HIGHLY CONFIDENTIAL

September 8, 2008

Good Morning

Overview

- Hydrocarbon prices rose over the weekend. **Crude oil up $0.79 to $107.02 per barrel; natural gas up $0.174 to $7.623 per mmBtu.**

News/Views

- Assuming OPEC does not decide to officially increase production, a nil-odds scenario, there are a few factors which are likely to keep prompt WTI within our previously discussed $100.00-$110.00 per barrel trading range which once again could easily end up as $105.00-$115.00 per barrel. Natural gas on its own and in sympathy is likely to retain support above $7.00 per mmBtu, still quite undervalued relative to oil in our view. First off, although it was a known entity last week, attention has focused on Hurricane Ike and its possible path into the Gulf of Mexico. Some analysts are already suggesting that Ike could lead to a greater influence on refinery operations and GOM production than Gustav, and thus for those so inclined to trade on this type of expectation, hope springs eternal. Our money still lies with the oil companies and their preparedness for such scenarios, however. The weekend bailout of Freddie and Fannie provided some hope of avoiding more deteriorating credit conditions, right or wrong, thus leading many to believe that economic activity, and thus oil demand, may not weaken further. A bit softer dollar is also providing a catalyst to buy, and overall events and news are tending to legitimize the technical support that was found at close to $105.00 per barrel. Pondering the outcome of the OPEC meeting and weekly stats likely reflecting the "Gustav effect" should also preclude prompt WTI from falling below $100.00 per barrel, which would remain consistent with our Base Case scenario which does not envision sub-century WTI until the first quarter of next year for reasons previously discussed.

- In terms of the OPEC meeting, with oil prices showing some signs of short-term stabilization it tends to increase the odds of our best-guess outlook for the meeting which was expanded upon via our intra-day e-mail sent out on Friday. For those of you who may have missed it, we had received updated input with regard to likely September and October Saudi production levels. September appears on its way to average about 9.25 MMB/D with October slated at around 9.1-9.2 MMB/D, all including the Neutral Zone. These averages imply a decline from summer Saudi levels of roughly 9.5 MMB/D or so. The peak still fell short of Ali Naimi's stated target of 9.7 MMB/D mentioned at the June 22 Jeddah meeting when oil prices were substantially higher and on their way to $145.00-$150.00 per barrel, but an unwillingness to offer incremental discounts led to actual levels falling short of publicly-stated targets. The decline in liftings for September and October is fully consistent at this point with our Base Case global balances which imply a need for Saudi deliveries over the next two quarters averaging some 8.9-9.1 MMB/D, since our global model "solves" for desired commercial inventory levels taking into account demand, credit conditions and term structure. This reduction in liftings even from September and October levels would be necessary to preclude any "involuntary" crude oil inventory accumulation. Thus, with prices for the time being halting their decline, it may lend additional support to an OPEC meeting scenario which agrees to quota compliance and not pro-rata official reductions, since the largest quota "violator" is Saudi Arabia who will end up "complying" in any event due to market forces, irrespective of OPEC's official actions.

- In terms of the latest CFTC data, on September 2 when the prompt NYMEX crude contract settled at $109.71 per barrel, non-commercials held futures-only net length of 14,331 contracts, a decline in net length from the previous week by 5,835 contracts. For natural gas, on September 2 when prompt NYMEX natural settled at $7.261 per mmBtu, funds held futures-only net short positions of 161,076 contracts, a rise in net shorts from the previous week by 4,932 contracts, setting yet another such all-time record for the sixth week in a row.

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