HIGHLY CONFIDENTIAL
March 23, 2009

Good Morning

Overview

- Hydrocarbon prices firmed over the weekend. **Crude oil (May) up $0.38 to $52.45 per barrel; natural gas up $0.023 to $4.250 per mmBtu.**

News/Views

- As we issue this note crude oil prices remain boosted by Fed actions assumed to be inflationary in the long term, thus stimulating interest in commodities in general. The U.S. plan to handle the toxic waste aspect of the global financial system is expected in turn to help boost demand. In reality, obviously the largest influence on crude oil prices recently has been financial. Whether all this pans out and is ultimately confirmed by the fundamentals, of course, remains to be seen, but as we completely anticipated the financial influence is here to stay in varying degrees. As we have previously discussed, a Barclays survey revealed that most investors planned to increase their commodity exposure over the next few years, a survey conducted well before the recent Fed moves. A study by Hedge Fund Research revealed that so-called energy hedge funds suffered as much or more liquidation and termination than the hedge fund space in general last year. However, although many of these funds were perpetually bullish and thus lost a good part of their capital, it would appear those who traded both sides of the coin are alive and well and are now able to boost investor inflows. In addition, indexes remain intact, with volume still implying substantial interest at current levels of crude oil prices. Clearly a "kick" for crude has been the recent weakness in the dollar and the *expectation* that such weakness represents a trend reversal, right or wrong. We have previously emphasized that a sizeable, positive financial influence is integral to our Base Case price forecast in tandem with fundamentals that are less bearish than the consensus now assumes.

- Having said this, however, were not inordinately depending upon a sustainably weaker dollar, but such a scenario would provide even more support to our outlook, if in fact the crude oil/dollar trade returns and has any modicum of "legs" to it. In this regard, updating our model once again suggests that when viewed in isolation, prompt WTI "should be" trading in the upper-$60s per barrel, levels we do not expect until August if *all* aspects of our Base Case pan out. The degree of near-term support that a trend-weakening dollar *could* provide is illustrated by comparing current prices to our Base Case forecast prepared in January. As mentioned on Friday, our expectation for March was a WTI average of about $47.80 per barrel, and March to date including April expiration has been $46.13 per barrel. However, our *calendar* April forecast average was "only" $51.18 per barrel, and thus if prices remain where they are we will end up a bit too low, almost incredible compared to where sentiment was one month ago. For the record, our Base Case May forecast has been about $54.65 per barrel.

- However, it would not surprise us to see the market back and fill, "reminded" periodically by current, as opposed to prospective fundamentals as exemplified by the weekly data. Also, it is far from clear how sustainable the positive reaction to the toxic waste plan will be. In this context, though, we would note that April's expiration last Friday was "less weak" than the prior two expirations. That is, on a settlement basis April expired $1.01 per barrel below May. Last month, March expired $1.09 per barrel below April, while the month before February expired $2.10 per barrel below March. We do not wish to read too much into this since expiration can be distorted by one or two players. However, it would be consistent with our perspective that crude inventories in general are finally stabilizing, with the prospect for declines over the next few months as our Base Case anticipates.

In terms of the latest CFTC data, on March 17 when the prompt NYMEX crude contract settled at $49.16 per barrel, non- commercials held futures-only net long positions of 13,507 contracts, a swing from the net short position of the previous week by 19,522 contracts. Commercials held futures-only net short positions of 16,390 contracts, a rise in net shorts from the previous week by 9,486 contracts. For natural gas, on March 17 when the prompt NYMEX natural contract settled at $3.812 per mmBtu, funds held futures-only net short positions totaling 115,187 contracts, a rise in net shorts from the previous week by 1,123 contracts. Commercials held futures-only net long positions of 76,847 contracts, a decline in net length from the previous week by 1,253 contracts.

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