



HORNSBY & COMPANY, INC.

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Energy Risk  
Management Services

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## HIGHLY CONFIDENTIAL

April 1, 2009

### Good Morning

#### Overview

- Hydrocarbon prices declined overnight. **Crude oil down \$1.22 to \$48.44 per barrel; natural gas down \$0.025 to \$3.751 per mmBtu.**

#### News/Views

- We are quite sure it is our imagination, but if we did not know better yesterday's and this morning's crude oil market behavior seemed to reflect end of quarter window dressing, confirming oil's status as an important alternative asset class, something we have felt was justified for the last ten years or so. Granted, the NYMEX appeared to largely follow the S&P 500 around yesterday, which clearly reflected window dressing, which would imply correlation and not causality. In any event, all the smiles generated by a positive March seem to be waning this morning, with down markets thus far almost across the board signaling the start of a new quarter. We should find out shortly whether March's behavior was the start of something big, or merely a brief rally in a long-lasting bear market. We would certainly vote for the former and not the latter, but the equity and commodity gods will have with us what they will.
- Enough speculation and review of history. We must now face the prospect for oil and natural gas prices for the month of April and beyond to determine in turn the implications for the energy equities. We will publish our Monthly Equity Review later today or at the latest tomorrow, but we would briefly review where we have been coming from on the stocks. Back in late January/early February, we suggested that by the end of February investors should opportunistically increase their energy equity holdings, if our Base Case hydrocarbon price outlook had any merit whatsoever. We stated then that we did not wish to issue a precise "Buy" recommendation on one day given the overall market volatility and our inability to determine for each of you your risk tolerances. We felt we could better serve all of you by offering some reasonable timing parameters in the context of our forecast of oil and gas price recovery.
- Technically we were off by a week or two, with the exact bottom in the OSX coming on March 3 and the low for the OIX coming a day earlier. The S&P 500 bottomed almost a week later on March 9. Perhaps we have been close enough for government work, but in any event directionally we were correct to recommend increasing energy equity length in the first quarter. The bottom thus far for crude oil, however, occurred back in February, which in our years of experience is somewhat unusual since we have given more credit to the equities for discounting ahead of oil in either direction. Clearly an influence in this regard has been natural gas, which has provided a couple false starts and declined by 10.9% in March in contrast to prompt NYMEX crude oil's 10.9% gain. Prompt WTI in calendar March averaged \$48.06 per barrel, compared to our forecast for March issued at the end of January of about \$47.75 per barrel. This *was* close enough for government work, and perhaps we should just stop there.
- We believe it is better to keep pressing on, however, since April strikes us as a month, not as important as May or June from a seasonal standpoint but important nonetheless, when the crux of our thesis will either begin to manifest itself or not. That is, we should begin to see more of a seasonal price influence from gasoline. Also, there should be more evidence that crude oil stocks have in fact peaked and are finally

stabilizing, setting the stage for a progressive decline. Our U.S. refinery balances do not imply a substantial stock draw for the month, but if traders and funds sense that the worst has passed, prompt WTI has a good chance of recovering back above \$50.00 per barrel. Our Base Case forecast for calendar April has called for an average of “only” \$51.15 per barrel and, as previously discussed, was running above our outlook until recently. The key from the energy equity weighting standpoint will be if WTI can begin responding to more favorable fundamentals, if in fact they begin to develop, if the S&P 500 is destined to wallow in a trading range. If our balances are even close to the mark, such a scenario should develop, with rising crude prices supplemented if in fact the equity market continues to gain. For natural gas, we believe that a bottom is finally near or at hand, particularly if our WTI forecast remains reasonable.

W.H. Brown, III

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