HIGHLY CONFIDENTIAL

February 24, 2009

Good Morning

Overview

- Hydrocarbon prices were mixed overnight. **Crude oil up $0.13 to $38.57 per barrel; natural gas down $0.067 to $4.030 per mmBtu.**

News/Views

- It is quite clear that if crude oil is ever to recover from current levels, it cannot depend on the equity market at this stage to provide any help. As we suspected and mentioned yesterday, it was premature to assume that happy days were here again. No matter what the Obama Administration comes up with these days to aid in economic and financial recovery, following an initial reaction the equity markets generally give it a "thumbs down". As we also discussed yesterday a key to crude oil's initial reaction to the Citi news was that fact that despite a knee-jerk gain back toward $41.00 per barrel, the prompt month weakened relative to the outer months, suggesting for the time being we have retuned to a trader strategy of sell the front, buy the back, assuming that inventories will remain high and that the pattern of the term structure over the last two months leading up to prompt contract expiration will replicate itself once again.

- Thus it would appear there is no "magic bullet" out there from a policy standpoint that will suddenly lead to massive short covering in all markets and clearly mark the beginning of the turnaround. This is despite the fact that year to date the S&P 500 is off by 17.7%, with the OIX and OSX off by 16.4% and 7.7%, respectively. "Bargain hunters" continue to encounter a market that simply wants to get cheaper every day for the time being. Given the natural human tendency to extrapolate current trends, *we* have to assume that the *consensus* will assume that the malaise and bloodbath will continue indefinitely in most markets. Thus, one has to rely, good bad or indifferent, on basic assumptions compiling into a forecast that will turn out to be reasonable or ridiculously wrong.

- Although the market does not care at the present time, it appears there is a good chance that February Saudi production will in fact average somewhat below 8.0 MMB/D as we anticipated. This is being called a unilateral move on the part of the Kingdom, but no doubt has also been influenced by further reduced refiner crude oil demands at the present time. Our global balances have assumed that Saudi crude oil deliveries will average about 7.9 MMB/D for both the first and second quarters. If our overall assessment is reasonable in terms of the rest of OPEC, it would lead to a net global stock draw in the second quarter in excess of 600 MB/D. The decline would include a build in distillate stocks, a "flattish" gasoline picture, but a significant decline in global crude oil inventories. We would strongly emphasize that such a net second quarter draw has never occurred before in the international oil industry, and there is absolutely no way such a scenario has been assumed by the consensus. Thus, we are a "severe outlier" in this regard as well.

If we are even remotely close to the mark, however, it would imply that world oil demand is not quite as weak as the market has assumed, and that non-OPEC supplies are gaining less than the market has estimated. We would surmise that our view is such an outlier that if it does not materialize, we believe the biggest risk to crude oil prices is that they continue to trade between $30.00-$40.00 per barrel over the next month or two, and not recover, as opposed to sinking down below $30.00 per barrel.