



HORNSBY & COMPANY, INC.

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Energy Risk  
Management Services

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## Monthly Energy Equity Review and Outlook

February 1, 2008

### Summary

Just about everyone we know is quite glad that January is over. Unless one was net or gross short almost anything when the month began, returns were hurt by either market direction or pure volatility. Energy stocks, as measured by the performance of the OIX and OSX, turned in among the worst single monthly declines in absolute terms of all time. To add insult to injury, both the OIX and OSX fell relative to a weak S&P 500. Generally declining crude oil prices during the month, offsetting stronger natural gas prices, accounted for some of the energy equity weakness of course, as traders who buy or sell the stocks coincident with commodity price movements decided to bail following the strong performance of 2007. To quantify all this, in January the OIX and the OSX declined by 11.7% and 16.2%, respectively, while the S&P 500 fell by 6.1%. Prompt WTI declined by only 4.4% during the month, while the prompt NYMEX natural gas contract rose by 7.9%.

Thinner refining margins also played a major role in declining stock prices, consistent with our conservative downstream thesis for this year. In tandem with overall equity market weakness, however, energy equities suffered from concerns of a U.S. recession, despite aggressive Fed moves to stave off such a development. We are of the school that the Fed is limited in how quickly it can stimulate the economy, however, and surging consumer energy prices last year in combination with credit and housing concerns lead to a consumer confidence crisis that is difficult to overcome over the short term.

Having said all this, our perspective on our energy sector remains one of looking for the appropriate timing to reestablish our short-term "Buy" on the group. We are in the process of working through our 2008 earnings estimates for our companies as the fourth quarter comes in within the context of our crude oil and natural gas price outlook for 2008 which, despite legitimate economic concerns, lies at the upper end if not above current consensus expectations.

We strongly emphasize that our more robust price outlook in terms of crude oil has little to do with fundamentals, but rather in response to what we observed to be a sizeable inflow of passive length into crude oil in January that is unlikely to exit en masse this year. Even if U.S. refined product demand turns negative, which we believe there is a good chance that it will, as long as global oil demand retains a modicum of net growth the "story" will remain intact for many commodity investors, particularly if equity markets continue to turn in lackluster returns.

Information contained herein is believed to be reliable but its accuracy cannot be guaranteed. Past performance is not indicative of future results and the risk of loss is substantial in futures trading. Hornsbly & Company, Inc. and W.H. Brown may, from time to time, have positions in the futures market relative to these recommendations.

**Select Energy Equity Performance,  
January 2008  
(Percentage Gain/Loss)**

<b>Major International Oils</b>		<b>Select Independent Producers</b>	
BP	-12.6	Anadarko	-11.0
Chevron	-10.8	Apache	-11.3
ConocoPhillips	-9.3	Chesapeake	-5.2
ENI	-10.7	Devon	-4.3
ExxonMobil	-7.8	Noble Energy	-8.7
Marathon	-22.7	Pioneer	-14.2
Royal Dutch	-15.2	Plains	-10.1
Total	-11.9		

**Select Service/Drilling Equities**

Baker Hughes	-20.0
Diamond Offshore	-20.7
Ensco	-14.3
Halliburton	-12.5
Rowan	-13.7
Schlumberger	-23.4
Smith	-26.8
Tidewater	-3.5
Transocean	-14.6

Putting it all together, despite our view of WTI for 2008 as a whole, we believe that over the next two months the odds are high that the prompt NYMEX crude oil contract will fall toward \$80.00 per barrel, and possibly lower to test last fall's support at \$78.00 per barrel or so, before experiencing a second quarter price rebound, which as previously discussed is expected to be somewhat muted this time around reflecting our more conservative outlook for the U.S. gasoline balance. **As such, at this point we will still keep our "short-term powder" dry, looking for the right timing to move to an overweighting in energy equities between now and the end of March.**

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