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CRUDE OIL

TIME TO PUT UP YOUR BULLISH HORNS

Dt: 4th Dec, 2008

WORLD ECONOMY BLEAK OUTLOOK

The recent dramatic deterioration in the outlook for economic growth in the United States and the rest of the world has led to a significant reduction in these assumptions for world economic growth and projections of energy demand and prices. World real gross domestic product (GDP) growth is projected to slow from about 4 percent in 2006 and 2007 to about 2.5 percent this year and 1.8 percent in 2009. Previous lows for world economic growth were 0.3 percent in 1982, 1.7 percent in 1993, and 1.5 percent in 2001.

The Euro-zone entered into technical recession in 3Q08 for the first time since the introduction of the single currency. The US economy contracted by 0.3% in 3Q08 and is expected to exhibit negative growth in the current quarter and possibly beyond. Unemployment in the US rose sharply to 6.5% with more than half a million jobs shed in the last two months alone. Central banks across the globe have moved to lower interest rates.

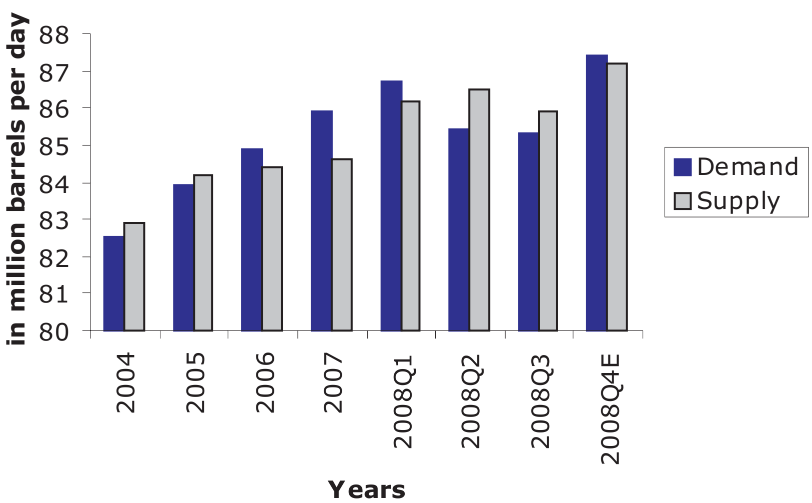
Although money markets have eased, confidence in equity markets in October evaporated and share prices fell sharply. As spillover effects to emerging markets become stronger and commodity prices continue to fall, more countries are being affected. Attention is now turning to the need for fiscal stimulus measures to lessen the depth and reduce the duration of the economic turndown. Coordinated measures to address the crisis were considered in the Washington G-20 Summit.

Following downward revisions, US growth in 2009 is now forecast at 0.3%, Euro-zone growth at 0.2% and Japanese growth is expected to turn negative at minus 0.2%. Developing Countries are now expected to grow at 4.9% while China's growth forecast now stands at 8.8% in 2009.

WORLD CRUDE OIL DEMAND AND SUPPLY EXPECTED TO COUNTINE TO BE IN DEFICIT

The U.S. crude oil production has been steadily declining since the 1970s, and the 2008 projection for crude oil production falls below 5 million bbl/d for the first time since 1946. However, its production is projected to increase in 2009 by 400,000 bbl/d to an average of 5.3 million bbl/d. Contributing to the increase in output are the Gulf of Mexico Thunder Horse platform, which is expected to come on stream later this year, and the Tahiti platform, expected to come on stream late in 2009.

