



HORNSBY & COMPANY, INC.

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Energy Risk  
Management Services

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**HIGHLY CONFIDENTIAL**

**April 8, 2009**

**Good Morning**

**Overview**

- Hydrocarbon prices declined again overnight. **Crude oil down \$1.56 to \$47.59 per barrel; natural gas down \$0.017 to \$3.545 per mmbtu.**

**News/Views**

- Near-term optimism on most fronts has disappeared once again, with global equity markets sagging over first quarter earnings worries, exacerbated by yesterday's bearish public comments by a couple well-known investors. The market's response, however, has been to either *current* considerations or "ancient" history such as the first quarter, and thus we will see the extent to which equities are ultimately willing to give back much of March's gains. Energy companies in general no doubt will have weak first quarter earnings, but customarily given the visibility and "track-ability" of relevant macro data that determine operating earnings, by and large either bearish or bullish expectations are usually almost fully discounted by the time earnings are actually reported, particularly for the large international integrated companies.
- With first quarter prompt WTI averaging some 56% below the first quarter of last year and with Henry Hub natural averaging about 49% below, the market should be expecting operating earnings for the majors to be more than cut in half with independents breaking even at best, so any positive surprises should lead to stability in the stock prices, given the fact that the OIX closed yesterday more than 37% below the same point in 2008. We fully concede that the unfolding of our Base Case for the remainder of 2009 is critical for any material upside in the equities to be realized from here. Having said this, however, we must retain our conviction. In this regard, companies such as Devon are obviously not reacting so much to first quarter history as it is *current* natural gas prices and the expectations this implies for the second quarter, although we have just entered the time period and much can unfold over the next 2+ months, let alone the remainder of 2009.
- As we suspected, prompt WTI has repeated the pattern of late March, and the jury is still out whether \$40.00 crude is in the cards or some stability can return. April thus far has averaged about 40 cents per barrel below our Base Case, but sinking fast. Aside from weaker equity markets and a stronger dollar, yesterday afternoon's catalyst was the generally bearish stats from the API, which reported a much larger than expected 6.9+ million barrel crude oil build. This placed stocks on their basis at 364.7 million barrels, and the market, while weaker, is holding off a larger decline pending release of the DOE stats later this morning to either confirm the API magnitude or not. Stocks continued to fall at Cushing last week, but thus far the market is paying little attention in terms of either the flat price or the term structure. The API also reported that primary gasoline supplies rose by 902,000 barrels, while distillate stocks fell by a larger than expected 2.3 million barrels reflecting a rebound in implied demand, as we suspected. This time of year, however, crude oil and gasoline are the primary price determinants.

In terms of the dollar, as we have previously discussed the relationship with crude oil tends to come and go these days as we can see both by daily observation and statistical analysis. Just "for the sake of good order", however, we updated our model looking at prompt WTI versus the dollar/euro rate in isolation and it suggests that prompt WTI "should be" trading at about \$59.00 per barrel, confirming that the relationship *has* weakened

and that obviously other factors are now more dominant in the equation, including the equity market, current crude oil-specific fundamentals, as well as concerns about refined product demand and pressure on refining margins.

**W.H. Brown, III**

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