

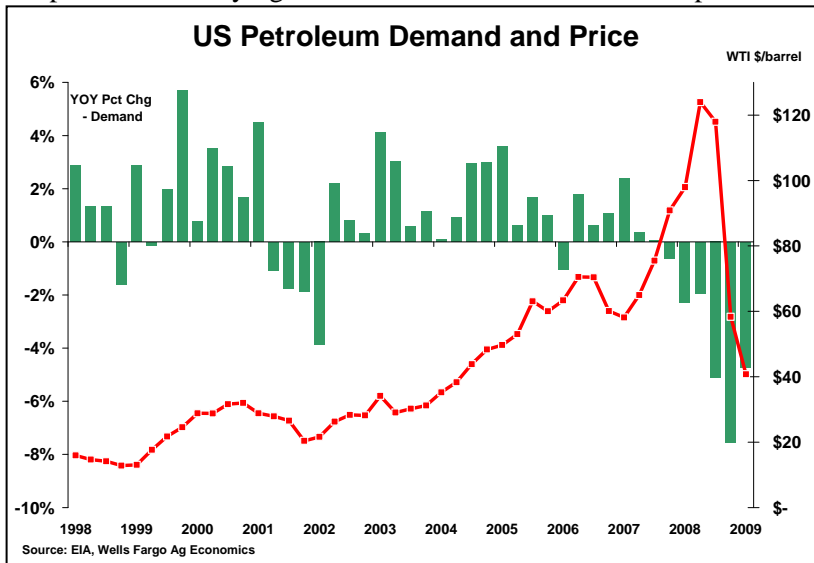


Energy Markets

Overall Summary: Waiting on the economic recovery

At the moment, the crude oil market seems stuck in the \$40 per barrel range. It appears that the market is waiting for a clear direction on the global economic recovery. This leads to the question of how much oil prices will rise once the economy recovers.

The problem with trying to estimate the eventual rise in oil prices involves the interaction between supply and

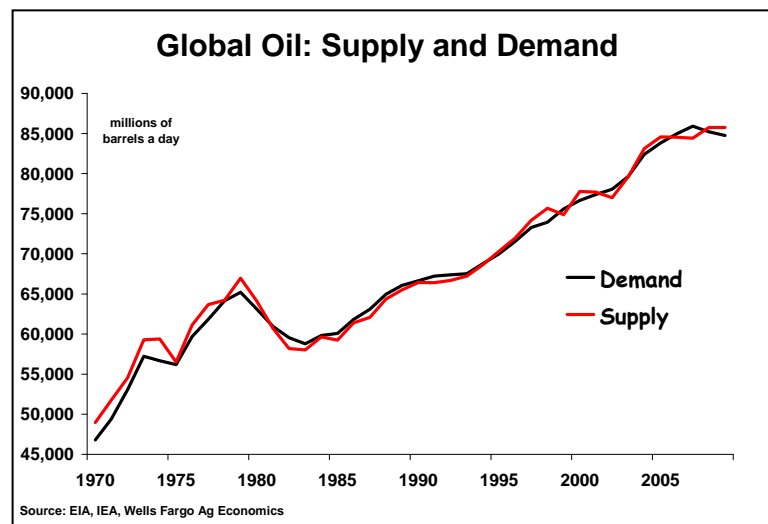


demand facts and the psychology of the market. In hindsight, it appears clear that the market clearly overshot the potential price for crude oil when it hit \$145 per barrel. At that price, demand destruction allows the supply to meet the demand. Additionally, it appears that alternative energies can compete with crude oil in that price range.

It would be difficult to argue that long-term oil prices will not need to rise significantly. Oil remains a finite resource, and demand for it grows over time. The difficulty with this argument is that it doesn't give any type of quantification to that rise or the timing.

Additionally, this long-term projection fails to take into account and predict technological change. In the short term, technological change can be literally left out of the equation, but in the long run technological change drives almost everything.

Leaving aside the issue of technological change, the eventual economic recovery will certainly be the biggest price driver of energy prices over the next 12 to 18 months. Two clear and opposed camps have emerged. The first camp, which I belong to, believes that this will be a severe economic recession ending some time late 2009 or in early 2010. In that case, energy prices will start to recover almost immediately with a clear end to the recession. The other camp believes that we are embarking upon a global depression. In that case, an increase in energy prices would not be the prediction for an extremely long time.



The US government can't stop this (or any) recession, but the US government could turn a severe recession into a global depression with the wrong type of policy decisions. The two biggest drivers of economic growth are capital investment and productivity change. Combined they account for over 80% of the long-term real growth of the economy. Any policy that reduces capital investment and reduce productivity change could easily knock long-term growth potential down and make a severe recession into a depression.

