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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

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Good Morning

Overview

- Hydrocarbon prices were mixed over the weekend. **Crude oil up \$0.24 to \$40.41 per barrel; natural gas down \$0.071 to \$4.703 per mmBtu.**

News/Views

- Observing crude oil price behavior on Friday confirmed in our minds beyond a shadow of a doubt that non-commercial participation has not “left the building” and that in fact our Base Case price outlook has a good chance of being realized if the fundamental component is reasonable. That is, if world oil demand does not decline to the extent of consensus belief this year and non-OPEC supply growth falls short of market expectations, the resultant price strength will be compounded by a non-commercial build up of length as we move through mid year and the third quarter.
- On Friday after trading lower for most of the day, the oil market ultimately had no choice but to recover in sympathy with a rising equity market, although March still settled lower on the day as traders continue to sell the front and buy the back. In our view, if stocks are due for a better year in 2009, we find it quite difficult to believe that crude oil will be left behind. Having said all this, we have to admit that the rationale for Friday’s equity market move was a bit stretched in our humble opinion. An employment report so dire that Congress has no choice but to pass the stimulus and bank plan? Perhaps, but if we had to choose between hard fact and the potential economic impact of Congressional action, our jury might still be out in this regard. In terms of oil specifically, it continues to give us the impression that it is somewhat tired of declining or even remaining in its recent range, but we concede we may be “talking our book” in terms of our own forecast for a seasonal price recovery.
- If in fact such a second quarter recovery is in the cards, “time is running out” for the market to languish at lower levels, based on historical experience. We had pegged January prompt WTI to average \$41.95 per barrel, and the actual came in at \$41.92 per barrel. This may end up being as accurate as we get this year since we made the estimate with most of the month in hand, but we all need to lay it on the line going forward as best we can. We had estimated that February would average \$42.22 per barrel, and thus far the month is averaging \$40.50. However, upon expiration of March the “roll” into April as the prompt month is likely to aid our cause given the current contango. March will be a larger test, however for a few reasons. First, history has shown that the odds generally favor WTI during **calendar** March averaging higher than calendar February WTI by

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a not insignificant amount. One reason is that until the recession hit, traders were willing to discount the upcoming gasoline season earlier and earlier, providing support for crude oil in the process. As previously discussed, we have assumed the impact, if any, will be more muted this year given the decline in demand, but as also discussed we have been impressed by the market's reaction whenever the weekly gasoline stats were not as onerous as consensus expectations.

- March also marks the OPEC meeting. We may be dead wrong, but we do not believe odds are that high that the Organization will vote to cut again. Saudi oil minister Ali Naimi will no doubt argue that current cuts are sufficient, provided compliance is maintained or improved. We would agree with him particularly, as previously mentioned, when applied to the second quarter. If we are right, however, and no further cuts are in the offing, no doubt some neotraders will be disappointed and sell in response. From our current perspectives, however, such a scenario would not lead us to reverse our Base Case expectations.
- With regard to the latest CFTC data, on February 3 when prompt NYMEX crude settled at \$40.78 per barrel, non-commercials held futures-only net length of 29,276 contracts, a decline in net length from the previous week by 22,376 contracts. Commercials held futures-only net short positions of 26,655 contracts, a fall in net shorts from the previous week by 14,119 contracts. In terms of natural gas, on February 3 when the prompt NYMEX natural contract settled at \$4.513 per mmBtu, funds held net futures-only net short positions of 144,779 contracts, a decline in net shorts from the previous week by 694 contracts. Commercials held futures-only net long positions of 110,487 contracts, a rise in net length from the previous week by 2,367 contracts.