



ENERGY RISK MANAGEMENT

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ENERGY MARKET REPORT FOR JULY 7, 2008

State Department spokesman Sean McCormack said officials from the five permanent members of the UN Security Council and Germany spoke via telephone on Monday to discuss Iran's response to a package of incentives to curb its nuclear activities. The major powers have offered Iran a package of incentives and said Iran must suspend its uranium enrichment work before formal talks can begin. Iran however has offered nothing more than negotiations. Iran's response make no reference to the proposal of preliminary talks to start with a mutual six week freeze both on a fourth round of UN

Market Watch

An energy economist said diesel demand may be driving much of the run up in oil prices. Demand for diesel is increasing in both the US and Europe and its price has been increasing much faster than that of gasoline. Over the past 12 months, while the price of gasoline has increased \$1.12 to \$4.15, the price of diesel increased by \$1.81 to \$4.66/gallon. The economist said that operators of refineries were responding to the rapid increase in diesel prices by bidding more and more for light, low sulfur crude. He said efforts to upgrade refineries to get more diesel from heavier crudes could take two years to relieve the shortage. He said refiners do not want to produce more diesel from the less costly heavier crude because that would mean more gasoline, sales of which have fallen in response to prices.

China's manufacturing hub, Guangdong has further increased subsidies to small oil fired power plants and extended them to May and June to help avert summer shortages. Local authorities have allowed some 30 small oil fired plants in the province to charge 1.14 yuan for each kilowatt hour of electricity generated for May and June. Guangdong started subsidizing generators last January by allowing them to charge higher than normal on grid tariffs to cope with the increasing cost of fuel oil.

Intercontinental Exchange Inc said it will begin operating its own clearinghouse by August, a month later than planned. Intercontinental will complete the transition after it reached an agreement with LCH.Clearnet on issues involved in moving customer accounts.

The CFTC said it increased its oversight of oil trading on the Dubai Mercantile Exchange. It said it will require the Dubai exchange to adopt position limits and accountability levels for all derivatives contracts linked to contracts traded in US regulated exchanges. It will require the exchange to provide quarterly reports on traders who exceed position limits or have won exemptions from those limits. The DME will be expected to publish trading information comparable to daily trading information supplied by US exchanges for the linked contracts and share daily reports revealing the owners of large positions that will fit into the weekly Commitment of Traders report. The Dubai exchange has 120 days to comply with the new regulations.

The Washington Post reported that rising fuel prices are not only benefiting oil companies and Middle Eastern producers. They are also increasing the investment returns of pensions funds. California's public employees' pension fund made its first investment of \$1.1 billion into oil and other commodities early last year and since then Calpers has seen it increase 68%. Other pension funds are rushing in to get in on the action as the prices of oil, precious metals, corn, uranium and other vital goods continue to reach record highs. Investors, including pension funds and speculators, have increased their commodity allocations since 2003 from \$13 billion to \$260 billion.

June Calendar Averages

CL – 142.80
HO – 402.27
RB – 352.91

Security Council sanctions and on the expansion of Iran's uranium enrichment program. Meanwhile, EU foreign policy chief Javier Solana said he hoped to meet with Iran's chief nuclear negotiator Saeed Jalili later this month to discuss the formal written response provided by Iran last week.

