Monthly Energy Equity Review and Outlook

February 3, 2009

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Summary

In last month's energy equity review, we suggested that January could be characterized by some retracement in the equity market overall and what we termed a "flattish" picture for energy equities. This scenario turned out to be not unreasonable, with unfortunately the S&P 500 declining by some 8.6% for the month. The OIX fell by 4.8%, but the OSX turned in a gain of 5.0%. These performances were in the context of a 6.5% decline in prompt WTI and a drop of 25.1% in the prompt NYMEX natural contract. Also in last month's report, however, we stated "we anticipate another 'bottom' in both the equities and commodity over the next month or so, setting the stage for a seasonal price recovery as we move through the second quarter".

We would retain that view, and as we have indicated in our morning notes, we would now place both the equities and the commodity on the "front burner", to monitor and begin to selectively increase long positions, starting with the major integrated oils and increasing beta by adding other sectors as we move through February.

We strongly emphasize, however, that we see no "instant catalyst" that will start the ball rolling with a great deal of fanfare. Rather, as previously discussed we are looking for some modest seasonality in crude oil prices this year, which will lead to higher prices in the second quarter relative to the first. Our seasonality is more premised on supply factors and a progressive reduction in crude oil inventories than a sudden turnaround in refined product demand. As previously discussed, the equation also requires a greater leap of faith and confidence in OPEC than we have been willing to give the Organization since our bullish call when Hugo Chavez first came to power in 1998. His coordination with Saudi Arabia in 1999 in combination with an eventual end to the Asian financial crisis was paramount in leading to a recovery in WTI from less than $12.00 per barrel in February of that year to almost $27.00 per barrel by year end. For this month, however, if we are anywhere close to the mark it will be a process whereby equities can be accumulated over the course of February, requiring some patience and opportunistic decision making.

Select Energy Equity Performance,
January 2009
(Percentage Gain/Loss)

Major International Oils

BP	-9.1
Chevron	-4.7
ConocoPhillips	-8.2
ENI	-11.4
ExxonMobil	-4.2
Hess	+3.7
Marathon	-0.5
Royal Dutch	-7.0
Total	-10.0

Select Independent Producers

Anadarko	-4.7
Apache	+0.6
Chesapeake	-2.2
Devon	-6.3
Noble Energy	-0.6
Pioneer	-9.5
Plains	-9.1

Select Refining Equities

Frontier	+13.1
Sun	+6.6
Tesoro	+30.8
Valero	+11.5

Select Service/Drilling Equities

Baker Hughes	+3.9
Diamond Offshore	+6.5
Ensco	-3.6
Halliburton	-5.1
Rowan	-20.4
Schlumberger	-3.6
Smith	-0.8
Tidewater	+3.3
Transocean	+15.6

Although we are constructive on the equities when looking at a time frame through the end of the year, for the month of February we would guess it may be a mixed performance as the equities try and decide whether to consolidate for a move up or simply languish indefinitely. Hopefully, however, by the end of the month the equities in general will be demonstrating clear signs they are poised for attractive gains through at least the second quarter.