



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

Monthly Energy Equity Review and Outlook

March 5, 2009

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Summary

Our overall thesis for the energy equity sector for 2009 has been so bold as to suggest a trough for both the stocks and underlying commodities in February. If reasonable, such an inflection point would be followed by a progressive recovery as we move through the third quarter of this year. Clearly, the performance last month provided an opportunity if our Base Case has any merit to begin with. In February, the S&P 500 turned in a dismal decline of 11.0%, the largest monthly drop since last October. Last month the OIX fell by 11.2%, while the OSX held up somewhat better by falling “only” 6.1%. Within this equity context, prompt WTI actually rose by 7.4%, while prompt NYMEX natural declined by 5.0%.

As we issue this report, March has not begun on a strong note, with the S&P 500, the OIX and the OSX all falling from the end of last month. Dismal economic news emerges unabated, with investors unsettled by either non-specific or conflicting words out of Washington in terms of “solving” the financial debacle and the plight of the automotive industry.

Within this context, in recent reports we have discussed the various factors that could help “de-link” crude oil from the S&P 500, if in fact the equity market is destined to either stagnate or decline further if 700 on the S&P 500 is “violated with conviction”. From our standpoint, it would be nice to see hydrocarbons marching to their own fundamental drummers once again, instead of periodically being led around by the nose by the equity market as a result of hedge fund correlation trading.

We have suggested that if we are correct in forecasting that crude oil inventories in the visible U.S. market will stabilize and subsequently decline, then prompt WTI will rise further in absolute terms, aided toward the end of the second quarter and into the third by a flattening term structure which will induce further destocking, as well as a more substantial move by funds and others back into passive length once again. In addition, we believe the U.S. natural gas balance will progressively improve in the second half of the year as dry gas production declines and manufacturing activity stabilizes, although we fully concede that the year-over-year working storage comparisons will become more onerous over the short term before the inflection point arrives. If our outlook is anywhere close to the mark, then energy equities in general should recover from the lows of February and early March.

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

Major International Oils		Select Independent Producers	
BP	-9.7	Anadarko	-4.9
Chevron	-13.9	Apache	-21.2
ConocoPhillips	-21.4	Chesapeake	-2.2
ENI	-5.6	Devon	-29.1
ExxonMobil	-11.2	Noble Energy	-6.9
Hess	- 1.7	Pioneer	-0.3
Marathon	-14.5	Plains	-9.4
Royal Dutch	-10.7		
Total	-5.2		
Select Refining Equities		Select Service/Drilling Equities	
Frontier	-4.4	Baker Hughes	-12.0
Sun	-27.8	Diamond Offshore	-0.2
Tesoro	-14.3	Ensco	-10.2
Valero	-19.7	Halliburton	-5.4
		Rowan	-4.3
		Schlumberger	-6.7
		Smith	-5.4
		Tidewater	-15.1
		Transocean	+9.4

In last month's report we suggested the month of February would be characterized by a mixed performance for energy equities, but this was an obvious understatement given the overall dismal state of equity markets. For March, as discussed above we have started on a weak note, but if our Base Case has any merit whatsoever, then by the end of the month energy equities in general should be trading at higher values than prices prevailing as we issue this report.