



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

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Monthly Energy Equity Review and Outlook

Summary

In last month's equity review we suggested that following favorable February performance the energy equity sector overall was likely to tread some water in March. Depending upon the subsector and stock, our thoughts turned out to be somewhat of an understatement. Last month, the S&P 500 declined by 0.6%, while the OIX fell by 3.4% with the OSX gaining by 0.4%. These results lie in the context of a 0.3% decline in WTI but an 8.7% rise in natural gas prices. Refining margins were weak and crude oil's price change was minimal, helping to explain the decline in the OIX, while a stronger natural gas market obviously helped the drilling and service sector. The dismal greenback dropped by 4.0% against the euro, helping to limit WTI's loss.

Just about everyone is glad the first quarter is over, and hopefully the equity market will fare better in the next three months, recession, real or assumed, notwithstanding. Even if a recession as technically defined is underway, the stock market is "supposed" to be a leading economic indicator and should begin to discount better growth prospects and more stable financial entities in 2009. In terms of hydrocarbon prices, despite all the discussion of a potential unwinding of speculative length, thus far in April crude oil remains in a trading range, without a settlement below \$100.00 per barrel since March 4. More recently, periodic surges reflecting fund buying have occurred, largely catalyzed by a weaker dollar but also the fact that U.S. gasoline inventories have turned the corner, as they invariably and seasonally were destined to do. The prompt NYMEX contract, however, has yet to revisit its record settlement high of \$110.33 per barrel set on March 13.

With regard to natural gas, substantial short covering by active CFTC-reporting funds has led as we suspected to a significant price recovery. Although if crude oil begins to work its way below \$100.00 per barrel natural gas prices will likely weaken as well, as we have previously discussed we would look for natural to remain firm *relative* to WTI.

Forecasting oil prices is hazardous duty these days if one is purely fundamentally driven, but we have long recognized that the financial funds flow influence will remain a major factor. With regard to fundamentals, we look for U.S. oil demand to continue to weaken, with further builds in crude oil stocks and a maintenance of gasoline inventories well above last year. In terms of the financial influence, however, we are not looking for a wholesale dumping of non-commercial crude oil length that would pull WTI back below \$80.00 per barrel at this time. If the dollar begins to stabilize as we assume, however, we believe it would imply settlements below \$100.00 per barrel once again.

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

Major International Oils

BP	-6.5
Chevron	-1.5
ConocoPhillips	-7.9
ENI	-1.2
ExxonMobil	-2.8
Marathon	-14.2
Royal Dutch	-3.5
Total	-1.8

Select Independent Producers

Anadarko	-1.1
Apache	+5.3
Chesapeake	+2.1
Devon	+1.6
Noble Energy	-5.9
Pioneer	+9.7
Plains	-1.6

Select Refining Equities

Frontier	-23.7
Sun	-14.1
Tesoro	-19.2
Valero	-15.0

Select Service/Drilling Equities

Baker Hughes	+1.8
Diamond Offshore	-3.7
Ensco	+4.6
Halliburton	+2.7
Rowan	+2.2
Schlumberger	+0.6
Smith	+1.9
Tidewater	-1.9
Transocean	-3.8

In terms of April prospects for the energy equity sector, the stocks have started the month on a strong note. We would suggest that the sector will at least hold its own for the time being. We have been looking for opportunities to upgrade the entire sector to “Buy” for several weeks now, but simply have not felt that the risk/reward ratio became as favorable as we would like to see. At this junction, therefore, our official “Buys” remain reserved for the refining sector which we upgraded on March 18. The severe decline in these equities since the beginning of the year in the context with our expectations that the gasoline balance would improve despite weaker demand made such a recommendation the most favorable from the standpoint of risk versus reward.

W.H. Brown, III

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