U.S. Natural Gas Perspectives
Monthly Review and Outlook

Summary

Over the past month the prompt NYMEX natural gas contract has risen by over $1.50 per mmBtu. Periodic storm activity in the Gulf of Mexico has led to temporary production shut ins, thus moderating the weekly storage builds, aided by production cuts in the Rocky Mountains and other areas, as we anticipated. The prompt month has thus recovered back broadly in line with our Base Case for early autumn prices. Helping to firm values as well has been some reduction in net short positions long held by managed commodity funds that report to the CFTC, with net shorts now the lowest since early July. Updating our fundamental natural gas balances, we have made little change to our overall outlook, with the net result a modest upward revision to our target end-2008 working storage positions. Supplies are still expected to be quite ample for the upcoming winter, once again assuming normal heating degree days, despite the fact that many observers are now leaning toward assuming more mild winters from here on.

With regard to price, looking first at the short term we have been looking for a December (basis January NYMEX) average of $7.15 per mmBtu based both on our balances and the belief that the winter price curve will continue to "flatten". As a result of our previous upward revision to forecast WTI average for the fourth quarter, we have revised up our December price target to $7.45 per mmBtu. Despite the revision, our outlook, if anywhere closer to the mark, would still imply downside risk from current price levels of about 60-70 cents per mmBtu.

For 2008, our long-standing Base Case had assumed a prompt NYMEX/Henry Hub average of $7.50 per mmBtu under a $60.00 per barrel WTI average. Last month we raised our 2008 forecast WTI average to $65.00 per barrel. At this juncture, however, based on updating our pricing models we are inclined to retain our $7.50 per mmBtu natural gas price average for next year. This implies in turn that natural will average about 69% of crude oil, compared to 75% previous assumed and about 55% at the present time. Thus, despite our crude oil price revision, we still anticipate that the gap between natural gas and crude oil prices will narrow.

+ U.S. natural gas demand is forecast to rise by 1.2%, or some 270 bcf next year.

+ 2008 domestic dry gas consumption is anticipated to gain by 0.4%, or about 75 bcf.

+ We expect a net draw in working storage next year of around 110 bcf.

Viewpoint

Over the past month the prompt NYMEX natural gas contract has risen by over $1.50 per mmBtu. On a settlement basis, the prompt NYMEX contract reached a 2007 low of $5.35 per mmBtu on August 31. At the end of August, prompt NYMEX natural was trading at only 43% of crude oil.

Since that time the recovery in natural gas prices has been in response to periodic storm activity in the Gulf of Mexico, leading to temporary production shut ins. This helped moderate the weekly storage build rate, aided by production cuts in the Rocky Mountains and other areas, as we anticipated and discussed in last month's report.

The prompt month has thus recovered back broadly in line with our Base Case for early autumn prices. Third quarter prompt NYMEX averaged $6.248 per mmBtu.

In addition to fundamentals, helping to firm prices has been some reduction in net short positions held by managed commodity funds that report to the CFTC.

To quantify, over the past month net futures-only short positions have declined by 8,889 contracts, corresponding to a near-$1.80 per mmBtu gain in price. CFTC-reporting active funds now hold the lowest net short position since early July.

Updating our fundamental natural gas balances, we have found little need to materially revise our overall outlook. Taking into account the most recent working storage position in the context of our demand and supply forecast, the net result is a modest upward revision to our target end-2008 working storage position, to be discussed later in this report.

Storage is still expected to be quite ample prior to the upcoming winter, and we once again assume normal heating degree days, despite the fact that many forecasters are now leaning toward assuming somewhat more mild winters, on average, from here on.

In terms of price, as we look first toward the short term we have anticipated a December (basis January NYMEX) average of $7.15 per mmBtu based both on our natural gas balances and the belief that the winter price curve will continue to "flatten".

As a result of our previous upward revision to forecast WTI average for the fourth quarter, we have revised up our December price target to $7.45 per mmBtu, as the "oil price premium" impact outweighs the revision in the volumetric balance.

Despite the price revision, our outlook, if anywhere closer to the mark, would still imply downside price risk from price levels of about 60-70 cents per mmBtu, without an equivalent decline in the November and December contracts.

For next year, our long-standing Base Case had assumed a prompt NYMEX/Henry Hub average of $7.50 per mmBtu under a $60.00 per barrel WTI average.

Last month we raised our 2008 forecast WTI average to $65.00 per barrel. At this juncture, however, based on updating our pricing models we are inclined to retain our $7.50 per mmBtu natural gas price average for next year.

This implies in turn that natural gas will average about 69% of crude oil, compared to 75% previously assumed and about 55% at the present time. Thus, despite our crude oil price revision, we still anticipate that the gap between natural gas and crude oil prices will narrow.

Demand: Review and Outlook

In its most recent natural gas monthly, the Department of Energy published downward revisions to its estimates of industrial sector natural gas consumption for 2006. The cuts amounted to almost 75 bcf for the year as a whole.

