



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

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Good Morning

Overview

- Hydrocarbon prices fell over the weekend. **Crude oil down \$1.39 to \$50.85 per barrel; natural gas down \$0.070 to \$3.540 per mmBtu.**

News/Views

- Following an equity-driven and pre-weekend short covering rally on Thursday, crude oil prices fell over the weekend, in part in response to weaker S&P 500 futures thus far this morning. Perhaps a greater influence, however, has been the market's reaction to the latest monthly IEA report issued on Good Friday. The Agency slashed their expectations for 2009 world oil demand once again, this time by roughly 1.0 MMB/D, now implying a 2.4 MMB/D drop in demand this year versus 2008. The IEA claimed the downward revision was more than just conjecture, since preliminary data for a good part of the first quarter has come in much lower than the IEA previously anticipated. We will provide more specific comment tomorrow morning once we go through all the details today, but the IEA also suggested that March production for the OPEC "11" averaged some 25.57 MMB/D, a decline of 245 MB/D from February but still some 720 MB/D above the Organization's current target ceiling. In response to their latest outlook, whereas previously the IEA had suggested that inventories would decline by the middle of the year if OPEC held the line, their slash in demand despite another cut in forecast non-OPEC production leads the IEA to conclude that stocks will not be trimmed until year end.
- In previous reports we have suggested that in our view the IEA had already gone too far in revising their demand outlook, just as they had been far too optimistic in early 2008 with regard to the prospects for last year. Their latest view would place them even farther away from our expectations than previously. As we have also said, no one holds the patent on precise forecasts of the global oil balance, particularly for the longer term, which we believe is a futile gesture anyway and basically has no investment or trading relevance. Having said all this however, we are still of the mind that demand in 2009 will not sink as much as consensus expectations and, if OPEC holds the line, stocks will be falling before year end. If we are dead wrong, we can envision prompt WTI trading in a \$40.00-\$55.00 per barrel range for all of 2009. Prices would not recover by August to the extent implied by our fundamental balances, aided by significant non-commercial participation. At the same time, however, we do not believe they will fall to the lows of earlier this year since we believe the equity market is on the right track for a slow, albeit unsteady rise reflecting an eventual economic rebound. If so, non-commercial trading should provide sufficient support. Also, if we are wrong and crude oil inventories do not decline as soon as we expect, we do not believe they can rise much further in the highly visible and price-influential United States, barring a large retracement in refined product demand below current levels, (i.e. a "double-dip" economically speaking), forcing refiners to cut runs even further, backing up crude supplies in turn. Although once again we will reserve more detailed comments until tomorrow morning, at this point we do not conclude that world oil demand will decline this year to the extent the IEA anticipates, particularly given preliminary and anecdotal evidence for the first quarter.

With regard to the latest CFTC data, on April 7 when the prompt NYMEX crude oil contract settled at \$49.15 per barrel, non-commercials held futures-only net long positions of 12,493 contracts, a rise in net length from

the previous week by 5,947 contracts. Commercials held futures-only net short positions of 19,244 contracts, a rise in net shorts from the previous week by 7,793 contracts. In terms of natural gas, on April 7 when prompt NYMEX natural settled at \$3.562 per mmBtu, funds held futures-only net short positions of 126,205 contracts, a rise in net shorts from the previous week by 3,747 contracts. Commercials held futures-only net length of 81,653 contracts, a rise in net length from the previous week by 292 contracts.

W.H. Brown, III

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