



HORNSBY & COMPANY, INC.

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Energy Risk  
Management Services

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**July 2, 2009**

## **Monthly Energy Equity Review and Outlook**

### Summary

Once again our apparent gift for the understatement has been exemplified by market behavior. In our last monthly equity review published on June 1 we stated, “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”. Our statement was made in the context of our expectation that prompt WTI would test the waters at \$70.00 per barrel, and we suggested at the time that it would not surprise us to see the first such test fail. In reality, energy equities started June on a positive note, but it was relatively short lived, with the peak in both the OIX and OSX generally coming within the first few days. Thereafter the equities broadly headed south, with refiners particularly hard hit. Prompt WTI not only tested the waters at \$70.00 per barrel, but somewhat higher at almost \$73.00 per barrel. Thus far, however, it has “failed” insofar as worrisome economic news and bearish weekly product stats have several times pulled prompt WTI back down below \$70.00 per barrel. Such behavior is occurring as we issue this report in response to disappointing jobs data.

For the month overall, therefore, energy equities in general were disappointments to those long, while crude oil realized a net gain for the month. Natural gas continued to languish with a couple rallies failing to have any “legs”. To quantify, for June the S&P 500 was about flat. The OIX declined by 6.7% while the OSX fell by 9.5%. In terms of the hydrocarbons, prompt NYMEX crude oil gained by 5.4%, while prompt NYMEX natural declined by 3.1%.

As we have previously suggested, the third quarter of any year, particularly August and September, usually contain some surprises that come out of the woodwork in either direction. At the present time, the markets are rethinking how much they wish to discount an inevitable economic recovery, with more and more evidence supporting our “stretched u” type of configuration. In terms of crude oil, if WTI were to remain below \$70.00 per barrel but find support at \$60.00 per barrel, it would be perfectly consistent with our long-standing Base Case. Our outlook then assumes that for August WTI recovers back above \$70.00 per barrel before beginning a retracement lasting through year end. At this point we see no reason to modify our forecast. If reasonable, then before the end of the third quarter we would expect a more sustainable recovery in natural gas prices, reflecting a progressive reduction in the year-over-year working storage “overage” that now exists.

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

**Major International Oils**

BP	-3.7
Chevron	-0.6
ConocoPhillips	-8.2
ENI	-2.2
ExxonMobil	+0.8
Hess	-19.3
Marathon	-5.5
Royal Dutch	-6.9
Total	-5.9

**Select Independent Producers**

Anadarko	-5.0
Apache	-14.4
Chesapeake	-12.5
Devon	-13.8
Noble Energy	-0.9
Pioneer	-9.3
Plains	-3.2

**Select Refining Equities**

Frontier	-25.0
Sun	-23.8
Tesoro	-24.9
Valero	-24.5

**Select Service/Drilling Equities**

Baker Hughes	-6.7
Diamond Offshore	-1.5
Ensco	-10.3
Halliburton	-9.7
Rowan	-5.6
Schlumberger	-5.5
Smith	-11.8
Tidewater	-10.1
Transocean	-6.5

The scenario we have outlined above under our Base Case implies some difficulty in determining the path of energy equities through the third quarter. If we are correct that prompt WTI will trade for the month of July in a range of \$60.00-\$70.00 per barrel, then we would not be expecting a particularly robust performance for the stocks. On the other hand, if we are also correct that crude oil and natural gas prices will recover in August, then we would be looking this month for what should be a short-term bottom in the equities followed by an attractive trading move up before the end of September.

Information contained herein is believed to be reliable but its accuracy cannot be guaranteed. Past performance is not indicative of future results and the risk of loss is substantial in futures trading. Hornsby & Company, Inc. and W.H. Brown may, from time to time, have positions in the futures market relative to these recommendations.