



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 energy equity review we suggested that following the strong April performance it would not surprise us to see the sector ease a bit, but we also believed that investors were waiting for any weakness in the stocks as an opportunity to buy. After trading water and/or slight easing early in the month, investors and traders alike indeed came in and bought, leading to another month of strong performance in general for energy equities, both in absolute terms and relative to the S&P 500. The OIX and OSX peaked for the time being on May 20 which, perhaps not coincidentally, occurred one day in advance of the peak thus far in the prompt NYMEX crude oil contract at \$133.17 per barrel.

In reviewing performance for the month of May, the S&P 500 managed to increase by 1.1%. In contrast, the OIX rose by 5.6% for the month, while the OSX gained by 7.3%. This equity performance was in large part a reflection of stronger hydrocarbon prices during the period. WTI rose by 12.3% in May, while Henry Hub natural gained by 7.9%.

We have always stated that in our view the equities tend to be "smarter" than the commodity, with the stocks discounting upcoming changes to industry fundamentals in advance of commodity prices, and recent experience has borne out our thoughts in this regard. It is difficult to precisely gauge current sentiment, but we detect that investors and traders are now substantially more concerned about the potential detrimental impact on oil demand from higher prices than previously. This perspective not only applies to the OECD, where demand has been faltering for some months now, but also to many countries in the non-OECD group. From a policy standpoint, Congress is pointing every finger possible, and it appears that the CFTC will try to more closely monitor trading conditions. As the November Presidential election approaches, we would expect the candidates to trade punches on an appropriate energy policy, with Senator Obama concentrating on the demand and regulatory issues.

On balance, given two strong back-to-back months of performance in the context of gains for 2008 thus far both in absolute terms and relative to the market, it would not surprise us to see energy equities, on average, retrace at least modestly in June, setting the stage for the second half of the year.

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

Major International Oils

BP	-0.9
Chevron	+3.1
ConocoPhillips	+8.1
ENI	+5.9
ExxonMobil	-4.6
Hess	+15.6
Marathon	+12.8
Royal Dutch	+6.5
Total	+3.9

Select Independent Producers

Anadarko	+12.6
Apache	-0.5
Chesapeake	+5.9
Devon	+2.2
Noble Energy	+12.0
Pioneer	+24.4
Plains	+14.8

Select Refining Equities

Frontier	+21.2
Sun	-4.2
Tesoro	-1.2
Valero	+4.1

Select Service/Drilling Equities

Baker Hughes	+9.6
Diamond Offshore	+8.8
Ensco	+12.7
Halliburton	+5.8
Rowan	+13.2
Schlumberger	+0.6
Smith	+3.1
Tidewater	+4.8
Transocean	+1.9

Reviewing the energy subsectors and individual stocks in May, it was somewhat of a mixed bag for the integrated group, with ExxonMobil lagging in a continued response to expectations of moderating production growth and investor concerns over corporate strategy. Hess has benefited from both strong hydrocarbon pricing as well as optimism over its equity output profile. The independents broadly gained once again as oil and gas prices rose, while the refining sector turned in a mixed bag, although even under our conservative demand environment we would look for this sector to perform better in the months ahead. Investors were somewhat more selective within the drilling/service sector, but the stocks generally built on their healthy momentum from April.

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