



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

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Good Morning

Overview

- Hydrocarbon prices declined overnight. **Crude oil down \$1.06 to \$40.11 per barrel; natural gas down \$0.042 to \$4.600 per mmBtu.**

News/Views

- Those crude oil market participants who trade only relationships in the hydrocarbon complex on a fundamental basis are receiving satisfaction from a weakening front month and stronger outer months in response to record storage levels at Cushing. Things make "sense" in this regard. However, those trying to trade the "flat" market based on fundamentals must feel a high degree of frustration these days, since the market can start the day on one foot and end on another based purely on where the equity market is headed. Discouraging unemployment data set a negative initial tone yesterday, which led to a weaker S&P 500 accompanied by another March test of sub-\$40.00 per barrel. By the end of the day, however, the S&P 500 recovered, accompanied by crude once again, reflecting optimism over the ability to pass a stimulus plan, loaded with pork though it is. If the implication is that the fate of WTI lies in the hands of Congress, may the Good Lord help us all.
- In any event, our February scenario is thus far panning out reasonably close to expectations, and as we issue this note crude oil prices are retracing some of yesterday's gains in advance of what is expected to be, right or wrong, a negative jobs report. If it is worse than expected and the equity market falls in response, we would assume that prompt WTI will test the waters yet once again somewhat below \$40.00 per barrel. Overall, however, and in line with our expectations, as we proceed through February toward March contract expiration, prompt WTI continues to weaken relative to the outer months trying, in our view, to find a seasonal price trough. We seem to be quite in the minority in this view that prices will establish a bottom this month followed by a progressive price recovery as we move through the second quarter. As we have previously discussed, if we are off the mark in our assessment of oil prices for 2009, in our minds the next most likely scenario is a rather boring situation where as each month becomes prompt, traders sell back toward \$40.00 per barrel or modestly below, such that WTI averages around \$40.00 per barrel this year.
- We would still suggest, however, that the year is long, and there has not been a year over the last two to three where expectations at the beginning of the year were one thing whereas reality proved to be quite another. The consensus forecast was severely wrong in every year, but we shall see what 2009 holds in store. In terms of our seasonality argument, we have discussed that we are relying more on an improving Atlantic Basin crude oil balance as opposed to major help from gasoline as is customarily the case. However, in observing the market's recent response to any modicum of constructive news or data, traders and funds appear ready and eager to jump in and buy particularly, as we mentioned yesterday, since gasoline is so weak relative to everything else. This is all happening in February. As the weather gets warmer, the price response could easily be greater than even we are now giving it credit for.
- Otherwise, we will retain our Base Case and in this context we are in the process of updating earnings estimates as fourth quarter results are reported. As we have previously discussed, we are recommending that this month the first equity group that should be opportunistically added is the major integrated oils.

We are finalizing our estimates for this group in particular at the present time toward publishing our report on the majors, which should be out the door before the end of next week. While our Base Case crude oil and natural gas price assumptions have been finalized, we wish to take a bit more time on our refining margin outlook and overall Base Case downstream profitability forecast. In a nutshell, however, our outlook would call for peak 2009 earnings to occur in the third quarter, and thus from a valuation standpoint it may not be unreasonable to annualize our third quarter targets and assign the appropriate multiple for each stock.

W.H. Brown, III

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