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Energy Risk
Management Services

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Good Morning

Overview

- Hydrocarbon prices firmed overnight. **Crude oil up \$0.24 to \$40.56 per barrel; natural gas up \$0.059 to \$4.656 per mmBtu.**

News/Views

- Cushing crude oil stocks have now managed to hit a record, according to the DOE. Despite this, however, in our observation of yesterday's activity it took a weaker equity market by the end of the day to pull March WTI back below the previous day's settlement. Most analysts had assumed the DOE crude oil build would not be as bearish as the API data had shown the day before, basing their entire arguments on the irreconcilability of the data. The assumption, however, was that the DOE would report as low an import number as the API, which turned out not to be the case. We suggested yesterday that perhaps part of the reason could be how offshore storage in tankers has been accounted for. We have been assuming that on a DOE basis landing such storage would be counted as imports as it occurred, as opposed to booking it as an import when title is transferred.
- In any event, despite a further weakening in the March-April crude oil spread, in our view the market overall exhibited relative resilience in the face of such an onerous stock position in PAD II. What gives? First, some of the credit has to be given to poor old RBOB, the whipping boy of the NYMEX for the last several months. A smaller than expected stock build contributed to RBOB's strength, as well as a few reported refinery problems around the country. In addition, however, we believe traders noticed that the last four weeks revealed a smaller decline in implied demand versus the previous year than we have seen in some time. We would caution that the data were impacted by the large recovery in implied demand last week, which we would suggest will reverse to a degree next week. Nonetheless, despite some recovery in the summer RBOB cracks over the last few weeks as we had anticipated, RBOB remains so "cheap" relative to WTI that crude oil could continue to receive support from this product as refiners continue to manage product supplies in the face of weaker demand.
- Another factor accounting for crude oil's relative resiliency ironically relates to crude oil itself. When the stock position at Cushing is so widely publicized and when storage levels hit all-time records and are close to or at capacity, the market may believe that we can go only two ways: storage levels remain where they are or volumes begin to fall. Either way, markets have a tendency to discount such scenarios, and we may be seeing such an outcome unfold at the present time. In addition, however, history has shown that crude oil prices have such discounting "power" that prices can rise even in the face of rising aggregate inventories. The market looks far down the road when inventories peak, willing to bid up in advance to capitalize as early as possible on a tightening market.
- If it appears we are looking for any elements in the current equation that would support our Base Case scenario, we are. The jury remains out, and we are somewhat concerned that the market may be assuming too much for the upcoming OPEC meeting on March 15. We do not assume another cut is in the offing, despite many ministers moaning erroneously about the upcoming "weak" second quarter. Nor do we believe the market needs it, and we believe Ali Naimi would agree with us, and will push the case for

continued and improved compliance as we move through the second quarter which, as we have previously discussed, marks the time period where OPEC has the greatest potential influence on price via withholding barrels from the visible and influential Atlantic Basin market. Once again, we do not rule out March testing lower levels below \$40.00 per barrel leading up to expiration, particularly given the ill health of the equity market. We would retain our view, however, that February will provide attractive opportunities to establish/increase net long positions in both equities and the commodity.

W.H. Brown, III

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