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Energy Risk
Management Services

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Good Morning

Overview

- Hydrocarbon prices firmed over the weekend. **Crude oil up \$0.70 to \$46.22 per barrel; natural gas up \$0.005 to \$3.950 per mmBtu.**

News/Views

- The petroleum gods always appear to be watching us, for better or worse. On Friday we discussed how over the past few months the crude oil/dollar trade had become less en vogue, and thus yielded, by definition, a weaker statistical relationship. Of course, therefore, on Friday the trade “woke up” once again, with a number of factors contributing to crude oil’s gains on the day, including a weaker dollar. Such sentiment is continuing as we issue our note this morning. In addition, however, we suspect that crude oil’s strength may also have derived from short covering. The potential impact of the U.S. Oil Index “roll” which now covers a four-day period but began on Friday, had been so well publicized it finally achieved a story in the Wall Street Journal. Many newer to the trade thus assumed it was a “lay up” to go short the front month and long the outer months on the day the roll began, assuming that the 500-pound gorilla would eventually come in and weaken the spreads further, allowing a bit of profit for those who came in first. It did not pan out as many may have expected, however, with other factors including the weaker dollar forcing short covering by the end of the trading day. From a “news” standpoint crude oil was likely impacted by word that the tanker SKS Satilla was listing in the Gulf of Mexico, with traders and funds perhaps assuming it would have some impact on crude oil supplies. On Sunday, however, the Coast Guard reported it was offloading the crude oil to other tankers given the finding of punctures in Satilla’s hull.
- Finally, speculation continues to assume, right or wrong, that OPEC will opt to officially trim supplies once again on March 15. In this regard, this morning OPEC Secretary General Abdullah al-Badri said that OPEC would indeed consider cutting output again, and that “all options are on the table”. Having said this, however, he previously indicated that although current oil price levels are not really “acceptable”, given the economic crisis they are “OK”. Thus, other market participants are likely to conclude that another cut is *not* a done deal, and that given the recent price run up and what looks to be a weaker equity market today we should be prepared for some hydrocarbon price volatility. In any event, the catalyst for OPEC’s possible action will be a further reduction in forecast world oil demand for this year as estimated by the OPEC Secretariat, who customarily present their thoughts as the groundwork for discussion. We are in the process of updating our global balances toward publishing our regular monthly report this week, and at this juncture we would still come up with a global balance that is more constructive than consensus, IEA, and OPEC expectations on both the demand and non-OPEC supply side of the equation.
- Otherwise, our thoughts the other day and “since it all began” that any news, particularly bad, regarding AIG has had a disproportionate impact on crude oil prices due to counterparty relationships have been completely substantiated as far as we are concerned. Over the weekend the Wall Street Journal reported that U.S. government bailout aid to AIG had effectively flowed through to important counterparties that have had heavy oil exposure such as Goldman Sachs. Once again our aim is not to point fingers or somehow “blame” financial entities, but merely be able to eliminate this non-fundamental “noise” that has and will likely continue to impact crude oil prices in the midst of the credit crisis.

- With regard to the latest CFTC data, on Tuesday March 3 when the prompt NYMEX crude oil contract settled at \$41.65 per barrel, non-commercials held futures-only net short positions of 532 contracts, a swing from the net length of the previous week by 29,281 contracts. Commercials held futures-only net length of 3,801 contracts, a swing from net short positions held the previous week by 34,345 contracts. In terms of natural gas, on March 3 when the prompt NYMEX natural contract settled at \$4.282 per mmBtu, funds held futures-only net short positions of 127,734 contracts, a decline in net shorts from the previous week by 21,170 contracts. Commercials held futures-only net long positions of 89,196 contracts, a decline in net length from the previous week by 7,765 contracts.

W.H. Brown, III

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