



HIGHLY CONFIDENTIAL

March 27, 2009

Good Morning

Overview

- Hydrocarbon prices eased overnight. **Crude oil down \$0.84 to \$53.50 per barrel; natural gas down \$0.022 to \$3.925 per mmBtu.**

News/Views

- Yet once again crude oil traded in tandem with the equity markets in the *expectation*, right or wrong, that the U.S. economy was beginning to stabilize. Clearly this is part of our Base Case, so we are not inclined to argue the point. WTI is therefore ignoring *current* crude oil fundamentals, but as we suggested yesterday since crude oil is trading more like the equities given the average profile of those trading oil these days, we believe it is appropriate to assume that crude will discount expectations more heavily and sooner than it has in the past. We will see the degree of “legs” all this has, but so far, so good. Prompt WTI has averaged \$47.73 per barrel March to date, compared to our forecast made back in January that March would average around \$47.80 per barrel. May crude oil settled yesterday at \$54.34 per barrel compared to our forecast that *calendar* April would average \$51.15 per barrel, and thus as previously discussed we are prepared for some “backing and filling”, since not even crude oil goes up or down in a straight line.
- This is all well and good for the energy equities, but the group lagged the S&P 500 gain yesterday thanks to natural gas. After beginning to show that there is indeed life after sub-\$4.00 per mmBtu, one week’s worth of storage data managed to tank natural back below \$4.00 per mmBtu, so we are back to where we started around mid March, with the prompt natural to crude oil ratio settling yesterday at a paltry 43.6%. While there is always the possibility that yesterday’s inordinate price decline reflected one or two players who had made huge bets prior to release of the stats, we will assume that the market overall was reacting to the fact that for the week ending March 20 supplies rose instead of falling as the consensus was looking for.
- As previously discussed, around this time of year the market moves from seasonal draws to seasonal builds, with the precise timing a bit uncertain depending of course upon the state of manufacturing activity, fuel switching, weather, production trends, and the weekly variation in import volume. Given the current state of the economy traders are naturally more sensitive to the deviation of weekly storage from expectations, but we would also argue that around this time of year the potential for estimation error and therefore price response is magnified. That is, at other times when we all expect a build or draw in storage in line with seasonal trends, prices respond to a degree whether the draw, for example, was larger or smaller than expected by, say, 10 bcf. This time of year, however, when a build instead of a draw occurs, even if the net deviation was also 10 bcf, the fact that *directionally* it defied expectations leads by definition to a larger price response.
- The timing was also a problem, not unrelated of course to expectations. If we look at the last five years, the table below lists the weeks when the market transitioned from a consistent seasonal draw in storage to a seasonal build. As can be seen, this transition tends to occur a bit later than the week ending March 20, i.e. the last week in March or later into April.

2008	Apr 4-Apr 11
2007	Apr 13-Apr 20
2006	Mar 31-Apr 7
2005	Mar 25-Apr 1
2004	Mar 26-Apr 2

- We hope to send out our latest monthly natural gas report this afternoon. Updating our balances still suggests that the current year-over-year working storage “overage” will get worse before it gets better. However, because we have revised down our domestic production and import expectations for the second half of the year, our forecast net build in working storage for 2009 as a whole is less than anticipated in last month’s report.

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