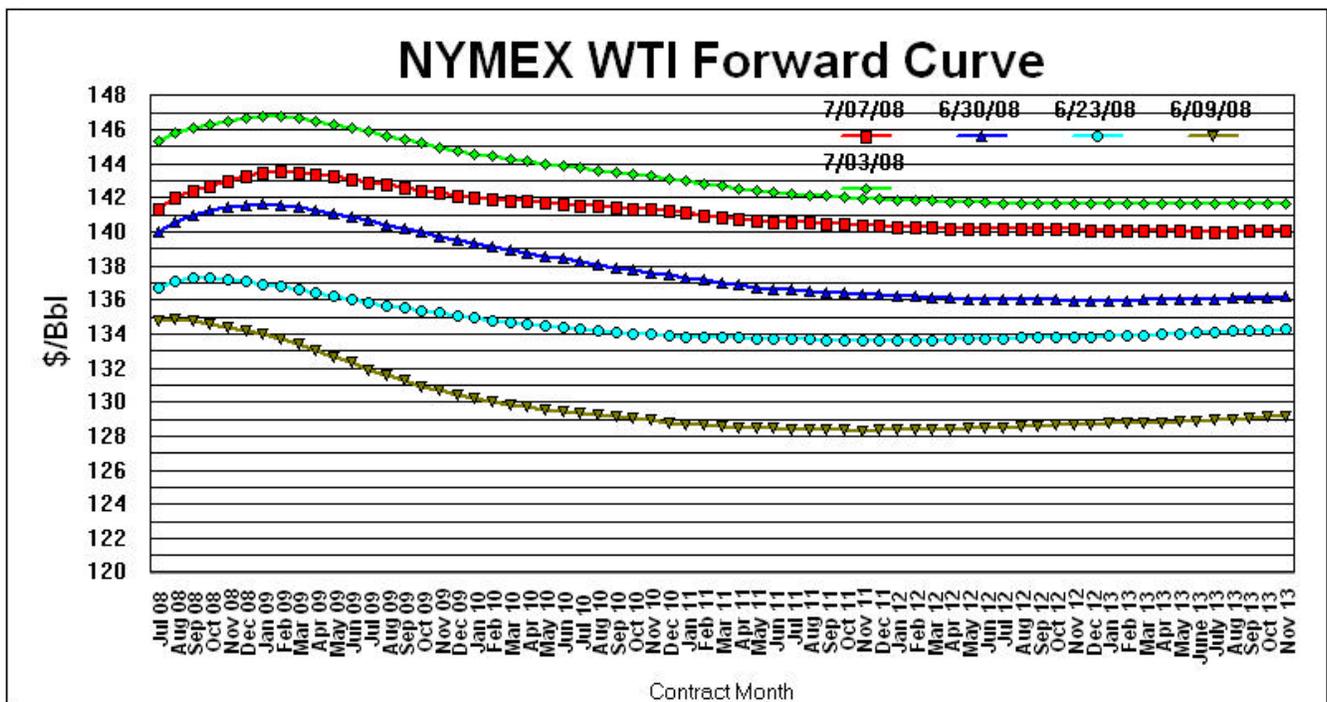
Iran's President Mahmoud Ahmadinejad said Iran would not stop enriching uranium and rejected as illegitimate a demand by major powers that it do so. He said Iran was ready to discuss its nuclear ambitions but that the language of threat was futile. He also stated that the US and Israel would not dare to attack Iran over its nuclear program. He said the Bush administration knows that it cannot use the language of force or threats with Iran and it should take into account Iran's demands.

The US Navy said it was carrying out an exercise in the Gulf. It said the aim of Exercise Stake Net is to practice the tactics and procedures to protect maritime infrastructure, such as gas and oil installations. Two US vessels were taking part in the exercise along with a British warship and one from Bahrain. Last week the commander of the US Navy's Fifth Fleet said the US would not allow Iran to block to Gulf after the head of Iran's Revolutionary Guards said it would impose controls on shipping in the Gulf and the strategic Strait of Hormuz if it was attacked. On Saturday, Iran's chief of staff, Maj. Gen. Hasan Firuzabadi said Iran's strategy is to keep the Strait of Hormuz in southern Iran open but added that if Iran's interests were jeopardized, Iran will not let any ship pass through.

Iran's new governor to OPEC, Mohammad Ali Khatibi said oil consuming countries need to invest in expanding oil producers' production capacity. He said they should decrease the tension in very important production areas and help for the development of upstream and downstream.

OPEC President Chakib Khelil expects crude oil prices to increase further in the coming weeks due to the continued weakness of the US dollar as well as strong demand from China and India. He said about 60% of the increase in oil prices is due to the fall in the value of the dollar and geopolitics while the remaining 40% of the increase can be attributed to the intrusion of bioethanol on the market.

Italy's Prime Minister Silvio Berlusconi said leaders of the Group of Eight nations gathering for a



summit in Japan fear further oil price increases. He said that in order to curb speculation, Italy favored a rise in the margin deposits for those making speculative bets on the futures market. Separately, World Bank President Robert Zoellick has called for reform of biofuel policies. He said biofuels have contributed to the increase in food prices. He urged G8 leaders to grow more food to feed the hungry.

