HIGHLY CONFIDENTIAL

December 18, 2009

Good Morning

Overview

- Hydrocarbon prices firmed overnight. **Crude oil up $1.31 to $73.96 per barrel; natural gas up $0.129 to $5.897 per mmBtu.**

News/Views

- We continue to witness an effective short-term de-linking of crude oil from the dollar, but we would suggest it may be a bit premature to draw any firm conclusions. As we discussed previously, prompt NYMEX crude oil trading in the upper $60s recently was "undervalued" relative to the then-prevailing dollar/euro rate. By coincidence or not, however, bullish weekly stats "corrected" this neotrader anomaly, bringing WTI back up to where it "should be" at around $72.00 per barrel or so. Now, with the dollar/euro rate at about $1.4400, prompt WTI is trading *above* where it "should be", i.e. about $69.00 per barrel. We do not wish to split hairs here and, quite frankly, we are gratified as analysts to see a de-linking of the no-brainer, automaton-neotrader activity of buying crude oil and selling the dollar for the primary reason that the trade has worked. Having said this, however, we wish to make sure we are not seeing some form of "head fake" over the short term that could ultimately weaken crude oil prices again perhaps more than we expect and, in turn, adversely impact energy equities. We sense that some of what is going on, as also discussed previously, is activity as we approach January crude oil contract expiration on Monday. The deep contango has no doubt made some traders on the right side of things some good money, and there is either a need or desire to start unwinding those trades by buying back the front and selling the back months. We can see this clearly in market behavior. Yesterday, while the January contract basically did its own thing, relatively immune to weaker equity markets and a stronger dollar, the outer months declined, although the drop was limited given the relative strength in January. What we are suggesting here is that we should all reserve final judgment in terms of crude oil's fate through the end of the year and into 2010 until January goes off the board.

- Of course, there is the possibility that the dollar could surge further and crude oil prices could either hold their own or rise. This would imply that crude oil prices are recovering based on their own fundamentals and/or are discounting a political event that will lead to a major surge in price currently unexpected. With regard to the latter, Iran obviously comes to mind given more missile tests, and will likely be a thorn in the market's side in terms of trying to predict what will actually happen next year. We have previously told the story how in the summer of 1990, when OPEC was "flooding the market" with little production discipline, prices actually stabilized in June at a whopping $15.00-$16.00 per barrel and subsequently began to rise. One commodity trader was buying and when asked why he did so, he said prices *should be* going down but they are rising. Two months later, Saddam Hussein invaded Kuwait and by October prompt WTI was trading at $40.00 per barrel. We are not suggesting that a major supply disruption is coming, but we always need to pay attention to markets when prices begin to deviate from the previous pattern and relationships. Once again, however, we need to wait until the air is cleared via January contract expiration.

- Natural gas continues to recover in absolute terms and relative to crude oil, and as we discussed yesterday the April contract is now trading somewhat above our target after previously trading at a substantial discount, but such is natural's volatility. As we also discussed, however, we would need to see April at

$6.50 or above to suggest that our producer friends begin hedging some 2010 volumes. To review our current thoughts for 2010, we are looking for prompt NYMEX/Henry Hub to average $5.75 per mmBtu in the context of prompt NYMEX crude oil averaging $71.50 per barrel. This pegs the simple Btu-adjusted discount for natural at about 48% of crude oil, roughly where it settled yesterday on a January basis. Clearly, throughout history the ratio has been lower, but generally higher. However, as we discussed with some of you yesterday, the fact that short-term fuel substitution is relegated to boiler fuel limits the ability of the ratio to recover completely versus crude oil. More importantly, however, crude oil has achieved a higher status, if you will, by becoming the hydrocarbon of choice for non-commercials desiring to allocate incremental capital to commodities and thus, as we have discussed for the last four years, has progressively "inflated" crude oil prices relative to fundamentals and in turn natural gas, which continues to trade more on the basis of its own fundamentals, with a dash of impact from crude oil.

W.H. Brown, III