Although down the road revisions may be in store for 2007, based on the current assessment the net effect is to imply a 0.7%, or 45 bcf decline in industrial sector gas demand for 2007. Recent data do not suggest a progressive deterioration in gas demand that might correspond to a weakening economy, since lower natural gas prices leading to fuel substitution at the margin have likely partially offset any material moderation in manufacturing output.

Having said this, our customary table illustrating the manufacturing output of the eight largest consumers of natural gas versus the previous year reveals a mixed picture for August compared to last month's table which compared output in July versus July 2006. Some industries improved, some weakened, with no obvious trend either way.

Eight Largest Industrial Consumers of Natural Gas August Manufacturing Output

Industry	YOY %Chg. Output
Chemicals	**-0.3**
Petroleum and Coal	**-2.5**
Primary Metals	**-0.4**
Paper	**-1.9**
Food	**+4.0**
Non-Metallic Mineral	**-0.9**
Fabricated Metal	**+2.1**
Transportation Equip.	**+2.5**

Total manufacturing output in August was up by only 1.7% versus August 2006. While the output gain was somewhat weaker than our long-standing forecast average of +2.5% for the second half of the year, at this point we have not made any material revisions for end 2007 and 2008 nor, more importantly, do we assume an outright recession is in the cards.

With regard to residential sector assumptions for next year, we have assumed, as is our custom, normal heating degree days based on the current NOAA definition, although some prognosticators have already come out with forecasts of a somewhat milder winter ahead.

Electric utility natural gas consumption is forecast to rise once again in 2008, aided both by new capacity and higher utilization of existing facilities.

Putting it all together, we are looking for U.S. natural gas consumption to gain by 1.2%, or about 270 bcf in 2008, roughly unchanged from last month's assessment.

Supply: Review and Outlook

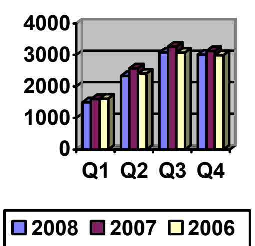
The bane for natural gas bulls this year has been the supply side and not demand, since consumption has held up reasonably well relative to long-standing expectations.

Canadian pipeline imports have held up well, despite incremental demand by synthetic crude oil producers. With regard to LNG, we estimate that imports will be up by more than 67% this year, with further gains likely for 2008. Net imports overall now represent about 23% of total requirements.

As we issue this report working storage stands at almost 3.3 tcf, marginally below the level at the comparable point in 2006. Going forward, barring a late-season devastating hurricane, natural gas supplies should be more than ample for the upcoming winter, even if it turns out to be as "normal" as we assume.

For the end of this year we are targeting working storage at about 3.1 tcf, essentially unchanged from last month's report. If reasonable, it would place storage about 55 bcf above the end of 2006.

End-Quarter Working Gas Storage Levels (BCF)



Looking at next year, implementing some slight revisions to each quarter on the demand side has the net effect of reducing modestly our forecast net draw in working storage for the year as a whole. For 2008, we now anticipate a net draw in working storage of some 110-115 bcf. At the end of next year we expect working storage to stand at about 3.0 tcf, which if reasonable would place it slightly below the end of 2006.

Implications for Price

We have been encouraged by the recent recovery in natural gas prices, allowing us to avoid any material revision to our outlook for the next few months. Avoiding the "wind sock" approach to price forecasting as we have over the years can either work to our advantage or, disadvantage if we are the last ones on the block to change our minds.

With the prompt months back broadly in line with our perspective, however, we still believe the winter months remain somewhat overvalued, and thus we continue with our prevailing theme anticipating a "flattening" of the winter price curve as we approach the end of the year.

In this context, we have updated our December (basis January NYMEX) price outlook as illustrated in our customary table below. In our last monthly report on the world oil market, we conceded that our previous fourth quarter forecast WTI average was likely too conservative.

This realization was not due to any revision in expected fundamentals whatsoever, but rather an underestimation of the willingness of financial institutions to not only hold crude oil but buy in the face of moderating world oil demand growth, led by the OECD.

Henry Hub Price Outlook
Average for Month of December 2007
($/mmBtu)

1990-2006 Relationships	**$3.45(E)**
1990-1999 Relationships	**$1.90(E)**
2000-2006 Relationships	**$5.69(E)**
2000-2006 Relationships Plus Oil Premium	**$7.45(E)(a)**

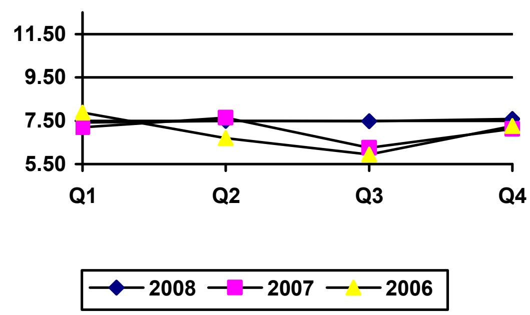
a) @ 210 cents per gallon distillate and $70.00 per barrel WTI.

