



ENERGY RISK MANAGEMENT

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ENERGY MARKET REPORT FOR MAY 10, 2006

Britain, France and Germany said today that they are preparing a package of fresh incentives for Iran, including affordable energy and greater trade with the West, in return for Tehran resuming negotiations on its nuclear program and its agreement to halt its enrichment activities. Meanwhile a prominent foreign policy advisor to Russian President Putin said today that Russia expects to propose a face saving formula that it hopes will entice Iran to cancel its uranium enrichment program. The proposal would have "established" nuclear weapons states to manufacture and supply enriched uranium to a large number of countries with peaceful nuclear energy programs. The plan may not be presented until July when Russia will host the G-8 meeting in St. Petersburg. The official said that Russia will make "all diplomatic efforts" to prevent Iran from developing nuclear arms.

The Indonesian President today offered to help mediate the Iranian standoff with the United States and other countries over its nuclear program. According to Indonesian officials, Iran was receptive to the Indonesian offer.

Market Watch

Richard Berner, chief economist with Morgan Stanley, said he does not expect a "doomsday" scenario for oil prices like the one in 1979, that swamped the world economy, but all it would take is a cutoff of Iran's oil exports to deliver a withering "shock" to the global economy. He suggested that oil prices could go as high as \$110 a barrel. As a result the world would be faced with several years of severe economic restructuring as consumers and businesses struggled to become more fuel-efficient.

Indonesia's oil minister said today that he saw oil prices falling to \$58-\$60 per barrel as fundamentals begin to play a role in determining price by 2007. He noted that the world is currently over-supplied.

Chinese government officials reportedly are considering a 6-8% increase in gasoline and diesel retail prices. The government raised prices this past March for the first time in eight months.

Kuwait's oil minister said today that the world oil markets are more than adequately supplied, and that high prices were the result of geopolitics and not a shortage of crude oil. He estimated that there is a 1.5-2.0 million barrel surplus of supply.

Citigroup said today that rising speculative fund positions in U.S. commodity markets has been a key driver in the latest surge in commodity prices. They estimated that the monthly average value of long term and short-term speculative positions held in U.S. commodity markets recovered sharply in April, rising by \$10 billion to \$120 billion. The group estimated that the all time high was in October of last year when \$128 billion was in the market. The group estimated that natural gas, with \$30.3 billion and crude oil with \$30.1 billion, dominated the 36 commodities analyzed. Gold and copper accounted for \$13.3 and \$3.8 billion respectively. Long and short speculative positions in U.S. commodity markets has risen by 430% in the past five years, with the greatest growth in late 2005.

China's Meteorological Administration said today that this summer in China should be hotter and stormier than normal, with the country seeing up to nine typhoons from June onward. A warm summer could strain the electricity grid and boost demand for diesel to drive individual generators.

Barclay's Capital said today that the letter from Iran's President to the U.S., instead of improving relations between the two countries, underscores "why a benign outcome" to the dispute over Iranian nuclear ambitions is not likely. "Given the severity of the situation, we believe that oil started to look cheap as it headed toward \$68 earlier this week" and "a base is now being built to push up and to maintain prices well into the \$70's."

Refinery News

Valero announced today that it was performing unscheduled maintenance on a coker at its Texas City refinery. The 50,000 b/d unit is expected to be off line for seven days.

ConocoPhillips reportedly was forced to cut runs today at its 263,000 b/d Bayway refinery following some problems with pumps at the facility. Dow Jones reported the cat cracker at the facility would be back at full operation by Sunday. The company also reported that the restart of its Pennsylvania refinery is taking longer than expected.

DOE Stocks	
Crude	– up 300,000 barrels
Distillate	– up 200,000 barrels
Gasoline	– up 2.4 million barrels
Refinery runs	– up 1.4%, at 90.2%

ADM announced today that it would build an ethanol plant with a 275 million gallon capacity in Cedar Rapids, Iowa. Construction is expected to be completed by the second half of 2008.

LUKOIL reportedly has more than halved its oil processing at its mid-sized Ukhta refinery in May due to planned maintenance. The refinery normally processes some 300,000 tonnes per month.

Algeria's 335,000 b/d Skikda refinery is due to start a rolling shutdown in mid-May for scheduled maintenance.

Taiwan's Bureau of Energy reported that oil product demand in the country in March was some 10.4% higher than the same month a year ago.

U.S. House Speaker Hastert said today he did not see an economic benefit for the United States in lifting import tariffs on ethanol. The Speaker is from the ethanol producing state of Illinois. Meanwhile the EIA again said that ending the tariff on ethanol imports would only increase supplies by 10,000-20,000 b/d. The U.S currently imports 22,000 b/d of ethanol.

The EPA said today that it does not believe Texas needs a waiver from federal clean gasoline rules at the moment, even though the state has experienced some fuel supply problems as oil refiners have switched from MTBE to ethanol. Texas did not specifically ask for a waiver, but only inquired about one, as have several other states. Only Maryland and Pennsylvania have officially asked the agency for clean fuel waivers.

Production News

Baker Hughes confirmed today that an expatriate employee of the firm was killed in Port Harcourt, Nigeria on his way to work. BBC reported that an attacker on a motorbike shot the employee as he drove to work in a car. No group though has claimed responsibility for the attack.

Chevron announced that it has decided to donate the production platform Typhoon, which capsized last year in the Gulf of Mexico, to a federal program that turns decommissioned oil and gas structures into artificial offshore reefs. The platform, which began pumping oil and gas in 2001, lost its moorings during Hurricane Rita and was found some 60 miles from its original location, inverted in 180 feet of water.

Iraq's crude oil exports are expected to remain stable at 1.6 million barrels per day through the end of the year. If exports from the north are able to resume then exports would be able to exceed 2 million b/d.

