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Energy Risk  
Management Services

**HIGHLY CONFIDENTIAL**

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**Good Morning**

**As we head off to the wilderness and I will return on Sunday  
with reports resuming on Monday.**

**W.H. Brown**

**Overview**

- Hydrocarbon prices were stable overnight. **Crude oil (Mar) up \$0.49 to \$41.33 per barrel; natural gas up \$0.017 to \$4.659 per mmBtu.**

**News/Views**

- Unfortunately for most investors, the advent of the Obama Administration was greeted by a major equity market selloff, catalyzed by ongoing banking woes and general concerns about the state of global economic activity. Perhaps adding fuel to the fire were George Soros' statements in Washington to the effect that the TARP money had been misused thus far, and that any recovery in the financial system would require substantially more funds than current thinking is contemplating.
- Back to our little world of the international petroleum market, yesterday's price behavior upon expiration of the February crude oil contract was proof positive that the severe contango that developed was, in a major way, a function of massive contango trading that was unwound, not only between Feb and March but between Feb and most outer months as well. The recovery in Feb obviously did little to help energy equities, but perhaps ironically we were encouraged to see the curve "flatten" to the extent that it did yesterday. This is not to say that a contango structure has not been justified on the basis of fundamentals. Ample prompt availability would naturally lead to such a structure. Some analysts would suggest that the weakness in the outer months yesterday would imply less confidence in the timing of any price recovery, but history has shown that a particular term structure *has never represented even the remotest indication of the future path of oil prices.*
- The flattening of the term structure therefore represents to us the setting of the stage down the road for a price recovery based on its developing characteristics, and not as a forecasting weathervane. That is, the flatter the curve, the less incentive to store at the margin. If the market moves into backwardation over time, there is an incentive to destock, which eventually shows up in the weekly data, encouraging buying by non-commercials. The flatter the outer months the greater the risk/reward to go long "out there" to begin with. We have to admit that even though we remain more constructive than the consensus for the next six months, we have been looking at June crude at well over \$50.00 per barrel and not considered it a bargain at the present time. June crude with a "mid-\$40s handle" or lower is another story, however.
- Having said all of this, we would still suggest that patience remains in order, since as previously discussed it may be premature to assume that Cushing stocks have stabilized and will begin to progressively fall. As such, we have also suggested that we would not be surprised to see, with the modest flattening of the curve, traders begin treating March crude with as much "disrespect" as February, i.e. selling March and buying April and outer months for the next couple weeks. Thus, we would suggest that if our outlook is

remotely close to the mark, **some time in February would represent reasonable timing to start buying the commodity, if one is able to do so, accompanied by a more sustainable recovery in energy equities in general.**

- Otherwise, we would note that the weekly U.S. stats are delayed until Thursday due to the Martin Luther King holiday on Monday. The latest Reuters consensus is looking for a 1.4 million barrel build in crude stocks, a 1.4 million barrel decline in distillate supplies, and a 2.1 million barrel rise in gasoline inventories for the week ending January 16. We would suggest somewhat more bullish crude oil data, with once again product stocks less constructive than the market is looking for.

W.H. Brown, III

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