



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

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Good Morning

Overview

- Hydrocarbon prices were stable overnight. **Crude oil up \$0.85 to \$53.62 per barrel; natural gas up \$0.005 to \$4.334 per mmBtu.**

News/Views

- Wednesday's crude oil trading activity held something for just about everyone. From a fundamental standpoint, there was indeed a "reasonable" reaction to the weekly data. Traders were balanced between the larger than expected aggregate crude oil stock build and the more constructive product draws, but the term structure was able to flatten modestly reflecting a stock decline at Cushing. In this regard, it was pointed out to us by one of our good friends that there was a rumor circulating that Cushing stocks for the previous week, i.e. the week ending March 13, had been "over counted" and thus the supply situation was more ample than met the eye. However, we were unable to get any confirmation, and we would be somewhat surprised if in fact this were the case. In any event, it is quite rare for the DOE to revise preliminary weekly oil data.
- Overall, however, the financial factors seemed to kick in once again, based on the market's performance throughout the day, with crude oil periodically following the S&P 500, with a "dash of Geithner" added when he stated he was open to expanding the use of the SDR as a reserve currency, as proposed by China. This weakened the dollar assuming the demand for dollars would fall as a reserve currency under such a scenario, providing a bit of a boost to crude oil. By the end of the day, however, despite the S&P 500's ability to end in positive territory in response to somewhat better than expected housing and durable goods data, crude oil ended lower on the day, impacted by the fact that crude oil stocks are now the highest in almost 16 years.
- Overall, the action provides yet further support for our dual financial/fundamental factor requirements for higher crude oil prices down the road. The financial aspect seems to be in hand, assuming our scenario of a higher equity market and a "bottoming" economy remains valid. The key, therefore, is the fundamental side of the coin, which we believe requires more constructive crude oil data than product data. This sounds intuitively obvious given where crude oil stocks stand compared to, say gasoline in the United States, but crude stocks given offshore storage are a bit harder to estimate, track, and determine when the balance will improve on a global basis. Then again, there is the potential problem with OPEC trying to sell a few more barrels as prices rise. While such intelligence and the market impact usually comes out only once or so per month when "tanker tracker" data are reported by Reuters and others, the degree of compliance in the months ahead remains a major unknown and requires an heroic assumption on our part.
- The visible, domestic crude oil picture should improve a bit by definition when crude oil refinery runs begin to inch up on a seasonal basis. "Inch up", however, is probably the appropriate term, since demand remains constrained for gasoline and remains in negative territory for diesel. From a price standpoint, these two products are obviously the most important, since hedge funds do not tend to trade lubes, asphalt, and heavy fuel oil to best of our knowledge. Of the two, gasoline should have the greater impact one way or another as we move into the driving season. The latest four-week rolling average of implied demand reveals some moderation from the previous trend, but as we have previously discussed the comparisons

are likely overstated in any event when comparing preliminary data for this year with “more final” data for last year.

- In addition to a run uptick, however, imports need to remain under control, which implies both the “drainage” of offshore storage and OPEC continuing its current level of compliance. Putting it all together and estimating the best we can, we believe that U.S. crude oil stocks will begin to decline on a consistent basis in May. One would normally think that crude oil prices will therefore go nowhere between now and then. However, given what we have proven to be the financial influence on WTI, we are increasingly of the mind that, as with equity behavior, crude oil prices will now tend to discount turning points in fundamentals farther in advance than historically has been the case.
- we will publish a brief review of activity in our absence later in the day on Monday upon our return.

W.H. Brown, III

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