



HORNSBY & COMPANY, INC.

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Energy Risk  
Management Services

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**November 2, 2007**

**Monthly Energy Equity Review and Outlook**

Summary

As we have previously discussed, the consensus now universally anticipates \$100.00 per barrel WTI, but we still believe that “bogie” is too “nice and round” to be achieved. Our guess is that we will either peak short of the number or events will blow us right through it before the end of the year. We say this simply in the context of observed commodity price behavior over the years. If the market falls short of \$100.00 per barrel, it is because no one wishes the honor of being the last buyer, particularly in the context of U.S. economic activity that has become increasingly questionable. If one has been long, why risk the last \$3.00-\$4.00 per barrel following a \$25.00 per barrel profit since August? If one is thinking of buying, unless one expects the Arabian Gulf to erupt in flames, is really worth the risk? On the other hand, if for whatever reason we actually do trade up to *exactly* \$100.00 per barrel, it would not take much above this “bogie” to trigger commodity fund buy stops, propelling the market higher under the assumption that demand is completely inelastic and that OECD economic growth will begin to accelerate.

While this discourse is all well and good if one trades the commodity, more importantly to us and to most of you is the performance of the energy equities and, for that matter, the equity market overall in the context of hydrocarbon price behavior. In this regard, energy equities have had another good year thus far, and while we maintain our long-term “Buy” on the group, we remain concerned about the preservation of your year-to-date returns as we move through November and December, particularly on an absolute price basis.

Our fundamental balances still suggest some rebuilding of global stocks before year end, particularly in the visible United States, and as we fully anticipated refiners had already lined up incremental supplies well before OPEC came up with their latest agreement, with data revealing oil on the water prior to November 1. While China, India, and OPEC can continue to fuel global oil demand growth, OECD oil demand continues to either decelerate or decline outright. While the consensus is paying little attention to this at present, if inventories *do* begin to rebuild, invariably attention will be paid when analysts feel it prudent to do so.

As third quarter earnings emerge for the integrated oils, the market is seeing that rarely can the companies have all cylinders firing at once. Other energy sectors are turning in somewhat better results relative to consensus expectations, and at the present time the energy sector appears to be in a “digesting mode” overall.

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

**Major International Oils**

BP	+12.5
Chevron	-2.2
ConocoPhillips	-3.2
ENI	-0.9
ExxonMobil	-0.6
Royal Dutch	+6.5
Total	-0.5

**Select Independent Producers**

Anadarko	+9.8
Apache	+15.3
Chesapeake	+12.0
Noble Energy	+9.3
Pioneer	+13.4
Plains	+15.2
Pogo	+12.1

**Select Service/Drilling Equities**

Baker Hughes	-4.0
Diamond Offshore	-0.1
Ensco	-1.1
GlobalSantaFe	+6.6
Halliburton	+2.7
Rowan	+6.6
Schlumberger	-8.0
Smith	-7.5
Tidewater	-13.0
Transocean	+5.6

Our best guess is that WTI, still the most expensive hydrocarbon on the planet on a *relative* basis, will peak short of \$100.00 per barrel, with greater downside risk than upside potential. Our fundamental outlook also suggests natural gas is vulnerable at current levels, despite substantial net short positions held by managed funds. On balance, we believe that even if WTI blows past \$100.00 per barrel, for the remainder of the year we are concerned, right or wrong, that the energy sector may tread water.

Reviewing October equity performance within the framework of oil and gas prices, the S&P 500 rose by 1.5%, while energy equity indices were mixed. The OIX index rose by 4.7% but the OSX index declined by 0.9%. In this context, WTI rose by a full 15.8% while the prompt NYMEX natural gas contract gained by a greater 21.3%.

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.

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

**Major International Oils**

BP	+1.8
Chevron	+5.5
ConocoPhillips	+5.1
ENI	+7.3
ExxonMobil	+6.1
Royal Dutch	+3.0
Total	+7.0

**Select Independent Producers**

Anadarko	+7.4
Apache	+13.4
Chesapeake	+7.4
Noble Energy	+11.7
Pioneer	+6.3
Plains	+12.1
Pogo	+4.4

**Select Service/Drilling Equities**

Baker Hughes	+5.9
Diamond Offshore	+4.7
Ensco	+1.6
GlobalSantaFe	+5.2
Halliburton	+9.7
Rowan	-4.3
Schlumberger	+4.9
Smith	+4.7
Tidewater	-5.8
Transocean	+4.7

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