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Energy Risk
Management Services

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February 26, 2009

Good Morning

Overview

- Hydrocarbon prices firmed overnight. **Crude oil up \$0.72 to \$43.22 per barrel; natural gas (April) up \$0.032 to \$4.061 per mmBtu.**

News/Views

- As fundamental energy analysts we were gratified to see oil prices marching to their own beat yesterday instead of being led around by the S&P 500, which in turn unfortunately has been led around by Beltway verbiage. Yesterday's market action confirmed two of our theses which compose our outlier view of a progressive rise in oil prices, with February marking the trough. Whether we are ultimately right or not remains to be seen, however, with no signs whatsoever that economic activity has begun to stabilize.
- In any event, in terms of crude oil specifically we had previously stated that given the market's tendency to discount, when the day came that stocks at Cushing stopped building, let alone began to decline, prompt WTI would likely move up since many traders had assumed that stock builds had further to go given the severe market contango. The other point we had previously made was that RBOB was so weak relative to crude oil that any evidence of refiners fine tuning yields to match weaker demand would lead to a favorable inventory position, particularly as we moved into the second quarter, aiding our Base Case price outlook. The significant gasoline stock draw for the week ending February 20 led to such an RBOB price surge, pulling crude oil up in sympathy. Traders also noticed the improvement in implied gasoline demand versus last year. We have previously made the point that last year at this time demand was relatively weak relative to the surrounding months and we may be witnessing a temporary recovery in winter discretionary driving reflecting \$2.00 gasoline, now "ancient history". Also, the DOE may end up revising down January and February demand. Nonetheless, for the moment the gasoline numbers are helping to pull the market up from what increasingly had been looking like the bottom in the market from a technical standpoint.
- In terms of distillate, little help was derived from this product, with stocks rising instead of seasonally declining. It would appear our previous assessment was right on the money. Namely, previous four-week rolling averages for implied demand eked out a modest gain versus last year, with colder weather more than offsetting weaker diesel demand. We had made the point that with more recent weather trends moderating versus last year as measured by home furnace-weighted heating degree days, as we moved through February the year-over-year demand comparisons would likely be less favorable. This is now occurring, with the most recent four weeks implied distillate demand off by 1.6%.

The crude oil market is heartened this morning by word that the Abu Dhabi National Oil Company (ADNOC) is trimming Asian customers in April versus March, which has come as a surprise to a number of physical traders in the Far East. This is having the double effect of confirming that the Arabian Gulf countries, including Saudi Arabia and Kuwait, mean business in terms of leveraging up prices. It also is leading many to believe that the odds have increased that OPEC might make additional cuts at the March 15 meeting, with the official outcome merely rubber stamping what was already in place. As previously discussed, our balances suggest that OPEC need not make further cuts next month, since maintaining current compliance through the

second quarter would be sufficient to reach our price targets in the third quarter given the critical dynamics of the crude oil balance during this period, i.e. the impact of the seasonal decline in North Sea production in combination with a recovery, albeit modest, in Atlantic Basin refiner crude oil requirements.

W.H. Brown, III

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