



HIGHLY CONFIDENTIAL

January 6, 2009

Good Morning

Overview

- Hydrocarbon prices gained again overnight. **Crude oil up \$.85 to \$49.66 per barrel; natural gas up \$0.123 to \$6.195 per mmBtu.**

News/Views

- There have been sufficient catalysts thus far in 2009, justified or not, to pull prompt WTI up close to the “nice round” number of \$50.00 per barrel as we issue this note. We should know relatively soon whether there is sufficient momentum to pull the prompt market above the half century mark. If the market remains below \$50.00 per barrel, traders and funds will likely be looking for signs that such a technical failure will be justified by news such as a diplomatic breakthrough or at least a cease fire between Israeli and Hamas forces and/or a resolution of the Russia/Ukraine natural gas standoff, either one of which could come at any moment. We have seen a number of times throughout history where technicals and news come together at once to form either a short-term peak or trough.
- If the market decides to break through \$50.00 per barrel, no doubt it will elicit many upward crude oil price forecast revisions for 2009 closer to our own, given the nature of the beast. This should in turn provide more momentum for the energy equities which are already looking better, as we have anticipated. Our forecast WTI average for 2009 has remained well above the consensus as most outlooks turned too bearish in the fourth quarter in our view, following the oil market down. Our outlook by definition has assumed that prompt WTI will in fact begin to exceed \$50.00 per barrel as we move through the first half of 2009. However, looking at the extreme short term we would guess that the market may have some difficulty pushing through \$50.00 per barrel with any conviction, although we must be mindful of market volatility and what it implies for price levels in either direction that are achievable over the short term.
- In this regard, recent price action, once again justified or not, *does* justify our long-standing position that 2009 will be characterized by substantial price volatility, with WTI achieving levels that will come as a major surprise to the consensus throughout various times in the year. We have assumed such a scenario because of our conviction that non-commercial participation in commodities will not “leave the building” despite their dismal performance (if one were only “bullish”) in the second half of last year. As we have previously discussed, there are a number of pension funds and other firms who see sub-\$40.00 per barrel WTI as an attractive “long” particularly since this was the base level for gains from 2004 through mid 2008. As we have also previously discussed, a number of funds have sought *active* commodity management as opposed to only passive length, which clearly adds to price volatility in either direction. As we stand today, for example, prompt WTI is more than 47% above its settlement low of late 2008, achieved in only 10 trading days, and only 33+% below our target for 2009, which had been viewed as almost unachievable by many observers as crude oil “tanked”.
- With regard to the latest CFTC data, on December 30 when the prompt NYMEX crude oil contract settled at \$39.03 per barrel, non commercials held futures-only net length of 64,548 contracts, a decline in net length from the previous week by 8,022 contracts. Commercials held net short positions of 64,831

contracts, a decline in net shorts from the previous week by 5,858 contracts. For natural gas, on December 30 when the prompt NYMEX natural contract settled at \$5.859 per mmBtu, funds held futures-only net short positions totaling 144,814 contracts, a decline in net shorts from the previous week by 9,799 contracts. Commercials held net long positions of 108,662 contracts, a decline in net length from the previous week by 11,203 contracts.

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