WORLD OIL DEMAND-SUPPLY

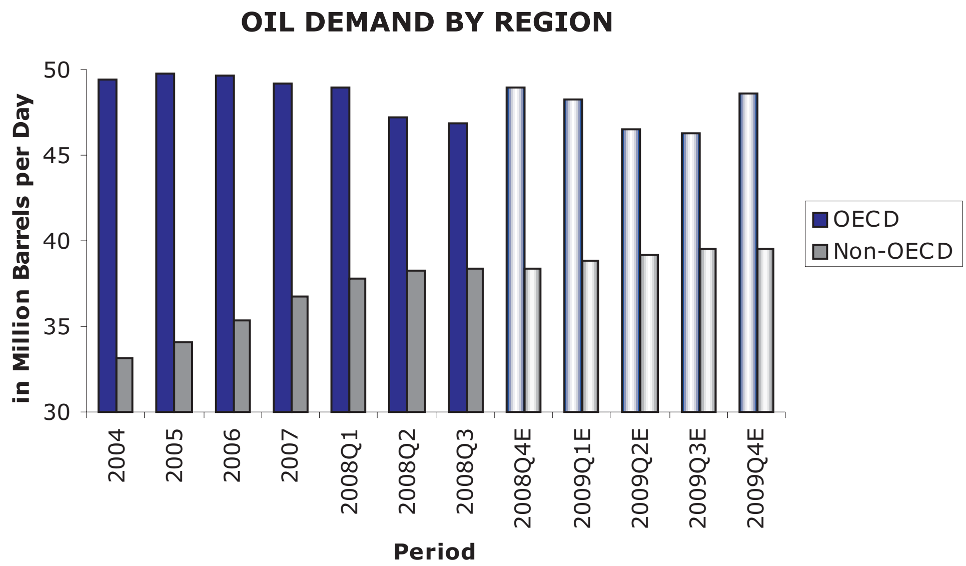


Iraqi oil wells, despite US efforts, have not been able to reach production levels of the pre-war era. England and Norway are seeing a winding down of their North Sea production and Venezuela does not have the political will or the technical expertise to increase production.

Even Russia, which increased production by 4 million bpd from 1996 to 2007 can't produce more. Over the past many years, Russia has accounted for almost 80 per cent of the growth in oil production outside the OPEC. Its production, which peaked at 9.9 million bpd, is gradually dipping

OECD DEMAND GEARING UP

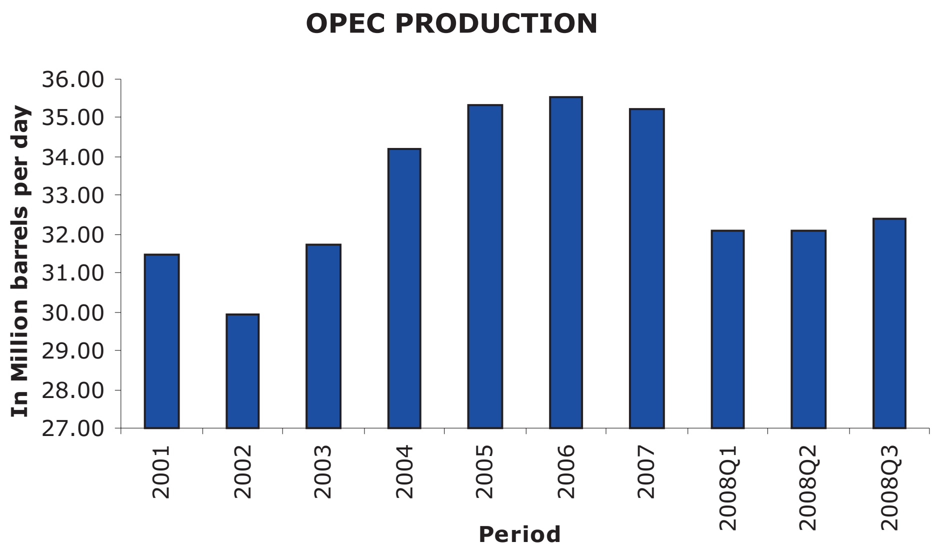
The demand from all over the world is manly classified in OECD nations and Non-OECD nations. The continuous rise in demand from Non-OECD shows the growth in demand from the developing nations. The consecutively growth from Non-OECD is contributed by China and other Asian countries. From the side of OECD, a significant decline in demand can be seen from the first quarter of 2008 based on the recession fears in U.S. and other developed nations. Poor economic performance from U.S., Europe, Japan and Russia has turn down the demand in second quarter also. Mainly non-OECD countries, particularly the Middle East, Asia, and China, will boost oil demand growth. Deteriorating economies in OECD countries are estimated to yield in declining oil demand which is forecast to pull total world oil demand growth down to less than 0.6 mb/d in 2009.



