



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

February 3, 2009

Good Morning

For the sake of good order, I will be out of the office Thursday and Friday February 5th and 6th but will be reachable via cell phone.

C.W. Hornsby

Overview

- Hydrocarbon prices firmed overnight. **Crude oil up \$0.17 to \$40.25 per barrel; natural gas up \$0.023 to \$4.580 per mmBtu.**

News/Views

- As we suspected, ongoing global economic concerns and a less than robust equity market have led to the March contract testing the waters below \$40.00 per barrel. However, the test so far has been short lived, and yesterday traders decided not to keep selling March and buying outer months for the time being. Are we seeing a bottom forming in the market, now setting the stage for a progressive recovery over the next few months?
- According to our thesis, at least from a timing standpoint we should not be far from the inflection. A few weeks ago we had discussed our thesis that if we were close to the mark that 2009 WTI would have at least *some* embedded seasonality, then according to our analysis the bottom would come around mid February or so. We had thought that the March contract had a chance of achieving the lows reached by the February contract as we approached expiration, reacting to the fact that the stock build at Cushing had not yet ended.
- This, or course, may still end up being the case. Picking market bottoms or tops is quite hazardous, but this is one of the aspects of the business we are in. We were hoping that the curve would flatten a bit, and thus if one were able to buy commodities as part of the portfolio one could buy June or "later" crude oil with a "4 handle", which is now evident through August. From the standpoint of the equities, January was not as onerous to the group overall as the pain suffered by the S&P 500, as we will discuss later today in our Monthly Equity Review, particularly for the OSX. We are obviously thinking out loud a bit, but given our small but elite client base we do not have to worry about any Supervisory Analyst getting in the way. At the least, **we now recommend that we all put monitoring the commodity and stocks on the front burner from this point forward and, depending upon individual risk profiles which we are obviously in no position to judge, start picking away on the long side. To play it conservative, one may wish to start with the major integrated oils on the equity side of the coin, increasing beta by adding the other sectors before the end of February. On the commodity side for those able to do it, to also play it conservative one can start buying the outer months, but buying close in puts as a hedge, despite obscene volatility. At present, however, we would still reserve much of the "powder" for the remainder of the month.**

- Of course, there is absolutely no shortage of negative sentiment or negative news to test the resiliency of the equities and the commodity as more shoes are dropped. One recent example was the neopress' emphasis of the DOE's downward revisions of November U.S. oil demand, claiming it was a market mover, which it may have been to a modest degree. In this regard, however, we will not "sugar coat" our reaction. For months on end as crude prices spiraled higher and the DOE consistently and substantially revised down demand data last year, few noticed or cared. Now all of a sudden when the obvious is evident, the neopress claims it has relevance. It is ancient news, however, most of us are used to these revisions, and we believe the market may also be so immune from this point forward.

Other risks are clearly a lackluster to weak equity market, with many spooked by January's dismal performance. Crude oil prices in particular, and to a lesser extent gas prices, may remain periodic slaves to the S&P 500. Overall, however, we sense that the hydrocarbon markets will do their absolute best to trade more on their own merits from this point forward. In this regard, as we have previously emphasized, OPEC compliance, however imperfect, will assume a greater importance in our minds than almost ever before, **particularly in the second quarter when, as our global balances suggest, OPEC has substantially greater "leverage" to reduce global crude oil stocks than at present due to the seasonality of Atlantic Basin crude oil demand.**

W.H. Brown, III

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