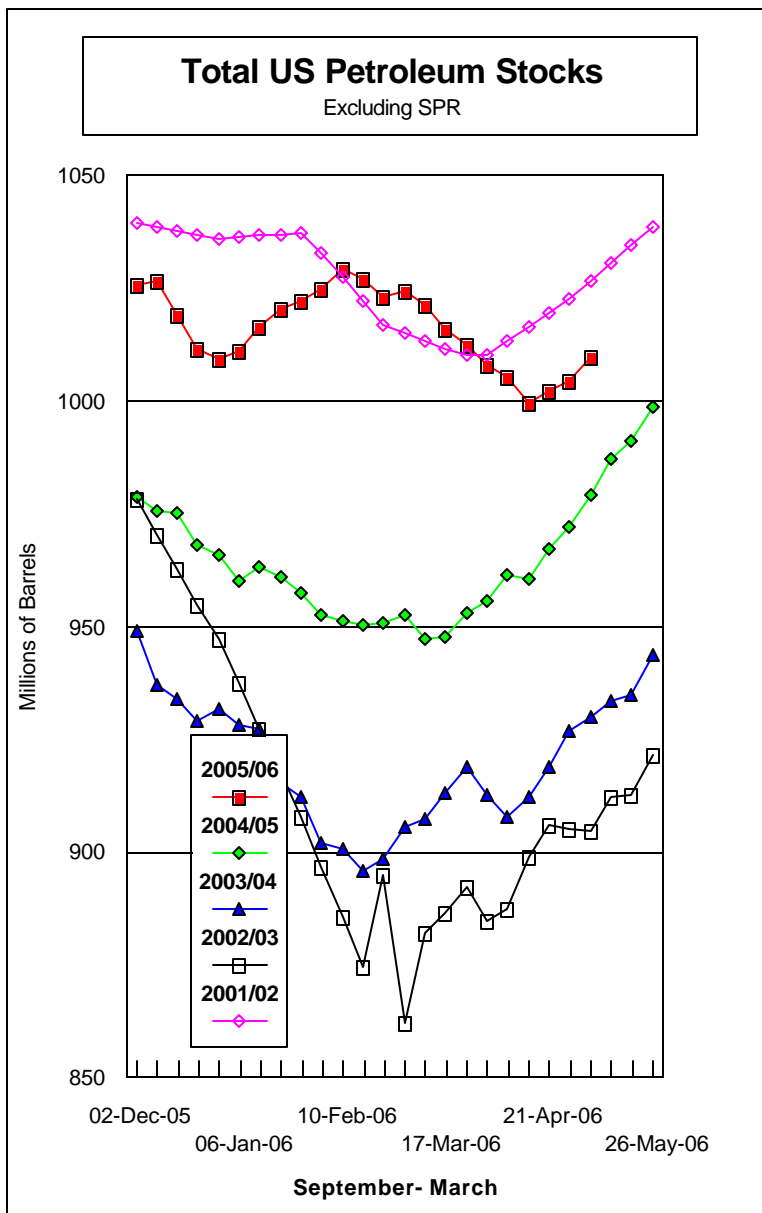
Brent crude oil production in June is scheduled to average 201,000 b/d, down some 20,000 b/d from May levels. The modest decline is due to seasonal maintenance activities.

Norway's Statfjord crude stream is set to export 228,000 b/d in June, down 47,800 b/d from May.

The Russian transport ministry today denied reports that silt would halt river shipments of oil from inland refineries to the port of St. Petersburg in 2007. Officials said planned dredging work this year should rectify the problems. Shipping companies had warned that river tankers of 5,000 dwt or more would be suspended next year due to canals becoming too shallow. Some 3.5 million tons have been committed to be shipped by water to the port this year.

Saudi Arabia reportedly will keep crude supplies to majors and European refiners steady in June from May levels.

President Bush said today that he was open to pending Congressional proposals to expand oil and natural gas leasing in federal waters provided it was at least 100 miles offshore. Some 3 million acres in the eastern Gulf of Mexico would be opened to oil and natural gas drilling under bipartisan Senate bill currently moving through the Senate.



Iraq's oil minister said today that Iraq is looking to drill 300 new oil wells in the southern oil fields in an effort to boost production from the region.

Market Commentary

The oil markets opened a bit weaker this morning on light trading volume, as traders seemed to stay on the sidelines in front of the EIA and API inventory reports. While the reports were modestly bearish, at face value, the selling pressure was short lived as rumors, and later confirmation of refinery problems propelled product prices higher, especially gasoline which saw its premium over crude oil gain some \$3.50 dollars following the release of the report and overall see prices settle nearly 11 cents

higher than yesterday. Volume was excellent with 315,000 traded in the WTI contract of which over 70% was booked via spreads. Heating oil and gasoline saw volumes of 65,000 and 60,000 contract respectively, with RBOB trading 7681 lots on the day.

If refinery problems continue to dominate the news wires tomorrow then we could see further gains in the crack spreads. But given the relatively bearish stats for gasoline and oil overall we would look for prices to begin to stall out once last week's highs are challenged. In crude oil we would look for resistance to be found initially at \$72.25-\$72.35 followed by additional resistance up at \$74.55-\$75.35. Support we see in the Jun crude at \$70.50-\$69.65, followed by \$68.25. One may be able to take a look at selling near term calls up at the \$80 strike. The June \$80 calls which expire on the 17th of this month traded between 4-6 cents today, and saw over 1600 lots of activity. Any further spike in prices could boost these premiums up toward attractive values. Fundamentally it does not seem that the Iranian crisis while simmering would quickly flare in the next week to put these calls at risk.