OPEC PRODUCTION CUTS

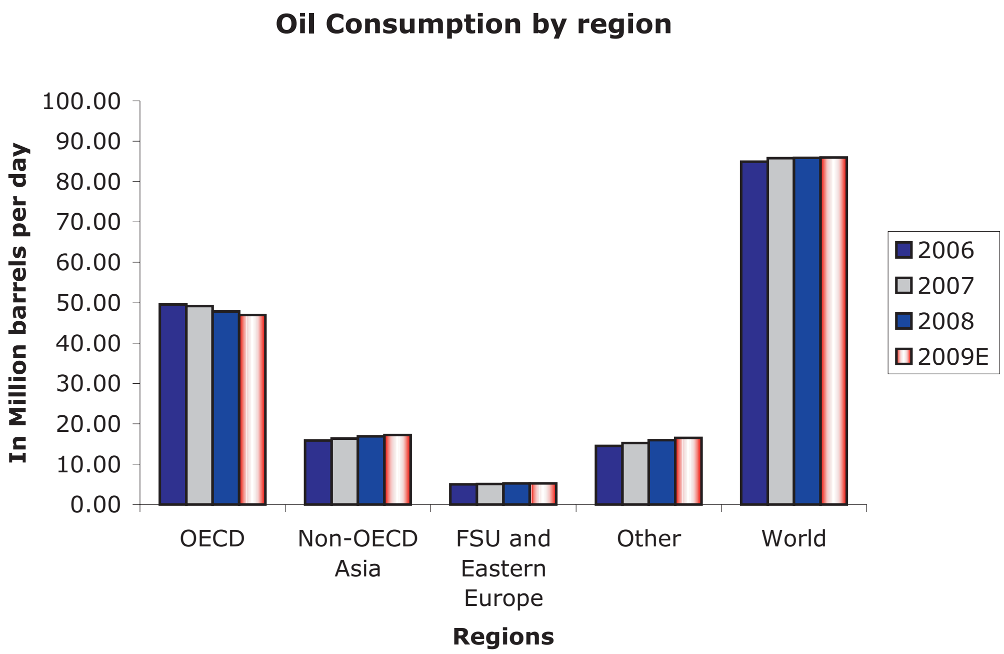
The OPEC (Organization of Petroleum Exporting countries) over the years has dominated the oil industry. OPEC Countries produce about 45 per cent of the world's crude oil and about 54 per cent of the oil traded internationally, any decisions to increase or reduce production may lower or raise the price of crude oil. OPEC decided at its November meeting to cut its crude oil production targets by 1.5 million bbl/d in response to the global economic slowdown, weakening oil demand, falling oil prices, and in anticipation of rising non-OPEC supplies. The decision is been delayed due to lack of production data and confusion among OPEC countries. The oil production declined from first quarter of 2008 with response to slowing demand and weak world economic condition. OPEC total oil production averaged 32.04 mb/d in October 2008, representing a drop of 132 tb/d from the previous month. The majority of the decrease came from Saudi Arabia, Venezuela, UAE and Iran, while production increases were seen in Angola and Iraq.

