



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

HIGHLY CONFIDENTIAL

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Good Morning

Overview

- Hydrocarbon prices firmed overnight. **Crude oil up \$0.35 to \$50.40 per barrel; natural gas up \$0.015 to \$3.643 per mmbtu.**

News/Views

- On Monday crude oil prices retraced much of last Thursday's gains, with factors including the negative monthly IEA report, a lack of any disruption over the long weekend leading to a reversal of Thursday's short covering, and perhaps some selling in response to the WSJ article discussing the longer-term prospects for U.S. gasoline demand which, of course, is ancient news as far as all of us are concerned. A secular decline in U.S. gasoline demand for at least the next couple years has been integral to our Base Case balances for over two years. The article cited an Exxon outlook suggesting a shrinkage of demand by some 22% between now and 2030, a time frame which, quite frankly, implies a compounding of potential error and is irrelevant from an investment and trading standpoint. We would point out, however, that during the hype about the need for more refining capacity as oil price surged, ExxonMobil continued to emphasize that no new grass roots refineries were needed, a thesis with which we totally agreed.
- As mentioned yesterday morning we wanted to follow up and discuss the latest IEA outlook in more detail in the context of our own Base Case forecast, which we are in the process of reviewing and revising where deemed appropriate based on updated statistics and anecdotal evidence as well as our own assumptions for the remaining three quarters of 2009. As mentioned yesterday, the IEA now believes world oil demand will fall by some 2.4 MMB/D this year. As previously discussed, the IEA is bound to amend their outlook whenever the IMF revises their economic forecast, and this was part of the reason for revising down world oil demand for this year since the IMF has become less optimistic about the prospects for economic recovery in 2009. However, most critical in our view is the quarterly pattern of world oil demand. In this regard, the IEA estimates that world oil demand fell by some 3.2 MMB/D in the first quarter, which is now history except for the likelihood of data revisions, e.g. when the "near final" monthly U.S. numbers become available for February and March.
- The depth of the estimated demand collapse in the first quarter is quite severe and, as the IEA discusses, has major potential implications for the path of global stocks as the year proceeds if in fact their first quarter estimate is anywhere close to the mark in terms of actual *consumption*. The IEA estimates that within the first quarter global demand decline of 3.2 MMB/D, OECD oil demand fell by 5.3%, or about 2.6 MMB/D. We have estimated that first quarter OECD oil demand fell by 2.8%. The IEA estimated that non-OECD oil demand in the first quarter fell by 1.6%, or around 600 MB/D, whereas we estimate non-OECD oil demand was actually up slightly based on preliminary March evidence for China. When we incorporate our non-OPEC supply estimates, which are more optimistic than the IEA who now expect a decline this year after revising down potential biofuels volumes, we believe there was a minimal net global stock change in the first quarter when including our estimated net build in floating storage, compared to the "normal" net draw of several hundred thousand barrels daily.
- We are not necessarily disputing the data, but we need to reserve final judgment until more final numbers are in for January and February, as well as data for March to round out the first quarter. In addition, there

are two factors that may be at work here that could impact the final outcome, underlying fundamentals, and psychology. The first is the possibility of a “v-shaped” economic recovery that will lead to a snapback in world oil demand by the second quarter, but we are not counting on this, nor should we. The second, more important factor is the strong possibility, one that we have periodically observed over the last number of years, that reported *implied* demand data around the world ***reflect inordinate de-stocking on down the supply chain.*** Whereas the crude oil contango led to a net global build in crude oil supplies, in terms of refined products distributors, as well as refiners, have had to adjust to lower final consumption, or “burn”, ***thus leading to a possible multiplied negative impact over the last few months when observed as reported, implied demand. If so, true underlying consumption in the first quarter has been understated via the available statistics, suggesting a rebound in the second quarter even without any underlying improvement in final consumption once non-primary de-stocking ends.***

W.H. Brown, III

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