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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

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Good Morning

Overview

- Hydrocarbon prices rose again overnight. **Crude oil up \$0.80 to \$41.58 per barrel; natural gas up \$0.027 to \$4.540 per mmBtu.**

News/Views

- Despite another test of the March NYMEX crude contract below \$40.00 per barrel, at the end of the day the complex was able to rebound and settle above this “bogie” once again, helped by words from OPEC that on March 15 another “cut” might be considered, although we believe at this point that Saudi Arabia is less likely to go along with further reductions until close to 100% compliance is achieved under the current deal. A near-term test of whether we in fact have troughed or not, as discussed yesterday, will of course be the market’s response to the weekly DOE data due out later this morning. As most of you are aware, the API has decided to release their weekly data set on Tuesday afternoons after a few years of releasing simultaneously Wednesday morning with the DOE. The API must have figured that if people are still going to pay for the API stats, they might as well get some “press” and have some “legs”. To us it is a bit futile, since why would anyone pay for the numbers when the DOE data are free, they are a more complete survey, and are, after all, the official U.S. government source of statistics. In any event, the neopress gives a summary for those interested. The AGA finally gave up and let the DOE publish the weekly natural gas storage data, and we had assumed the API would be so inclined, but not thus far.
- The market seems to appreciate the fact that the API data can and often do diverge from the DOE over the short-term, although there tends to be a convergence over time. In this context, the API reported an 8.1 million barrel crude oil build, a 2.1 million barrel gain in gasoline stocks, and an 800,000 barrel decline in distillate inventories. The market nonetheless continued to gain because it recognized the crude oil data did not add up, i.e., the large drop in imports should have led to a much smaller stock build. As we discuss each week, the DOE stats do not always add up either when one takes their estimate of domestic production, refinery crude oil runs, and estimated net imports, but usually the divergence is not substantial. We were most impressed by the market’s non-reaction to the numbers, right or wrong, suggesting that some neotradors are perhaps being weeded out, since ordinarily there would have been another test below \$40.00 in response. The API data may simply be catching up to the DOE stats.
- However, we should all bear in mind the saying “chance favors the prepared mind” and not assume that the DOE data will be bullish, or at the least less bearish. As previously discussed, although we are sticking our necks out and suggesting that February is the month when one should assume some risk and go net long in both the equities and commodity, we have also suggested that up to March contract expiration the market may wish to take further looks at sub-\$40.00 per barrel to decide one way or another whether a trough is justified or not. We are increasingly of the mind, however, that if our WTI forecast is wrong, the next most likely alternative scenario is for WTI to simply stagnate in its current trading range for the next few months, as opposed to setting the stage for sub-\$30.00 per barrel values. That is, we see a scenario where demand remains weak, inventories peak and start to decline, but every time prices improve word emerges that some OPEC members are selling more crude oil. As we move into each month of contract expiration, traders sell, bringing prompt values back toward \$40.00 with the cycle repeated each

time. Under such a scenario, while the energy equities as a group are likely to stabilize, we doubt they would realize the gains that we would be looking for under our Base Case scenario.

W.H. Brown, III

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