HORNSBY & COMPANY, INC.

www.hornsbyco.com

Energy Risk
Management Services

Monthly Energy Equity Review and Outlook

June 2, 2009

Monthly Energy Equity Review and Outlook

Summary

We seem to have a gift for the understatement. In our last report at the beginning of May we stated: *"We believe that if our crude oil price forecast for the month ends up as reasonable, the Street will revise up their price outlooks and earnings assessments, providing a positive environment for the energy sector in general. The boost to energy will also be aided by the possibility of portfolio rotation from the sectors that performed the best in March and April into those energy equities such as the major integrated oils that have lagged the move in the overall energy sector to date"*. Our bullish WTI forecast average for the month of May was not only reached it was exceeded by more than $4.00 per barrel. May's actual average of $59.21 per barrel was close to Base Case expectations for June of $59.30 per barrel. Therefore, the producing and drilling/service sectors tended to do the best in general while the foreign-based major international integrated oil companies also did well, aided by a weaker dollar, but unfortunately ExxonMobil and Chevron lagged the overall energy sector move. One of the several reasons prompt WTI exceeded our outlook, as discussed in this morning's note, was what we have termed the "Naimi factor", i.e. his and King Abdullah's suggestion prior to the OPEC meeting that global economic activity had improved sufficiently to "support" WTI at $75.00-$80.00 per barrel, the target they had first annunciated last autumn before economic and financial chaos unfolded to the extent that it did.

Our Base Case set forth in January assumed that WTI in August would average in excess of $70.00 per barrel. At the same time, however, our outlook implies such a level will not be sustainable through the reminder of 2009, given what even *we* believe to be a tenuous economic recovery. In addition, prices much beyond $70.00 will certainly elicit more barrels out of OPEC. Even in the case of Saudi Arabia, we have suggested that Saudi Aramco will begin to sell more barrels at these price levels *if* such prices also reflect rising refiner nominations in addition to the financial factors we have laid out previously. At this point, despite May prices averaging above even *our* expectations, we are not inclined to revise our outlook for the remainder of the second quarter. In our view Naimi's public price target will be used by funds to take pause once we get to $70.00+ per barrel whether it comes in June or August. We also believe the Obama Administration will be less tolerant of crude oil approaching $100.00 per barrel once again than the previous Administration. Returning to May, looking at the numbers, the S&P 500 managed to gain by 5.3%, while the OIX and OSX rose by 12.7% and 17.1%, respectively. Prompt WTI

increased by 29.7% during the month, while prompt NYMEX natural managed to recover by 17.3%.

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

Major International Oils

BP	+16.6
Chevron	+0.9
ConocoPhillips	+11.8
ENI	+13.6
ExxonMobil	+4.0
Hess	+21.5
Marathon	+7.3
Royal Dutch	+18.0
Total	+15.9

Select Independent Producers

Anadarko	+11.0
Apache	+15.6
Chesapeake	+15.0
Devon	+22.0
Noble Energy	+4.8
Pioneer	+21.6
Plains	+49.9

Select Refining Equities

Frontier	+37.5
Sun	+14.8
Tesoro	+11.1
Valero	+12.8

Select Service/Drilling Equities

Baker Hughes	+9.8
Diamond Offshore	+16.4
Ensco	+37.5
Halliburton	+13.4
Rowan	+31.1
Schlumberger	+16.8
Smith	+12.9
Tidewater	+10.2
Transocean	+17.8

As we issue this report energy equities, the S&P 500, and hydrocarbon prices are all beginning the month on a positive note. As we have discussed it would not surprise us to see prompt WTI test the waters at $70.00 per barrel or so over the near term, particularly since traders and funds will obviously have the blessing of Ali Naimi. Energy equities should respond accordingly. Although we see higher prices later in the summer, it would not surprise us to see the first test of $70.00 per barrel fail. The market may then "back and fill" for a while, particularly if economic data do not improve from the current "deltas". If so, it may end up a bit of a mixed month for the energy equities after their strong gains of the last few months, i.e. stronger earlier in June followed by some "backing and filling" of their own.