On the supply front the sharp rise in prices in the previous quarter called in for an increase in Saudi Arabian production of 500,000 barrels. However with the receding prices the OPEC now is signaling for a possible cut in the excess production. In 2008 the global oil supply is to average around 85.88 million barrels. The OPEC production is likely to be trimmed down in the Q4, given the slump in prices. Its production in the Q3 averaged around 32.7 million barrels and is likely to be trimmed down to 32.44 in current quarter. Given that the excess production comes from Saudi Arabia, the likely cut in production will depend solely at its execution.



WORLD CRUDE OIL CONSUMPTION CONTINE TO RISE

World oil consumption has substantially increased in 2008 compare to 2007 and is expected to increase further in 2009. Transportation has been one of the driving forces behind the rise in the consumption of petroleum products. The increase in this sector's oil consumption is due to the rapid growth in the number of vehicles worldwide in the last three decades. The developing Asian countries have now reached income levels that will sustain rapidly growing transportation fuel demand for the foreseeable future. Consumption from Non- OECD Asia is continuously increased in past years and expected to increase further in 2009 as developing countries are offsetting demand from OECD countries. However, consumption from OECD has declined in past years due to ailing economic condition and slowing industrial demand. In this gloomy economic outlook, the consumption from OECD is expected to decrease in 2009



China is the world's most populous country and the second largest oil consumer, behind the U.S. In recent years, China has been undergoing a process of industrialization and is one of the fastest growing economies in the world. With real gross domestic product growing at a rate of 8-10% a year, China's need for energy is projected to increase by 150 percent by 2020. China's oil consumption grows by 7.5% per year, seven times faster than the U.S. A report by the International Energy Agency predicted that by 2030, Chinese oil imports would equal imports by the U.S. today.

Oil and gas represent over 40 per cent of the total energy consumption in India. The consumption of petroleum products in the country is on the rise and demand already far exceeds domestic supply. Therefore, the country has to depend largely on imports. The country's existing annual crude oil production is peaked at about 32 million tonnes as against the demand of about 110 million tonnes. With inadequate crude production, the country is heavily dependent on imports. Crude is the single largest item on India's import list. Estimates show that the demand is likely to grow at a faster pace over the next decade.

