HIGHLY CONFIDENTIAL

March 5, 2009

Good Morning

Overview

- Hydrocarbon prices fell overnight. **Crude oil down $1.10 to $44.28 per barrel; natural gas down $0.007 to $4.333 per mmBtu.**

News/Views

- Following the markets' suffering from the China syndrome recently, yesterday witnessed a one-day change in sentiment in response to word that the China Purchasing Manager's Index, although still declining, moderated its fall in February to almost neutral territory at 49.0, up from 45.3 in January. Within the aggregate index, the strongest component was export orders, rising from 33.7 in January to 43.4 last month. Commodities in general rose in response, with the S&P 500 also gaining to a smaller degree as energy and other commodity-based equities led the recovery. As we often say, usually for good reason, one day does not a market make, but in terms of crude oil it strikes us that many bears have now become frustrated that prompt WTI has yet to witness $30.00 per barrel in all this economic malaise. As we anticipated, those willing to buy $30 puts at 100% vols have yet to be satisfied this year. Now there is much more activity in the $50 calls, and why not, given it's one of the "nicest roundest" numbers around. The odds of reaching such a bogie over the near term will no doubt depend upon today's activity following yesterday's rally, i.e. are there any short-term "legs" to it, or are we simply remaining in a $35.00-$45.00 per barrel trading range. Also of importance, of course, is the extent to which oil and, for that matter natural gas, can divorce themselves from the S&P 500 which still remains subject to Washington verbiage and economic stats that in this world are ancient history.

- Helping out matters in this regard were the weekly crude oil stats, which managed to offset product builds as refiners increased runs. We would suspect that traders and funds will try and pay more attention to the crude oil data from here on if possible, given the desire to establish positions in this more liquid instrument. From a long-term fundamental basis, ultimately the price of crude should be determined by the market value of the products refined from that crude oil. In this new fundamental/financial world of ours, however, crude oil can call the tune, often to the consternation of refiners. In any event, yesterday's data response was consistent with our thesis that once crude stocks at Cushing stabilized and began to fall, this would have a disproportionate impact on price given how heavily the bulging stock scenario had already been discounted. Despite the fact that the DOE-reported Cushing draw was significantly less than the API-reported decline, the DOE data confirmation of the *direction* of the API numbers was enough to lift WTI. Our balances, as previously discussed, suggest this behavior will continue, on average, through the second quarter, although of course the vagaries of weekly data do not imply a straight line.

Otherwise, underlying all this is the "will they or won't they" attitude of traders with regard to the outcome of the March 15 OPEC meeting. Whatever the official result, it still appears that Saudi Arabia means business in terms of trying to leverage prices back up. Whether they are successful or not remains the obvious question. As we have previously stated, the $75.00 per barrel goal stated by the Kingdom a few months ago can be achieved only through a combination of fundamental and financial factors all working in one direction, and not fundamentals alone. Those who believed that fundamentals accounted for +90% of the price move toward $150.00 per barrel would clearly disagree with us, but price history since then has obviously proven our perspective to be accurate. In any event, it looks like Saudi Arabia's crude oil production is now falling below quota, which we estimate at 7.755 MMB/D, since OPEC long ago suspended publishing individual allocations. In our view the Saudi situation remains a combination of reduced refiner demand and an attempt to fall a bit short of nominations, although market allocations vary across the world, with the largest reductions destined for the U.S. Saudi Aramco hiked crude oil prices to Europe for April delivery more than refiners expected. However, this appears to reflect the strength in the dated Brent market and not a proactive attempt to limit offtake via higher prices as opposed to the customary route, i.e. negotiating on a volume basis.

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