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Energy Risk
Management Services

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Good Morning

Overview

- Hydrocarbon prices rose over the weekend. **Crude oil up \$.67 to \$47.01 per barrel; natural gas up \$0.0129 to \$6.000 per mmBtu.**

News/Views

- In our morning notes of December 23 we stated “there are a couple factors out there that are worth mentioning that could have a more constructive bearing on price down the road.” The first factor we cited was the possibility of a Russian gas supply disruption to the Ukraine, and in turn, to Europe. We suggested that any news in this regard would have a positive price effect, if only temporary. The second factor we mentioned was the market’s ultimate appreciation of what we had discussed at that time, i.e. better OPEC compliance and, in the case of Saudi Arabia, a determination to leverage prices back up that would, for one of the rare times in Saudi oil policy history, actually manifest itself by via proactive and preemptive denial of incremental barrels to refiners. Both factors have in fact unfolded and have led to a positive price response, albeit so far on relatively thin volume.
- Another factor that has developed is obviously the Israeli attacks against Hamas in the Gaza Strip. Although as we previously discussed the odds are clearly against this limited war expanding throughout the Arabian Gulf and disrupting oil supplies, the Iranian news agency reported on Sunday that an Iranian commander called for an oil boycott against Israel’s supporters which is, of course, a non-starter. The market may be discounting, however, the possibility that Israel might ultimately attack Iran’s nuclear facilities, despite Israeli’s own air force previously suggesting that accurate attacks would be quite difficult. Nonetheless, in retaliation for backing Hamas, the scenario of any such attacks against nuclear facilities would in turn elicit a cutoff in Iranian oil supplies, either by Iran’s own hand, an event with nil probability as we discussed last year, or via an expanded Gulf conflict.
- While from a global demand standpoint nothing has changed, we thus begin the New Year with crude oil prices some \$10.00 per barrel higher than before the holidays. As we also have previously discussed, we have been anticipating a much more constructive oil market in 2009 than consensus expectations. Forecasting much higher oil prices for much of this year than currently exist, we are also mindful that some of the recent catalysts for higher prices are transitory in nature, and as mentioned in previous notes it would not surprise us to see somewhat weaker prices through the middle of January reflecting a recovery in U.S. crude oil imports on the Gulf Coast following year-end tax strategies, as well as the inevitable and incorrect consensus discounting of the upcoming “weak” second quarter. This would be followed by a seasonal price recovery as we moved through the second quarter. As we did last year, we wish to observe January price behavior in almost its entirety before confirming our Base Case WTI outlook for 2009 to gauge non-commercial behavior. Although we have assumed there would be some reduction in passive length via a “re-indexing” process by pension funds and others early in the year, no doubt this will be at least partially offset by many non-commercials finding current price levels too low to resist, particularly since we are already witnessing potential positive price impacts reflecting the ever-present geopolitical risk. In any event, we expect to largely retain our higher-than-consensus price outlook for this year.

The DOE seems to agree, since the neopress is also emphasizing this morning the announcement that some 25.2 million barrels of crude oil will be purchased and stored in the SPR reflecting paybacks for hurricane borrowings and other factors, so incredibly the government is finally “buying low” for once. The peak fill rates will come in the February-April period, which also corresponds with the customary beginning of the seasonal rise in crude oil prices. In April volumes will approach 200 MB/D. This should, by definition, have at least some positive impact on price. We would not overemphasize the effect, however, since it was clear that last year when the U.S. fill program was finally suspended, it did not have much immediate price impact, and we recall that crude oil prices actually *rose* on the announcement, influenced by a bullish Goldman Sachs report issued on the same day.

W.H. Brown, III

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