



HORNSBY & COMPANY, INC.

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Energy Risk
Management Services

Monthly Energy Equity Review and Outlook

September 5, 2007

Summary

August turned out to be a somewhat volatile month for energy equities, influenced by the overall fate of the equity market and related concerns about the pace of economic activity amidst subprime woes, as well as the decline and subsequent recovery in oil prices while natural gas values continued to erode. These forces all pushed and pulled at various times, sometimes together, sometimes not, but by the end of the month energy equities in general managed to marginally underperform the S&P 500 in August.

We were anticipating the opportunity to reinstate our short-term “Buy” on the energy sector when we saw that the subprime crisis was mounting and WTI slipped below \$70.00 per barrel. Overall, the best opportunity for doing so came on August 16, but the intraday drop to target prices was so brief that, as previously discussed, it would have been unrealistic to assume that our clients could have built up sufficient position size to warrant the issuance of an official recommendation. We honestly felt that either a bit more downside was in the cards, or at the least the stocks could have spent a few days at these lower levels to allow sufficient time to buy in size. We nevertheless retained our long-term “Buys” on the stocks, and are gratified that the stocks have recovered off their lows, although still shy of the prices when we recommended on July 24 that some short-term money come off the table and/or positions be hedged.

The remainder of the year looks cloudy, to say the least. Our fundamental refinery balances are still calling for further declines in crude stocks, which as previously discussed may be incorrectly interpreted by the consensus as a tightening of the world crude oil balance. Nonetheless, we fully recognize that funds may decide to build up net length once again, firming prices back toward the previous record nominal high for WTI. Our numbers also suggest some improvement in natural gas prices from current levels. As such, one would normally expect energy equities to recover further in sympathy.

On the other side of the coin, economic uncertainty is likely to continue, leading to equity markets possibly trading in a range, if not declining from current levels. We also still expect the visible IEA to reduce their outlook for world oil demand. All these forces combined could lead on balance to a further recovery in energy equities, but we do not see the upside of sufficient strength over the short-term to reinstate our short-term “Buys” at this time. Alternatively, as also previously discussed if a downdraft in equity markets occurs with a sympathetic decline in energy stocks, we would be inclined to reinstate our short-term “Buys”, even if crude oil falls in sympathy.

**Select Energy Equity Performance,
August 2007
(Percentage Gain/Loss)**

Major International Oils

BP	-2.9
Chevron	+2.9
ConocoPhillips	+1.3
ENI	-1.1
ExxonMobil	+0.7
Royal Dutch	-0.3
Total	-4.5

Select Independent Producers

Anadarko	-2.7
Apache	-4.3
Chesapeake	-5.2
Noble Energy	-1.8
Pioneer	-9.8
Plains	-13.1
Pogo	-6.5

Select Service/Drilling Equities

Baker Hughes	+0.1
Diamond Offshore	+1.9
Ensco	-11.2
GlobalSantaFe	-1.6
Halliburton	-4.0
Rowan	-11.0
Schlumberger	+1.9
Smith	+9.1
Tidewater	-4.3
Transocean	-2.2

Reviewing specific August performance in the context of oil and gas prices, the S&P 500 rose by 1.3%, while energy equity indices turned in a mixed performance, with the OIX index declining by 1.0% and the OSX index rising by 1.0%. In terms of crude oil and gas prices during August, WTI fell by 5.3%. The prompt NYMEX natural gas contract dropped by 13.6% last month, suffering once again from rising storage and a lack of any material impact from Gulf of Mexico hurricane activity.

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