drops. We would continue to defend the front months with PUT options as they will drop the quickest if the cheese market falls apart. Buy the Jan 1875 PUT for 25¢ and place a target order for the Feb 17.50 PUT for 30¢. Until the uncertainty picture becomes clearer, we would continue to stay away from selling the entire year outright.

Note: Just a reminder again that our offices will be closed both Monday and Tuesday next week in observance of New Year's Day. Dairy markets are closed on both days. May you and yours experience a happy and prosperous 2008.

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