



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

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Good Morning

I will be in Europe next week, January 12th-16th. The daily reports may be delayed slightly but should be on your desks each day within a reasonable time frame. I can be reached via email and will be checking messages and returning calls while out of the country. I wish you all good trading/hedging in my absence.

C.W. Hornsby

Overview

- Hydrocarbon prices were mixed overnight. **Crude oil down \$.49 to \$41.21 per barrel; natural gas up \$.016 to \$5.599 per mmBtu.**

News/Views

- Depending upon the path of the equity market today in response to the monthly jobs data due out later this morning, we may well see where prompt WTI is likely to bottom over the near term. Aside from financial market variables, the oil market is still responding to the latest weekly stock builds as reported by the DOE on Wednesday. In addition, however, it appears that progress has been made on the Russia/Ukraine front, as might be expected. Although no new contract has yet been signed as we issue these notes, yesterday in Brussels both Russia and the Ukraine agreed to restart gas supplies to Europe as long as European monitors were in place to oversee the transit of hydrocarbons.
- In addition, the market may yet experience a full reaction to word that Shell has lifted force majeure on crude oil exports from the Nigerian Bonny, Forcados, and Bonga loading terminals. We have not assumed that Nigeria is likely to fully comply with its OPEC allocation in the event that production and exports are able to recover over time. In point of fact our Base Case for 2009 has long assumed that Nigerian production will experience a modest recovery of about 50 MB/D relative to the average of last year, and we would emphasize in this regard that our balances are still more constructive than consensus expectations.
- Otherwise, based on highly preliminary data it would appear that 2008 world oil demand declined modestly from 2007. We had long suspected through the course of last year that if our assumption of minimal growth was off the mark, the odds favored lower demand and not higher. The consensus in its bearish view of world oil demand for 2009 has now finally emphasized the fact that world oil demand growth has been decelerating for some time. As crude oil prices began their progressive rise from 2004

through mid 2008, we had emphasized that in fact 2004 witnessed the recent peak in world oil demand growth, exacerbated by a surge in China diesel demand from portable generators to supplement electricity shortages. Demand growth consistently decelerated every year since 2004, culminating thus far in the stagnation/decline of 2008.

- However, we do not wish to become too engrained with what actually happened last year for two reasons. First of all, it is now ancient history and has little or no bearing on 2009. Second, low and behold and for the sake of good order we wish to point out that when the DOE released the latest Petroleum Supply Monthly (PSM) in late December with “near final” data for the month of October, it revealed an *upward* revision from the preliminaries as reported in the Weekly Petroleum Status Report (WPSR) for the four weeks ending October 31. The WPSR suggested that total implied refined product demand dropped by a full 6.7% from October 2007, which at the time struck us as somewhat excessive. The latest PSM suggests that October product demand fell by “only” about 4.0%, or some 812 MB/D, an upward revision from the preliminary numbers by 546 MB/D. In terms of the major product breakdown, gasoline demand was revised down by 42 MB/D, implying a 2.9% decline from October of 2007. Distillate demand was revised up by 161 MB/D, suggesting only a 0.5% decline from the previous year. Jet fuel demand was revised up by 26 MB/D, implying a 14.3% drop from October of 2007, while heavy fuel oil was revised up by 155 MB/D, suggesting a decline in October demand of 5.3% from the prior year.

W.H. Brown, III

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