



**HIGHLY CONFIDENTIAL**

March 2, 2009

**Good Morning**

**Overview**

- Hydrocarbon prices were mixed over the weekend. **Crude oil down \$2.35 to \$42.41 per barrel; natural gas up \$0.020 to \$4.218 per mmBtu.**

**News/Views**

- The continued demise of the S&P 500 has precluded prompt WTI from settling above \$45.00 per barrel for a second day in a row, with further weakness characterizing the market thus far this morning following product expiration on Friday. Crude oil may also be spooked by word that the CFTC is looking into the market's 500-pound gorilla, USO, to see what if any impact its position size and the required rolls are having on the market, with some traders therefore assuming that any required length liquidation would pressure WTI further.
- Under our thesis that February would provide the most attractive opportunities on the long side for both the energy equities and the commodity, they certainly did thus far, with crude oil off its trough at the end of the month and equities setting new lows on the last day. Obviously, however, both will have to be higher by March 31 if we are to be anywhere close to the mark. In our case we suppose "in like a lion, out like a lamb" is really "in like a bear, out like a bull", although we have never cared for either term, at least when applied to Homo sapiens. In any event, the first day of the month appears to be growling, no doubt. As we have previously discussed, if we are wrong, crude oil will likely be characterized by yet another month of selling front, buying back, possibly working our way back below \$40.00 per barrel once again.
- Otherwise, "for the sake of good order" and for the record we mention that, as usual, the DOE revised down demand for 2008, this time for the month of December relative to the preliminary numbers. The latest Petroleum Supply Monthly (PSM) released late last week revealed that on a "near final" basis, December implied refined product demand averaged only 19.199 MMB/D. This marked a whopping downward revision of 909 MB/D relative to the preliminaries as represented by the four-week averages for the week ending January 2 as published in the Weekly Petroleum Status Report (WPSR). Total refined product demand therefore dropped by 8.0%, and not the 2.9% shown in the preliminaries.
- For gasoline, December demand was cut by 114 MB/D to 8.921 MMB/D, a 3.5% decline from December 2007. Distillate fuel oil demand was revised down by 421 MB/D to 3.784 MMB/D, a decline in demand from December 2007 of 13.1%. Jet fuel demand was cut by 63 MB/D, averaging 1.394 MMB/D, a 13.0% drop in demand from December 2007. Heavy fuel oil demand was revised down by 26 MB/D and averaged 753 MB/D in December, an increase of 13.7% versus December 2007. This all implies that "other" demand, most sensitive to economic activity, was revised down by 285 MB/D. Given the accelerating decline in the U.S. economy toward the end of last year, it is surprising that the "other" category was not revised down more than it was, given that the preliminary data are based largely on estimates from algorithms, and not actual surveys. All these revisions should give some pause when interpreting the recent WPSR preliminary data which have reported a modest increase in gasoline demand earlier this year, although we would note that in December, the latest month where data are available, the DOT reported that travel on all roads declined by only 1.6%, and given the drop in pump prices in the first quarter, discretionary driving likely recovered modestly.

With regard to the latest CFTC data, On Tuesday February 24 when the prompt NYMEX crude oil contract settled at \$39.96 per barrel, non-commercials held futures-only net long positions of 28,749 contracts, a drop in net length from the previous week by 16,267 contracts. Commercials held futures-only net short positions of 30,544 contracts, a decline in net shorts from the previous week by 5,147 contracts. In terms of natural gas, on February 24 when the prompt NYMEX natural contract settled at \$4.236 per mmBtu, funds held futures-only net short positions of 148,904 contracts, a rise in net shorts from the previous week by 8,380 contracts. Commercials held future-only net long positions of 96,961 contracts, a fall in net length from the previous week by 4,851 contracts.

W.H. Brown, III

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