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Subject: Pre-NYMEX Trading is Slightly Lower for Oil and Natural Gas

In pre-NYMEX trading, energy commodities are trading slightly lower than yesterday's close. Light crude oil is now trading \$68.62 per barrel, down \$.181. Natural gas is now trading:

December: \$7.187, down \$.032

January: \$7.408, down \$.039

February: \$7.456, down \$.043

March: \$7.380, down \$.057

The big three drivers all pointed in the same direction for the oil, natural gas and equity bulls on Tuesday. The election rally in equities came a day earlier than expected as many began to price in an Obama victory beginning early yesterday morning. At the same time, the dollar was hit with a strong round of profit-taking (selling), resulting in an absolutely strong day for oil prices. The short-covering rally in oil was further fueled by reports that the Saudi's were cutting all they said they were going to cut, as well as plethora of refinery problems in the US.

After two years of presidential campaigning, the election is finally over and change is coming. What kind of change or whether it is good or negative is still yet to be answered. The new President will be faced with the realities of an economic downturn both in the US and internationally, Iraq & Afghanistan, many major geopolitical problems, a global financial system weakened by the meltdown, jobs declining and much more. How much of the change promised during the election will likely be soon very soon.

It is still a bit unclear as to who the winners & losers will be in the business sector and in particular the energy and financial sectors. However, some events may now have a higher probability of occurring. For example:

- Major oil will likely be a target for taxing as they remain one of the few major industries still producing decent returns as well as having been on the radar of Congress since the price spikes earlier this year.
- Alternative fuel companies should get a support boost
- Although the general public supports offshore oil drilling, it will likely take years before it begins outside of the Gulf of Mexico
- Cap and trade will likely become a reality
- Nuclear power should get another boost
- This will be the era of new regulation of anything that has the word financial in it. The push to regulate will not only come from the US but will occur globally. The first meeting of G20 will be held on Nov 15th in Washington, DC and regulation will be a major topic of the meeting. The only hope here is it will be well thought out.

There are many more issues relating to energy, commodities, financials and regulation that will be predicted as the new administration begins to unfold. For now it appears the energy industry will have some bumps to overcome over the next few years as will the financial sector. However, challenges create opportunities and all of these sectors are already searching for the opportunities.

How does all of this impact price? In the near term the price of oil, natural gas and most other commodities will not be driven by yesterday's election results rather it will be driven primarily by:

- The direction of the US dollar which still has more room to the upside. A stronger dollar will be bearish for oil prices
- The direction of the global equity markets. So far we are into the 3rd week of gains for most of the world's equity markets. If this week's gains hold and continue to move higher it would suggest that the market sentiment has changed and indicate a global recession that may not be as deep or as long as originally projected. If this is the case, it would be bullish for oil as it would suggest that the decline in oil consumption may be nearing an end.
- Oil fundamentals. OPEC has played their first hole card. So far we see news snippets indicating that many of the OPEC members have announced cuts in exports to their customers. The real indication will come in about 3 more weeks when less oil should be arriving in the US, Europe and Asia. Inventories in the US and OECD countries should begin to decline. OPEC is expected to make another cut of about 1 million bpd. Venezuela has been all over the airwaves over the last two days proposing such a cut. If prices revert back to the low 60's in the near term, it is likely OPEC will call another emergency meeting. If not, OPEC will wait for the planned December meeting in Algeria. In the near term, the fundamentals are starting to paint a neutral picture with a view toward slightly bullish. OPEC's determination to balance supply & demand is slowly going to work.

In the medium to longer term, the price of oil will be a direct function as to how much surplus capacity becomes available to the world and how much of the current demand reduction becomes permanent. The new US Administration's energy policies will also impact the medium to longer term price pattern. The long term uptrend which began earlier this decade will remain in place and ultimately we will see higher prices going forward.

Surplus capacity of crude oil is defined as oil that has been found and being held in the ground waiting for demand. Low surplus capacity (as has been the case for the last several years) has caused oil prices to surge every time a potential geopolitical event pops into the news. Surplus capacity is increasing at the moment not because a huge amount of new supply is coming on stream; rather it is a result of global demand reduction. Demand will return over time and if investment is slowed (for example the Saudi's are currently re-evaluating their investments in the current low price environment) surplus capacity will once again become an issue.

All of the ongoing geopolitical "hot spots" that have recently surfaced have not gone away. The world has just been paying less attention to Iran, Iraq, Russia, Nigeria, etc. as the financial turmoil and US election have dominated the airwaves. Just this morning the Russian President announced that Russia will deploy missiles in western outposts in response to plans by the US to build an anti-missile defense shield in Europe. Cold War Part II is slowly emerging. Anyone of the usual suspects moving from potential to reality could quickly cause a major imbalance in supply & demand and yet another major price spike like experienced earlier this year.

By the end of the year oil prices (as measured by the spot NYMEX WTI contract) will likely be trading in a range of \$80 to \$90/bbl. OPEC cuts will impact inventories and a portion of lost demand to return as a result of lower prices. Beyond that we will need to see how the winter space heating and other demands for oil compares to supply here and in the Europe.

Today oil inventories will be released (see table below for projections). Most analysts are expecting a mixed report showing another build in crude oil and distillate and decline in gasoline

stocks as refiners minimize gasoline production due to poor refinery margins. If the actual numbers come in as projected, today's report would be neutral.

The energy market remains neutral as the election results sink in and as the market awaits today's fundamentals snapshot. Also the risk/reward profile of the market still remains overly biased to the risk side. It is a neutral time for buy side hedgers. Yesterday's oil and natural gas rally was strongly driven by the direction of the dollar which may recover quickly as both the EU & UK are expected to lower their interest rates before the end of the week. This would be a bullish event for the dollar and thus a bearish event for oil prices.

Currently oil is lower, equities are slightly lower and the dollar is trading about unchanged.