HIGHLY CONFIDENTIAL

January 7, 2009

Good Morning

Overview

- Hydrocarbon prices were mixed overnight. **Crude oil down $.27 to $48.31 per barrel; natural gas up $0.022 to $6.005 per mmBtu.**

News/Views

- As we suspected, thus far at least the prompt NYMEX crude oil contract has been unwilling to pierce $50.00 per barrel with any conviction, and has decided, pending further news and the weekly stats due out later this morning, to ease modestly after four straight days of gains totaling almost $10.00 per barrel. Diplomatic efforts by Egypt toward a cease fire in the Gaza Strip have gained some Western support, and we would have to believe that with respect to OPEC, current prices still retain an embedded security premium already boosted by early-year non-commercial asset allocation strategies.

- In terms of the Russian/Ukraine gas dispute, we had flagged possible price impacts prior to the market and consensus, but we also did not believe the dispute would be prolonged in duration. At this point we are inclined to retain our view. Gas supplies have been reduced to Europe, with Italy, Germany and France among others all impacted, but storage builds in anticipation of the dispute have mitigated any major impact thus far, and we expect when all is said and done the incremental impact on fuel oil demand as a result of fuel switching will be relatively minimal in the context of overall lower European refined product consumption.

- However, we need to monitor the situation closely since are seeing cargoes out of the Baltic already moving to replace lost natural gas. It makes sense in many respects for both Russia and the Ukraine to play public and private hardball on this issue. It enables Russia to flex its muscles a bit and recover some global political esteem that was lost as crude oil prices plummeted. The market has helped Russia prove that its hydrocarbon supplies are still vital and that any shift in availability, however transient, can lead to a spike in price. The bottom line, however, is that everyone needs everyone else. Europe needs Russian gas and Russia needs to prove to Europe and others that it is a reliable supplier and encourage capital investment, while Russia and the Ukraine obviously need each other to deliver the goods.

- With regard to OPEC, the market gained some comfort from word that even Iran has been trimming sales at long last, and this would fit into the scenario that we had disseminated prior to the holidays. That is, because Iran also sells to independent traders and storage owners, their crude oil sales reduction would lag that of Saudi Arabia reflecting purchases for storage to capitalize on the market contango and, in many cases, lower tanker costs for storage as a result of the economic downturn. We argued that eventually such storage demand would wind down, and when this occurred NIOC would allow sales to fall off, with the consensus assuming a proactive compliance effort on the part of Iran. Thus far at least, all of this appears to be consistent with our global balances and OPEC behavior as we enter 2009.

- Another shot at $50.00 per barrel may or may not come in response to the weekly U.S. oil data due out later this morning. The latest Platts survey is looking for a 1.5 million build in crude oil stocks, a 700,000 barrel build in distillate supplies, and a 1.6 million barrel increase in gasoline inventories. Our estimates would suggest a distillate build in line with the consensus, but somewhat more constructive crude oil and gasoline data.

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