French Finance Minister Christine Lagarde called for more transparency in European oil stocks. He said France expects the EU to confirm by the end of 2008 whether or not it will publish its oil stocks data to keep the markets better informed.

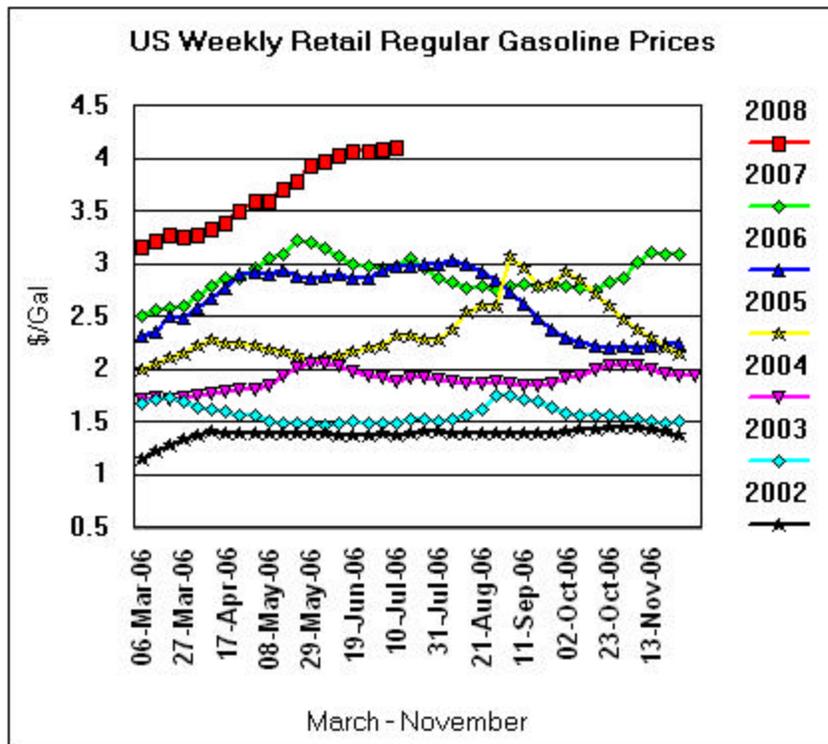
The EIA reported that the US average price of gasoline increased by 1.9 cents/gallon to \$4.114/gallon in the week ending July 7th. It also reported that the US average retail price of diesel increased by 8.2 cents/gallon to \$4.727/gallon on the week.

The AAA reported that the US average price of regular gasoline increased 0.1 cent to \$4.108/gallon.

Merrill Lynch reported that supply and demand has so far shown little response to the higher prices. It said lax monetary policy, a shortage of diesel supply, a lack of sophisticated refining capacity and low inventory levels could still push oil prices above \$150/barrel in the second half of the year. It stated that weaker growth in the airline and road transportation has brought about demand destruction of about 716,000 bpd. World oil demand growth is estimated at 616,000 bpd for 2008. It also stated that while there is no shortage of sour crude, the middle distillate market remains tight and added that diesel crack spreads could still rally to new highs ahead of the winter as stocks are unlikely to build sufficiently in the coming months.

Refinery News

Pemex cut the amount of crude oil it supplies to Texas refineries operated by Royal Dutch Shell and Valero Energy Corp as falling production curbs exports. The guaranteed amount of Mayan crude for Shell's Deer Park, Texas refinery was cut by 15% while its crude supplies to Valero's Port Arthur, Texas refinery was cut by 5.8% due to declining production. Meanwhile, crude production from Mexico's Cantarell field is falling at the fastest pace in 12 years as investment limits keep Pemex from fully exploiting deposits and finding new ones. Production at the Gulf of Mexico development fell by 540,000 bpd or 34% on the year in May. Mexico's Energy Minister Georgina Kessel said in June that Pemex may need to cut its exports this year to meet domestic demand as production falls. Pemex is seeking \$20 billion in exploration and production funding for next year, up from its 2008 budget of \$15 billion. Pemex replaced 50% of the oil extracted in 2007. At current production rates, Pemex's oil reserves would run out in 9.2 years if it added no new deposits.



