



What once seemed unattainable is finally reality. Crude prices are now over \$100/bbl and appear to be headed higher. Oil prices have increased almost \$14/bbl since February 6, which is an increase of 16%! Furthermore, oil prices are now almost \$40/bbl above this same time last year, which is a gain of 64%!

Oil prices have increased over the last few weeks despite a struggling U.S. economy and inventory builds. Prices have been strengthened by a weakening U.S. dollar, strong distillate prices both in the U.S. and Europe, geo-political tensions, cold weather, and an inflow of dollars from large hedge funds.

It appears that the Bulls are in control of the current oil market. At the moment, it appears unlikely that this will change. Oil prices are likely to push higher over the short-term. Below are the key indicators that we feel will play an important role in crude prices over the short-term.

1. **U.S./Global Economy:** The U.S. economy continues to show signs of weakness, and the hits keep coming.
 - Consumer Confidence dropped to its lowest level since March 2003.
 - Sales of existing homes in January fell to its lowest rate since 1999.
 - January home foreclosures were up 57% over the previous year.
 - Inflation at the wholesale level soared in January by the fastest pace in 16 years, pushed higher by costs for food, energy, and medicine.
 - Orders for durable goods for January declined 5.3%, which was the first setback since October and was the biggest decline since last August.

Because of the negative economic news, many analysts believe that further interest rate decreases will be made by the FED. This, in turn, has led to the value of the dollar setting an all-time low against the Euro. The decrease in the value of the dollar has helped push crude prices higher.

We expect the U.S. economy will be shaky at best over the short-term. The Economist magazine recently lowered its 2008 GDP forecast for the U.S. to 0.8% from 1.5%, after preliminary fourth-quarter GDP estimates showed only a 0.6% growth. The question will be how much of an impact this will have on oil demand and oil prices. In the short-term, we expect little impact. Long-term, we cannot see how the current economy can support oil prices over \$100/bbl.

Elsewhere, world economies seem to be a little more stable than the U.S. economy. China's GDP increased 11.4% in 2007 and is expected to be slightly over 10% in 2008. Furthermore, Japan's fourth quarter 2007 GDP increased by a robust 3.7%. It will be interesting to see what effect a struggling U.S. economy will have on other world economies.

2. **Weather:** Normally, at this time of the year, we are talking about the end of winter weather. However, recent cold spells in the Northeast have helped to strengthen distillate and crude prices. It looks like winter weather may be lasting a little while longer as the Northeast is expecting another cold spell this week. Furthermore, some of private weather forecasters are suggesting colder than normal March temperatures across most of the U.S. In addition, cold weather in Europe has led to tight gasoil/diesel inventories and helped strengthen distillate prices in Europe.



3. **U.S. Inventory Levels:** In the latest weekly report for the EIA, U.S. crude oil and gasoline stocks continued to build, while distillate stocks reported another decline. Crude oil stocks are now at 308.5 million bbls, which is 5 million bbls over the 5-year average but is 21.5 million bbls under last year's levels. This is the seventh straight week that crude oil stocks increased.

Gasoline stocks also reported a build in this weeks report and now stand at 232.6 million bbls. Gasoline stocks are now 16 million bbls over the 5-year average, 12.5 million bbls over last year, and are now at the highest level of supply in 14 years. Days of supply for gasoline is now at 25.8 days, which is up 1.7 days from last year.

Distillate stocks were down once again this week and are now at 119.9 million bbls, which is 1.6 million bbls above the 5-year average but is 8.4 million bbls below last year. Days of supply for distillates is at 27.5 days, which is up slightly from last year's 26.5 days.

U.S. Refinery Utilization increased slightly this week to 84.7%. Last week's refinery utilization was 83.5%. This was the second lowest level outside of Hurricanes Katrina and Rita.

Normally, at this time of the year, the market starts to focus on gasoline supplies as we begin to enter the driving season. At some point, we think that this will happen and that robust gasoline inventories will have an impact on the market. However, that does not appear imminent at the moment.

4. **Oil Supply/Demand:** According to the International Energy Agency (IEA), world oil demand for 2008 is forecasted at 87.8 million bbls, which would be an increase of 2 million bbls over 2007. For the U.S., 2008 oil demand is expected to be relatively flat, with 2007 oil demand of 20.8 million bbls. This is due to the expected slowing economic growth in the U.S. during 2008. Most oil-consuming countries are expected to have slight gains in demand over 2007, with China and the Middle East leading the way, each with an increase of 0.4 million bbls.

According to the IEA, Non-OPEC oil supply is expected to increase slightly in 2008 as compared to 2007. Non-OPEC supplies are expected to be 50.7 million bbls in 2008, which is an increase of 0.6 million bbls. OPEC production will also need to increase by 0.6 million bbls in 2008 to meet the forecast for world oil demand.

5. **Geo-Political Tensions:** Geo-political tensions have been relatively calm as of late. There were reported skirmishes between Turkish forces and Kurds in Northern Iraq last weekend, but no oil supply disruptions were reported. Iran continues to make threats if UN sanctions are increased in response to its ongoing nuclear program. Many still think that we could see additional problems in Nigeria as last year's disputed presidential elections were upheld. The thought is that this may result in rebels attacking Nigeria's oil infrastructure. While things have been quiet, any geo-political headline will easily push oil prices higher.



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6. **OPEC:** The next OPEC meeting is scheduled for March 5. It was just a few weeks ago that OPEC members were talking about cutting production as crude oil prices were falling and oil demand forecasts were reduced amid the talks of a recession in the U.S. However, with oil prices now above \$100/bbl, we think it will be highly unlikely that OPEC will cut its current production rates. OPEC members clearly are happy at current price levels as the OPEC basket price has averaged \$88.94/bbl so far this year.
7. **Speculative Investors/Hedge Funds:** Large amounts of investments continue to be poured into the commodity markets. With the struggling stock market, investors and funds continue to look toward commodities as the place to put their money. As of February 19, speculative funds increased their net long positions by almost 21,000 contracts to 60,873 contracts. This is the largest net long position since January 15, which was a net long position of 83,991. With the U.S. dollar hitting all-time lows against the Euro, we would expect the speculative funds to continue to increase their long positions, which would help to strengthen oil prices.

Recommendations and Strategies

The future direction of crude oil prices is a difficult call. On the surface, we see an unstable U.S. economy, a struggling stock market, surplus of gasoline stocks, and falling gasoline demand. This would lead one to think that oil prices would be under pressure to decrease. However, that has not been the case. Oil prices have surged on the back of speculative/hedge fund investments and the decreasing value of the dollar.

In the short-term, we could see the trend continuing. While it seems unfathomable with an unstable economy, we think oil prices could push higher, possibly to the \$107-\$110/bbl range. We also think that short-term support for oil prices is likely to be around \$95/bbl.

In the long-term, we have trouble believing that the current economy will be able to support \$100/bbl crude prices. With the housing market a mess, dwindling consumer confidence, and increased inflation, one would think that energy demand would have to slip, which would result in decreasing oil prices.

Our recommended strategy would be to use our Flex-Term program to reduce risk against short-term price increases. This program allows you to fix your fuel price over a three-month window. You indicate the amount of gallons that you wish to commit and then have the flexibility to pull the gallons at any time during the three months. For a longer term strategy, our KnockOut and PayZone programs provide a wide range of protection as fuel prices remain volatile.

Food for Thought (or Fuel for Thought)

Our friends at Cameron Hanover provided us with this little piece of information. American businesses and consumers have spent more than \$1.3 trillion more on energy in the first 7 years of the 21st century than they did in the last 7 years of the 20th century.