



HIGHLY CONFIDENTIAL

March 12, 2009

Good Morning

Overview

- Hydrocarbon prices firmed overnight. **Crude oil up \$0.46 to \$42.79 per barrel; natural gas up \$0.003 to \$3.801 per mmbtu.**

News/Views

- It would appear that our 500-pound gorilla, the U.S. Oil Fund, finally had the market impact that many traders were looking for in the first place. As previously discussed, USO changed to a four-day roll period as announced back in February, which for this month began last Friday, March 6. We had indicated in previous morning notes that part of the recent run up to \$48.00 per barrel may have been caused by trader short covering in April when the roll did not have the effect assumed. OPEC production cut speculation and Shell's declaration of force majeure on Forcados loadings all precluded prompt WTI from declining. Traders were then forced to come in and cover short April positions as a result, contributing to the run up.
- However, on Tuesday, but to a greater degree yesterday, the roll had the effect originally assumed, with a lack of bullish news, neutral weekly stats, and the revised market assumption that OPEC may not cut output on Sunday creating a vacuum of bullish catalysts, fully exposing the impact of the roll. While the GSCI has a ratable roll period, we were unable to determine that USO has such a policy, and thus perhaps the bulk of the roll was accomplished later on Tuesday and all day Wednesday, although we emphasize this is an assumption on our part. If all of what we are saying makes any sense, then it would not surprise us now that the USO roll period has ended to see some short covering in advance of the OPEC meeting. The neopress attributed yesterday's crude oil price decline to the reported DOE crude oil stock build, but since supplies fell at Cushing one would normally look for the term structure to flatten even in a declining market. The opposite actually took place, thus suggesting the roll effect dominated trading activity.
- We had previously warned OPEC not to make bullish "cut" statements prior to Sunday's meeting, creating overly optimistic expectations. With prompt WTI falling back from \$48.00+ per barrel, however, the market has now reduced its odds for a cut which, from OPEC's standpoint, is a good thing. In this context, yesterday Algeria's oil minister Chakib Khelil stated "if you disappoint the market, then the market is going to disappoint you". Truer words were never spoken. Iran's oil minister, Gholamhossein Nozari, continues his non-typical "dovish" statements, suggesting that OPEC may not cut production but if they do, then non-OPEC should chip in. In this regard, it would not surprise us to see some words of cooperation from Russia, for example, whose cut would simply be a confirmation of the production decline we anticipate for 2009. For the month of March, within the context of the current 24.845 MMB/D ceiling for the OPEC "11", we estimate production averaging about 25.760 MMB/D, which would imply an "overage" of some 915 MB/D.

The largest "violators" are Angola, Iran, and Nigeria, totaling around 830 MB/D, or +90% of the "excess". We remain amazed that Angola chose to join OPEC in the first place. In Nigeria's case, OPEC is likely to "cut them some slack" given the "underage" that has existed for the last couple years due to Delta violence. The real key, particularly from a psychological standpoint, is Iran. If Ali Naimi can convince Nozari to "visibly" reduce even a little bit more without appearing confrontational, then any potential post-meeting price weakness should be

minimal. In the context of our overall balances, however, short of a market share war we still conclude there will be a net global stock draw in the second quarter, which is unprecedented and which the consensus is not even close to anticipating at this time.

W.H. Brown, III

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