



**HIGHLY CONFIDENTIAL**

March 19, 2009

**Good Morning**

**Overview**

- Hydrocarbon prices firmed overnight. **Crude oil up \$1.72 to \$49.86 per barrel; natural gas up \$0.001 to \$3.685 per mmBtu.**

**News/Views**

- Yesterday's crude oil market action was yet further confirmation of our long-standing thesis that financial factors remain alive and well in terms of influencing crude oil prices. After an initial negative reaction to the weekly DOE data, the market recovered off the lows of the day, with April settling at \$48.14 pr barrel. Post settlement, however, markets began reacting to the Fed move to buy \$300 billion in long-term Treasuries and even more in mortgage-backed securities. Rising equity markets were accompanied by the spread to commodities, with April crude oil managing another assault on \$50.00 per barrel.
- Thus far, it is unclear whether prompt WTI will fail at \$50.00 per barrel or so and reestablish a new trading range of roughly \$40.00-\$50.00 per barrel, or whether conditions are now in place to move above \$50.00 as we believe will eventually occur over the next couple months. Quite frankly, no one will know the answer to this until or unless prompt WTI settles above \$50.00, setting off a new stage of buy stops and psychology in the process. Of course, looking at volume, the market clearly has more focus on May as we move toward April expiration, which has in fact been able to settle above \$50.00, but without firm conviction thus far.
- The neopress claimed that part of yesterday's post-settlement crude oil recovery was due to a sagging dollar following the Fed announcements. Updating our model would suggest that when viewed in isolation yesterday's 3.7% crash in the dollar versus the euro would imply a whopping \$15.00 per barrel gain in WTI, confirming once again our previous discussion that crude oil's influence from the dollar has waned. When the inverse relationship was much tighter a few months ago our model was quite accurate in explaining the periodic and significant impact on WTI from a major change in the dollar/euro rate. Just for the sake of it, however, yesterday's dollar/euro rate would imply a value for prompt WTI of some \$68.00 per barrel if the "olden days" of the tight relationship were to return. Right or wrong, coincidentally or not, this magnitude of price happens to coincide with our Base Case target for August established in January, which most consider quite insane at this point.
- In terms of the market response to the DOE data yesterday, perhaps some of the recovery in crude oil off the lows could be attributed to the realization that the crude oil stock build was not quite as bearish as the market's initial reaction. Granted, supplies rose at Cushing, and the market was probably discounting no further builds if not an outright draw. However, when adjusting for the build in PAD V which the market has come to realize can be quite volatile due to the timing of ANS bookings, the stock build was not much out of line with consensus expectations.

The gasoline build was, on the face of it, quite bearish compared to what the market was expecting. However, we believe that part of the numbers may be attributed to the beginning of the period when quality issues can greatly impact the movement within the refinery system and secondary storage, with greater week-to-week volatility in primary stock movements and changes in implied demand the result. The bulk of the build last

week was in fact blendstocks and not finished gasoline, whereas finished mogas stocks have continued to decline. The aggregate stock rise at the primary level was exacerbated by a slight decline in implied demand from the prior week, perhaps reflecting a bit of secondary destocking, although we would continue to emphasize that actual final consumer gasoline consumption is likely somewhat weaker than the preliminary DOE data would imply. For distillate, the build was less than expected, but there is no question the mid barrel remains in plentiful supply. The last four weeks' demand fell by 9.3%, and this "makes sense" to us. Although we do not have manufacturing data for the first two weeks of March, we know that output dropped 13.1% in February versus the prior year as reflected in the latest release from the FRB. Weather versus last year over the last three-odd weeks has jumped around a bit from warmer to colder, and thus the drop in implied distillate demand largely reflects weak diesel sales..

W.H. Brown, III

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