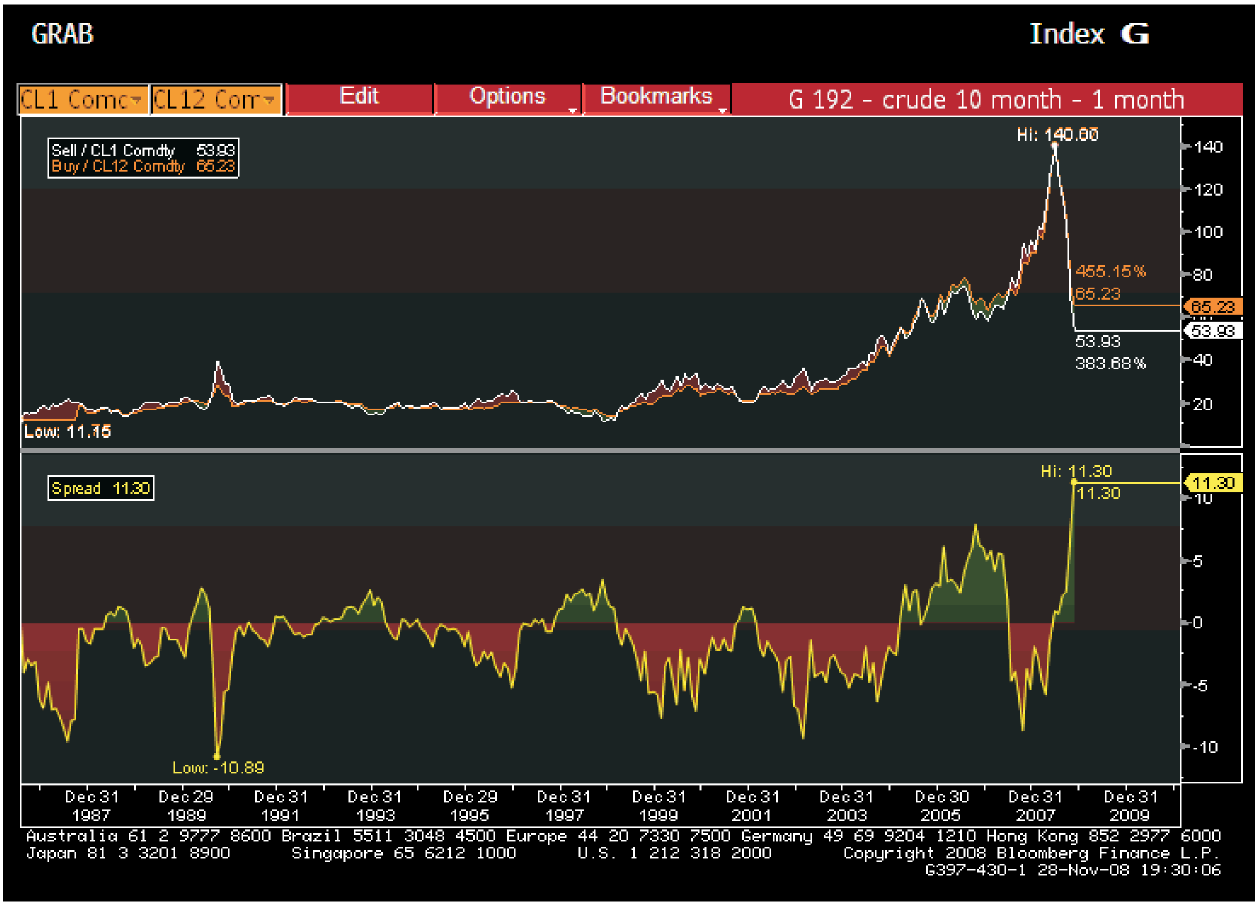
GEOPOLITICAL TURMOIL PERSISTENT

Historically various events on the geopolitical front had their significant impact on oil prices. The Iran Iraq war in 1980-81 has resulted in prices hitting a high of above $70 per barrel. With these nations being a part of the OPEC cartel and among the top producing nations may potential supply disruption in these nations acts as a risk premium leading to the price surge. In the recent past the continuous attacks by militants in Nigeria on various oil fields have lessened supplies and hence become a factor of rising prices. Threat from the pirates of Somalia is now a major worry for oil transportation. Gulf of Aden and Suez is the busiest route for the oil exporting countries for transportation. Rising violence in Nigeria and state nationalism in Venezuela and Russia are giving the jitters to global oil majors and raising concerns over the continued supply of whatever the world can produce. Besides, the increased closeness of Iran, Venezuela and China does not augur well for the rest of the world.

The gulf region is an important producer and distributor of oil and natural gas for the nation as a whole. It produces 6.5% of domestic crude oil consumption and 16% of natural gas consumption. This is important to track ed as the Gulf of Mexico concentrates the oil refinery activity and the supplies of US. When Hurricane Katrina and Rita struck the U.S. Gulf Coast in 2005, they imparted record damage to offshore Gulf of Mexico oil and Gas production and facilities, which leads the prices to record levels.

TECHNICAL ASPECTS

Monthly Chart of NYMEX Crude Oil and its Spread (12 Month- 1Month)



