



HIGHLY CONFIDENTIAL

March 4, 2009

Good Morning

Overview

- Hydrocarbon prices were mixed overnight. **Crude oil up \$1.56 to \$43.21 per barrel; natural gas down \$0.012 to \$4.270 per mmBtu.**

News/Views

- In the context of our “de-link” discussion yesterday morning, crude oil managed a modest gain by the end of Tuesday despite a down day for the S&P 500, albeit off its lows. Thus far this morning, global equity markets appear heartened for the moment in response to President Obama’s equity analysis who, in contrast to any quantitative analysis with regard to enterprise value and appropriate multiples, suggested publicly that the stock market looked like a good deal. We’ll take it. The “legs of the de-linking” will of course depend upon a number of variables that we discussed in this context yesterday such as weekly inventory data, OPEC confabs, and the trend in implied demand. The latter is most critical for the United States since the numbers are the most timely and visible, however faulty. All of us need not kid ourselves in terms of the accuracy we are all able to achieve on a global basis over the short term. In addition, the general concept of all the economic malaise is that the U.S. “started it”, with a subsequent “roll around the world”, and if the U.S. begins to show some signs of stabilization the market will assume that over time it will help prevent China from weakening at the tail end as much as the consensus now expects.
- Back to crude oil behavior specifically, the more we think about it and discuss the matter with a number of friends and contacts, we would retain our observation of market behavior on Monday. That is, crude oil’s substantial decline was assumed to be attributed largely if not exclusively to a “homogenous market’s thumbs down” to the prospect of financial stability following the news on AIG, Citi, and other institutions. While this may be true to some degree, we believe these traders added to the weakness that was already in evidence from AIG-specific positions and transactions. That is, when news of a larger loss and new bailout emerged, we suspect the counterparty liquidation of CDFs and other instruments related to oil that AIG had with others were unwound to the extent they could be. Adding fuel to the fire as the market declined was any required selling by indexes such as USO. Similar market behavior occurred when the first news of AIG’s problems emerged, with traders selling assuming that many positions with GS and others would have to be unwound. We are not trying to sit here and point fingers or spread rumors. We simply want to try to discern and observe “clean” market behavior, since if we are correct it would suggest that once again prompt WTI was oversold relative to what the majority of the world thinks about it. We are able to discuss these matters on these pages because our client base is so small and elite.
- A bit of a test to all this has come via the release of the weekly API data late yesterday afternoon. The API reported that for the week ending February 27, crude oil stocks fell by 463,000 barrels in contrast to expectations of a build. The decline came about through the combination of lower imports and rising runs. Gasoline supplies fell by 643,000 barrels, less than previous week due to higher refinery output, higher imports, and stable demand. Distillate stocks rose by 1.646 million barrels, in contrast to expectations of a decline, confirming that weaker diesel demand has now been joined by moderating weather trends, in contrast to a few weeks ago. Thus far at least, the market has chosen to trade up on the crude data, since within the aggregate stocks at Cushing declined by a sizeable 3.122 million barrels,

confirming our previous thoughts that according to our physical crude oil trading friends the storage trade at Cushing does not “work” to the extent it did previously. In any event, the market will wait as it usually does until the DOE data are released later this morning, either confirming or negating the overall picture presented by the API.

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