**HIGHLY CONFIDENTIAL**
**February 11, 2009**

# Good Morning

## Overview

- Hydrocarbon prices firmed overnight. **Crude oil up $0.25 to $37.80 per barrel; natural gas up $0.020 to $4.563 per mmBtu.**

## News/Views

- Yesterday was yet another one of those days which we all wish never occurred from an equity standpoint, unless one happened to be gross short going into the Washington verbiage. The market was looking for, perhaps unrealistically, a high degree of specifics and details from the Treasury Department which Secretary Geithner did not have, or at least did not disseminate. As has been the custom lately, crude oil eventually took its cue from the S&P 500, ending down on the day. We would have to say, however, that crude oil exhibited a relative degree of resiliency, not yet willing to test the lows for the year on a prompt basis.

- Adding to negative oil market sentiment was a fairly bearish short-term energy outlook released by the EIA. Assuming a decline in real GDP this year of some 2.7%, the EIA believes that U.S. refined product demand will fall by 460 MB/D to 19.02 MMB/D. The EIA also expects natural gas demand to decline by 1.3% this year. In terms of oil, our Base Case calls for U.S. oil demand to fall by 1.5% to around 19.2 MMB/D. While one can argue about 200 MB/D despite being less than one month's DOE demand revision, we have been prepared for current conditions, looking for a decline in U.S. oil demand in 2009 since July of last year, far earlier than the EIA or anyone else. For natural gas, our Base Case calls for a 1.0% decline in demand in 2009. The IEA released their latest monthly report this morning, and the Agency is now calling for a fall in world oil demand this year of 980 MB/D, a greater decline than last month's assessment which expected a 500 MB/D world oil demand drop. We acknowledge that the IEA is compelled to try and be consistent with the IMF economic outlook, which is now calling for global GDP growth this year of only 0.5%.

- However, there is no question that it is much easier to be bearish on demand in the current environment than look for any inflection point, and many analysts have been burned from overly optimistic demand outlooks for last year and 2009. Once again by making only modest revisions to our consistently conservative forecasts for the past 6+ months, right or wrong, the consensus has now significantly passed us by on the downside. Our task is therefore to determine whether we are once again way out on a limb, or simply out to lunch. One key to what may lie down the road is the pure velocity of the economic decline and the fact that it caught so many by surprise. This is not to say that malaise cannot last through this year and the next 2-3 years, but the speed and depth of this phenomenon makes us naturally suspicious that the bulk of the downturn relates to the seizing up of the global credit system, which will now clearly be unfrozen. In any event, even if we are off the mark it strikes us that the IEA in particular will, over the next several months, begin to rethink and revise its outlook to one that is less negative, aiding our second half 2009 scenario of non-commercial crude oil buying, which in turn will complement any price recovery based purely on fundamentals.

- The one point where we would concur with the IEA is on the supply side and the potential impact on inventories as 2009 progresses if OPEC is reasonably successful at “holding the line”. The Agency suggests there is the potential for a “substantial” draw in stocks later in the year if OPEC is successful in implementing output cuts, since supply would average below even the IEA’s demand outlook by some 1.5 MMB/D. Our balances suggest that even if after holding the line through the critical second quarter producers relax constraints as prices recover, 2009 would still witness a net global stock draw averaging in excess of 500 MB/D. Thus, barring a global depression *and* a major surge in non-OPEC supply, it appears that OPEC has gotten the numbers broadly correct. It remains, however, a matter of implementation, as always.

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