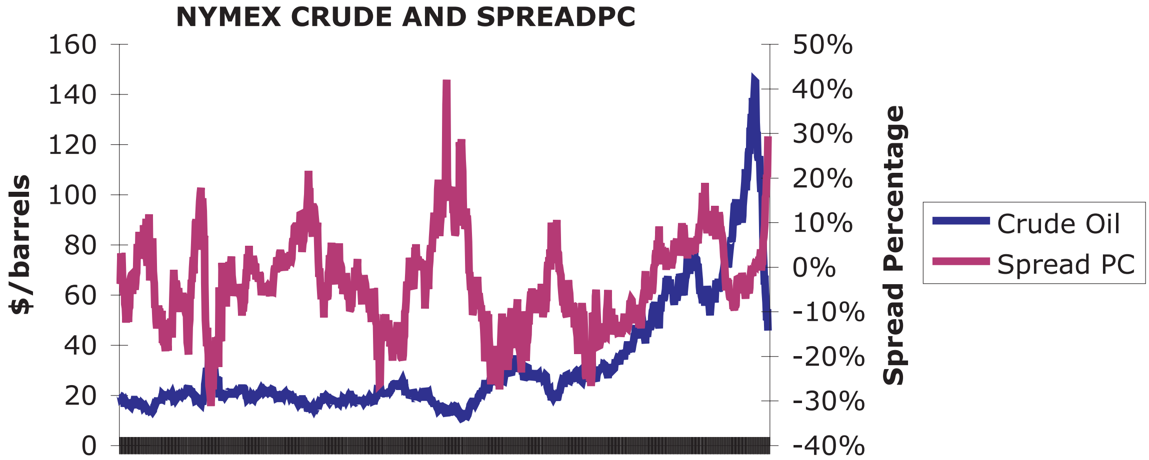
Source: Bloomberg

There are four instances in the graph when spread has gone above $2 and then reversed, which has caused significant rally in Crude Prices of around 150%. In all instances shown above, rally is seen merely in 9 to 12 months.

		Crude Price Rally after Spread topped	Return
First Instance	Mar 1990 to Jul 1990	16 to 40	150%
Second Instance	Dec 1992 to Apr1994	13 to 20	53%
Third Instance	Nov 1997 to Feb 1999	12 to 35	190%
Fourth Instance	Mar 2005 to Jun 2007	52 to 145	180%

In Third and Fourth Instance, Crude prices first fell by around 5% and then rallied to 190% and 180% respectively.

If we take Spread as a percentage of Crude Prices and call it a Spread PC, it is found that whenever Spread PC rises 15%, there is buying opportunity in Crude as prices rally after that.



Below is the table, which illustrates that if Investment is Crude would have been made in past when SpreadPC is more than 15%. We have identified four such Opportunities and their return:

Invst Date	Buy Price	Low Price registered after Buying	% Loss	High Price	Period	Return
7-Jun-90	$17.50	$15.06 after 1 Month	8%	$41.45	in 4 Months	136%
17-Dec-93	$15.05	$13.70 in same Month	8%	$21.00	in 6 Months	40%
6-Mar-98	$15.50	$10.30 after 9 months	33%	$38.00	in 22 Months	145%
27-Oct-06	$59.43	$49.90 after 3 Months	14%	$147.27	in 22 Months	148%

VIEW

The price of oil is now at its lowest level in over three years and some $100 cheaper per barrel than at its peak in July. Crude Oil prices have fallen about 70% from its record high of $147, discounting all of its negative factors fundamentally and technically. We see very limited downside in prices from here.

Saudi Arabia's oil minister claims that $75 a barrel is needed to encourage new oil production to prevent a possible shortage in the future—although he is referring to expensive options such as exploiting tar sands in Canada, rather than tapping Saudi Arabia's own much cheaper fields. The International Energy Agency, a rich-country energy watchdog, estimates that fresh sources of oil that could provide the equivalent to six times the current Saudi output will have to be found to meet expected demand in 2030. If prices are low, this is less likely to happen, making a painful shortage more likely later on.

Currently 12Mn-1Mn Spread of NYMEX Crude is $13, which is 30% of the Prices. The gap between some near-term contracts and those for delivery or settlement further in the future is at its widest in a decade. It seems that spread may top out here and prices start recovering.

We recommend investing 50% of amount now at current prices ($46) and put next 25% amount on every 10% fall in prices. This strategy is expected to give more than 50% returns in next 1 year as we expect Crude prices to trade around $70 in medium term.