Our revision led to our current expected fourth quarter WTI average of $75.00 per barrel, and assuming for the moment a smooth weakening through the end of the year from current levels, it would imply a $70.00 per barrel December WTI average, versus our previous $66.00 per barrel.

As discussed previously, our target year-end working storage level is roughly unchanged from last month. Thus, we are compelled to modestly revise up our December natural gas price target on the basis of oil prices alone.

The arithmetic of our models would now suggest a calendar December average, again basis January NYMEX, of $7.45 per mmBtu, marking an upward revision from our previous target by some 30 cents per mmBtu.

Henry Hub Prices
2006-2008
(Dollars per MCF)



For 2008, as previously discussed, our current forecast average for WTI is $65.00 per barrel, an upward revision of $5.00 per barrel from our long-standing Base Case in effect since early summer.

By the same token, as also previously discussed we have modestly reduced our forecast net draw in working storage for next year. The net effect is that we are compelled, both for quantitative and qualitative reasons, to retain our 2008 forecast prompt NYMEX/Henry Hub average of $7.50 per mmBtu.

Although the crude oil price effect modestly outweighs the storage effect in our models, we do not now believe that natural gas will narrow its discount to crude oil quite to the extent previously anticipated, with managed funds likely to retain relatively large net short positions in natural and net long positions in crude oil.

October 8, 2007

U.S. Natural Gas Supply and Demand Balances
2007-2008
(Billion Cubic Feet)

	Q1	Q2	Q3(E)	Q4(E)	2007(E)	%Chg 07-06	Q1(E)	Q2(E)	Q3(E)	Q4(E)	2008(E)	%Chg 08-07
Supply												
Total Dry Gas Production	4,602	4,694	4,791	4,766	18,854	**1.7**	4,620	4,713	4,811	4,785	18,929	**0.4**
Withdrawals From Storage	1,791	241	410	653	3,096	24.2	1,954	389	367	579	3,289	6.3
Supplemental Gaseous Fuels	18	12	16	16	63	1.5	19	12	16	16	64	1.5
Imports	1,147	1,125	1,139	1,146	4,558	8.9	1,174	1,055	1,109	1,138	4,476	-1.8
Canada	963	846	876	896	3,580	-0.3	939	825	854	873	3,491	-2.5
LNG	184	280	264	250	978		235	230	255	265	985	
Other	0	0	0	0	0		0	0	0	0	0	
Balancing Item	77	223	(135)	(180)	(15)		0	95	0	(40)	55	
Total Supply	7,636	6,296	6,223	6,401	26,555	4.7	7,767	6,264	6,302	6,479	26,813	1.0
Disposition												
Additions To Storage	327	1,209	1,100	510	3,146	7.6	330	1,221	1,111	515	3,177	1.0
Exports	203	204	187	205	798	10.2	180	185	185	205	755	-5.4
Consumption	7,106	4,883	4,936	5,686	22,611	**4.1**	7,257	4,858	5,007	5,759	22,880	**1.2**
Lease And Plant Fuel	282	288	290	286	1,146	0.9	277	283	289	287	1,136	-0.9
Pipeline and Dsitribution Use	186	129	140	145	600	4.2	152	151	154	158	615	2.4
Residential	2,316	762	346	1,361	4,786	9.8	2,436	714	344	1,375	4,870	1.8
Commercial(a)	1,260	562	389	829	3,040	6.2	1,324	525	386	825	3,060	0.7
Industrial	1,755	1,534	1,526	1,687	6,501	-0.7	1,735	1,549	1,547	1,711	6,542	0.6
Electric Power	1,307	1,608	2,245	1,378	6,538	4.7	1,332	1,637	2,287	1,403	6,658	1.8
Total Disposition	7,636	6,296	6,223	6,401	26,555	4.7	7,767	6,264	6,302	6,479	26,813	1.0
Addendum:												
Net Storage Injections	(1,464)	968	689	(143)	50		(1,624)	832	744	(64)	(112)	
End Period Working Gas In Storage	1,603	2,580	3,270	3,127	**3,127**		1,504	2,335	3,080	3,016	**3,016**	
Henry Hub Price (Dollars Per mmBtu)	**7.20**	**7.64**	**6.25**	**7.12**	**7.05**	**1.5**	**7.42**	**7.50**	**7.48**	**7.58**	**7.50**	**6.3**
Gas Wells Drilled					34,746	10.0					38,220	10.0
Total Discoveries(Bcf)					15,636	-1.0					15,288	-2.2
Discoveries Per Well(Bcf)					0.45	-10.0					0.40	-11.1
Total Revisions and Adjustments(Bcf)					4,000	0.0					4,000	0.0
Total Reserve Additions(Bcf)					19,636	-0.8					19,288	-1.8
Reserve Replacement Ratio					104%						102%	
Total Recoverable Reserves (Bcf)					187,658	0.4					188,018	0.2
Reserve To Production Ratio(Years)					10.0						9.9	

Source: Historical Data, U.S. Department of Energy.
Note: May not sum to totals in all cases due to rounding.
(E) WHB Energy Research LLC estimates.
(a) Includes minor use as vehicle fuel.