ConocoPhillips said flaring at its 76,000 bpd refinery in Rodeo, California on Sunday night was due to a minor upset and had no impact on production.

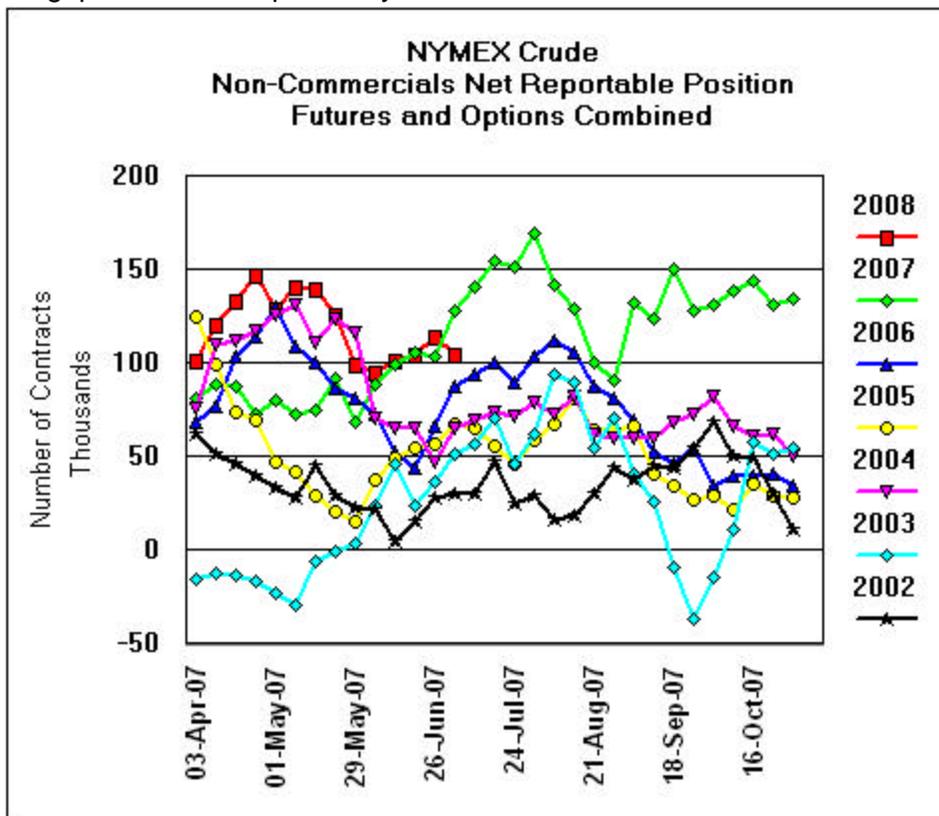
Credit Suisse said US refinery margins fell further as record high crude prices continued to cut refinery profits. Gulf Coast margins fell by 25.8% to \$2.96/barrel to \$8.50/barrel in the week ending July 4. West Coast margins fell for the fourth week in a row, down 21.5% or \$3.86 to \$14.08/barrel. In the Midwest margins fell 19.4% or \$2.06 to \$8.55/barrel while margins in the Rockies fell by 17.8% or \$3.41 to \$15.74/barrel and margins in the Northeast fell by 14.9% or \$1.13 to \$6.43/barrel.

China's 200,000 bpd Qingdao refinery will process at just over 70% of capacity this month, above an earlier forecast.

Rosneft plans to shut a crude unit at its 143,000 bpd Novokuibyshev refinery for 15 days in July, a crude unit at its 185,000 bpd Angarsk refinery for 15 days in September and one at its 130,000 bpd Syzran refinery for the full month of September. Meanwhile, Lukoil is scheduled to shut a crude unit at its 240,000 bpd Perm refinery for 24 days in September. Russneft's 100,000 bpd Orsk and its 54,000 bpd Afipsky refinery will shut crude units in July and September, respectively. TAIF's 170,000 bpd Nizhnekamsk refinery is scheduled to shut a crude unit from August 11 to September 15.

