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Energy Risk  
Management Services

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**HIGHLY CONFIDENTIAL**

March 3, 2009

**Good Morning**

**Overview**

- Hydrocarbon prices firmed overnight. **Crude oil up \$0.61 to \$40.76 per barrel; natural gas up \$0.072 to \$4.224 per mmBtu.**

**News/Views**

- The massive market moves yesterday were among the most disconcerting thus far, and we have to believe there is a dominance by hedge fund and required counterparty transactions in all of this since AIG, as we anticipated, is proving to be a bottomless pit. The volatility simply does not smack of large-scale selling of the equity market by most investors because earnings are expected to be weaker than previously thought. The absolute dollar move in crude oil yesterday was the same magnitude we witnessed when WTI was trading at least twice its current level, now monumental in percentage terms. Nonetheless, we all have to live with it for the time being unless or until the S&P 500 decides that 700 is the mother of all bottoms. Crude oil's drop yesterday was also aided by a stronger dollar.
- In terms of fundamental impacts, crude oil was impacted by conflicting words from OPEC ministers as to whether another production cut is in the cards on March 15 or not. Algeria's oil minister, Chakib Khelil, suggested a strong possibility of such action, but believe it or not Iran's minister of all people, Gholamhossein Nozari, indicated that he doubted OPEC would agree to a new cut. We will *almost* straddle the fence at this point and suggest the odds are 45% of another reduction. Previously, we suggested the odds were strongly against it since we thought Saudi oil minister Ali Naimi would prefer to see tighter compliance with the existing accord without worrying about another cut that may lack market credibility. Since then, however, word that ADNOC had cut April Asian supplies more than expected brought to mind the possibility that another modest cut was possible to simply legitimize current sales rates. This perspective would still bring us short of 50% odds or greater of another reduction, however.
- Otherwise, we have been speaking with some of you with regard to signals that might help divorce crude oil from its fund-induced linkage to the S&P 500. We have suggested that stability and subsequent declines in visible U.S. crude oil inventories would go a long way in breaking the WTI-equity bond. Although we have strongly emphasized, and been correct, in terms of the financial influence on oil prices in this new world of ours, it does not have to be consistent or last forever. Prompt WTI has been so pummeled by bulging stocks that in our view it appears to be overly discounted, with the market assuming March will be yet another month of selling the front and buying the back. As we have previously discussed this is a likely scenario if our Base Case is off the mark, but it also suggests to us that any positive surprises will have a magnified impact on price.

Another obvious factor that could delink crude oil from the S&P 500 is visible U.S. product demand. As we have indicated, there were some misleading signals when implied demand looked a bit more positive a couple weeks ago, for which we offered our thoughts and explanations. Having said this, however, the year-over year comparisons should begin to look somewhat "easier" by the end of the second quarter, and there is no question

based on recent behavior that the market will take notice of this. Not only would crude oil benefit, but it also appears for the moment at least that our Base Case natural gas price outlook may pan out as expected.

William H. Brown, III

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