Indonesia's Pertamina plans to shut its visbreaker unit at its Cilacap refinery in August for two weeks of maintenance. Separately, Indonesia's Pertamina is expected to import 13.04 million barrels of oil products in August.

China plans to export over 200,000 tons of fuel oil to Singapore in July as high prices have weakened. Lower demand is prompting Chinese buyers to re-export their stocks to Singapore and Hong Kong. Meanwhile, ConocoPhillips has booked a tanker to ship 60,000 tons of fuel oil from South China to Singapore, a move spurred by weak demand from Chinese utilities.



BP's head of biofuels said plans to build a 330,000 metric ton wheat based ethanol plant in northern England are on track. Despite a UK government report suggesting reforms to UK biofuels policy, a joint venture between Associated British Foods, DuPont and BP would not be affected.

Production News

Canada's Nexen Inc resumed production at its 200,000 bpd Buzzard oil field in the North Sea following scheduled maintenance.

The Neptune project in the deepwater Gulf of Mexico

has produced its first oil and gas, after a delay of more than three months for work to strengthen structural components. The project is designed to handle up to 50,000 bpd of oil and 50,000 mmcf/d of natural gas.

Suncor Energy reported that production at its oil sands facility during June averaged about 144,000 bpd.

Nigeria's Brass River crude production is expected to increase soon. Italy's Eni declared force majeure on the light, sweet Brass crude exports in June following an oil spill from a pipeline in Nigeria. Eni and the Nigeria National Petroleum Corp said the force majeure had not been lifted yet. Loading programs show about 123,000 bpd of Brass River will be exported for July and August.

Power Holding Company Nigeria said the country is embarking on a program to ration electricity following continued militant attacks on gas fired plants cutting the supply of natural gas. Output from the plants has fallen to 900 Mw from the combined generating capacity of over 3,000 Mw. The plants are fed with gas from Shell and Chevron oil fields. The central bank of Nigeria has warned that the country's economy is at risk of total collapse if the energy crisis continues.

Azerbaijan produced an average of 1,005,590 bpd of oil in June, up 8.7% on the month. BP Plc said it produced 830,733 bpd in June, up 10.7% on the month while Azerbaijan's Socar produced 174,857 bpd in June, up 0.1% on the month. An average of 807,277 bpd of oil was exported in June, down 4.5% from May.

Kazakhstan's ambassador to Azerbaijan said Kazakhstan prefers Iran over Russia and Azerbaijan as an alternative crude oil transport route to Europe. Kazakhstan is expected to export about 200 million tons of oil annually and will be the second largest exporter after Russia.

Nigeria's government has cancelled three oil licenses awarded to two Indian companies last year. The leases for oil blocks 226, 2005 and 2006 were awarded to Eassar Exploration and Production Ltd and Sterling Global Resources Ltd during the oil bidding round held in May 2007. It withdrew the award of the oil licenses on the grounds that neither of the firms had met the prequalification requirements to participate in the 2007 bid round.

Ecuador's Mining and Oil Ministry reported that the country's average oil production fell by 4% to 494,732 bpd in June from 514,797 bpd in June 2007. It was down 0.8% from 499,157 bpd produced in May.

Al Jazeera reported that at least 5,000 Malaysians protested in the capital against an increase in fuel prices despite a warning from police that the demonstration was illegal. Petrol prices increased 40% in Malaysia after the government scrapped billions of dollars in fuel subsidies. Public anger over fuel prices has increased in recent weeks after the government led by the National Front Coalition increased petrol prices by 41% and diesel prices by 63% last month. Government critics argue that there is no need for an increase in prices given the revenue Malaysia earns from its oil exports.

OPEC's news agency reported that OPEC's basket of crudes fell to \$140.14/barrel on Friday, down from Thursday's \$140.73/barrel. It also reported that OPEC's basket of crudes increased \$6.71/barrel to \$138.31/barrel in the week ending July 4.

Man Group Plc plans to raise \$1.5 billion to invest in projects that use gas generated from crude oil production in the Middle East and North Africa. The Abu-Dhabi government owned International Petroleum Investment co has agreed to invest \$300 million into the MENA Associated Gas and Global

Environment Fund. The MENA fund will invest in projects that capture associated gas from crude production and use it to generate electricity and other products.

Iran produced more than 10.3 billion cubic meters of natural gas from the South Pars gas field during the first three months of the Iranian year. During the same period, 14.7 million barrels of natural gas condensates were produced in South Pars refineries and exported to world markets. South Pars refineries produced 249,000 tons of liquid gas such as butane and propane during the three months, up 55% on the year.

Russia's hydropower levels have declined to the lowest level for 16 years and coal fired plants are struggling to make up the shortfall because the rail wagon shortage is making it hard for them to get the fuel. There are not enough rail wagons available in the network to move all the commodities competing for space. Russian coal exports are already projected to fall by at least 10-12 million tons in 2008 from 2007's level of about 85 million tons. Russian gas exports may also be affected in the winter if it is difficult to get enough coal to power plants to meet winter demand.

Market Commentary

The oil market, which traded to a high of \$144.53 on Globex, gave up its overnight gains amid the strength in the dollar and easing of concerns over Iran's nuclear program as Iran's foreign minister expressed confidence in talks with western governments. The market sold off to \$140.12 before another bout of selling pushed the market below the \$140 level. It extended its losses to over \$5.70 as it sold off to a low of \$139.52. However the market once again bounced off its low and retraced most of its losses as the dip below \$140 was seen as a buying opportunity. Statements made by Iran's President, who stated that the country would not halt its uranium enrichment program, also supported the market. The market later retraced some of gains ahead of the close and settled down \$3.92 at \$141.37. The crude market is seen finding support at its area of congestion just above \$139.00. The August/September crude spread, which settled at -.66 is still seen targeting the -.95 level. The product markets also sold off sharply, with the RBOB market settling down 8.83 cents at 348.27 and the heating oil market settling down 13.64 cents at 396.96. The RBOB market remained in negative territory as it sold off to a low of 348.30 early in the session. The market retraced some of its losses ahead of afternoon trading. The August RBOB crack retraced some of its previous losses and settled at \$4.90. The heating oil market retraced some of its previous gains as it sold off sharply amid the losses in the crude. The market, which traded to a high of 407.65 extended its losses to over 16.9 cents as it posted a low of 393.64 early in the session. It retraced some of its losses ahead of the close. It is seen finding support at its previous low of \$392.10 followed by \$391.72. Open interest in the crude market increased just slightly by 341 lots, with open interest in the August contract increasing by 1,124 lots and by 4,505 lots in the September contract while the December contract saw open interest fall by 5,286 contracts. Open interest in the RBOB market built by 1,034 contracts, with open

interest in the August contract falling by 1,934 contracts while open interest in the September contract increasing

		Explanation	
CL	Resistance	145.85, 146.48, 149.41, 150.00	Previous high
		142.00, 142.45, 143.44, 145.68	Monday's high
	Support	139.52	Monday's low
HO		139.17, 138.61, 133.68	Previous lows
	Resistance	411.00, 413.50	Previous highs
		400.00, 403.46, 407.65	Monday's high
RB	Support	392.10	Monday's low
		391.72, 389.37, 385.00, 378.27	38%(356.49 and 413.50), Previous low, 50% and 62%
	Resistance	357.96, 359.27, 360.21	Previous highs
RB		353.85, 355.75	Monday's high
	Support	343.54	Monday's low
		340.14, 334.64	Previous lows

by 2,959 contracts. Open interest in the heating oil increased by 2,824 lots, with open interest in the August contract falling by 523 lots while open interest in the September contract increased by 1,524 lots.

The Commitment of Traders report showed that non-commercials in the crude market cut their net long position by 2,249 contracts to 21,968 lots in the week ending July 1st. The combined futures and options report showed that non-commercials cut their net long position by 10,145 contracts to 104,706 contracts on the week. The funds increased their total short positions by 6,394 contracts to 141,266 contracts while they cut their long position by 3,751 contracts. The non-commercials have likely increased their net long position late last week as the market continued to rally head of the long weekend. Meanwhile non-commercials in the product markets increased their net long positions, with funds in the heating oil increasing their net long position by 3,303 contracts to 17,965 and funds in the RBOB increasing their net long position by 5,995 contracts to 60,921 contracts.