- Long-term GDP growth is 3%
- Output grows with inputs and productivity
 - ◆ Larger labor pool **0.5%**
 - ◆ More capital invested **1.1%**
 - ◆ Productivity gains **1.4%**
- A recession temporarily reduces demand not supply capacity

One thing that capital investment and productivity share in common is their risky nature. As the economist Keynes pointed out, investors aren't as worried about interest rates as they are risk. They really hate to take a nice liquid asset such as cash and turn it into fixed assets which could lose their value very quickly in the uncertain environment. A major part of the uncertainty is the eventual taxation rates on the earnings and regulatory restrictions. At the moment,

many investors and managers are restricting their investment activities because of the economic uncertainty and tax uncertainty.

In a recession, at some point, investors collectively decide that the conditions are good for making new investments. When this occurs, they start buying and investing triggering a new employment cycle growth. The employment growth will lead to consumption growth which is the signal that the energy markets are waiting for at this time. When the U.S. starts to grow, expect global growth to also accelerate at the same time. This will lead to a repeat of the 2007 to mid-2008 cycle with a surge in crude oil, natural gas and ethanol prices. It won't be just the fundamental supply and demand facts at work. The speculators who were such a major part of the run-up in 2007 and 2008 will pile onto the buy side of energy complex.

The speculative component of the market always forces the market beyond its rational economic balance. Energy traders will find it advantageous to take on bigger long positions as the price rises with the economic recovery. They will return to borrowing and adding to their long positions accelerating the market's climb. This type of activity could easily add \$20 to \$40 per barrel of oil price. So if the long-term price of oil should be somewhere between \$60 and \$80 per barrel, oils price range could end up someplace between \$80 and \$120 per barrel of oil in an economic recovery mode.

This type of price recovery in the oil market will lead to price changes in both the natural gas and ethanol markets. Both of these markets have their own unique supply and demand issues. However, at the end of the day they trade relative to all other energies based on their transportability and BTU content. In the case of ethanol, it typically trades at parity to gasoline adjusted for the energy differential and tax support it is receiving. Historically, a \$10 change in the price of crude oil leads to about a 30¢ per gallon change in the price of ethanol.

If crude oil prices were to rise from \$40 a barrel to \$80 a barrel, this historical trading relationship would indicate that ethanol would rise by a \$1.20 per gallon. Given that there are 2.8 gallons of ethanol in a bushel of corn, the \$40 increase in the price of crude oil would unlock on additional \$3.36 per bushel of corn value. Of course, these relationships are historical and approximate. However, they show clearly that the volatility of corn and all other competing row crops remain tied to the alternative value of their energy content.

In the end, the key question asks whether we are in a recession or depression. If this is simply a severe recession that will end in the next twelve to eighteen months, we should expect a major rally in both energy prices and agricultural commodity prices when this happens. These rallies will be pushed by the speculative element as much as the fundamental supply and demand situation. Conversely, if we make this into another great depression commodity prices will be stagnant for many years.

And, as always, be aware of "geeks" bearing numbers.

Wells Fargo Ag Industries presents this analysis as a service to its employees and customers. It can not guarantee the accuracy of all the sources of data. And, commodity prices are extremely volatile based on unforeseeable changes. These estimates represent a likely scenario at this time.

Cash/Futures Price Forecast Petroleum and Diesel Markets 1st Quarter 2009

Summary: US crude oil production has shown a nice recovery. February production averaged 5.33 million barrels a day. This is the highest rate of domestic production since pre-Katrina production back in August 2005. It appears that once the capacity comes online, the lifting cost is sufficiently low that the production continues even with domestic crude oil prices in the \$40/barrel range.

At the same time, February 2009 petroleum distributions averaged 19.54 million barrels per day down 4.9% from a year ago. This is the sixth straight quarterly contraction in US petroleum demand. US demand peaked in September 2007 at 21 million barrels a day. The 1.5 million barrel decline represents a 1.7% decline in total global demand.

Between domestic crude oil, natural gas condensates and ethanol expansion, total US supply has recovered significantly. The supply increase and demand decline has squeezed net imports down to 9.03 million barrels a day from 9.62 million barrels a day a year ago. This represents a 6.1% volume decline which combines with the \$48.60/barrel price decline. Lower prices and lower volume reduced the US petroleum trade deficit by \$844 million in February 2009 versus February 2008.

The biggest problem in the crude oil complex continues to be the price war at the gas pump with ethanol. With per capita 2008 US driving miles down 4.4% from 2007. This is the largest decline in driving miles recorded including the turbulence of the early 1970s. Although, December's numbers were the first month to show a slower rate of contraction than the month prior. Given the 81% refinery utilization rate, there will be no relief in the price war between gasoline and ethanol in the foreseeable future. It remains unlikely that increasing blending requirements will be viable in the current economic environment.

Expected Price Range (next 12 months): NYMEX Crude Futures \$35 to \$70 a barrel
National Diesel \$1.75 to \$2.65 a gallon

Higher Prices

- OPEC cartel actions
- Middle-east political instability
- Slow non-OPEC supply growth

Lower Prices

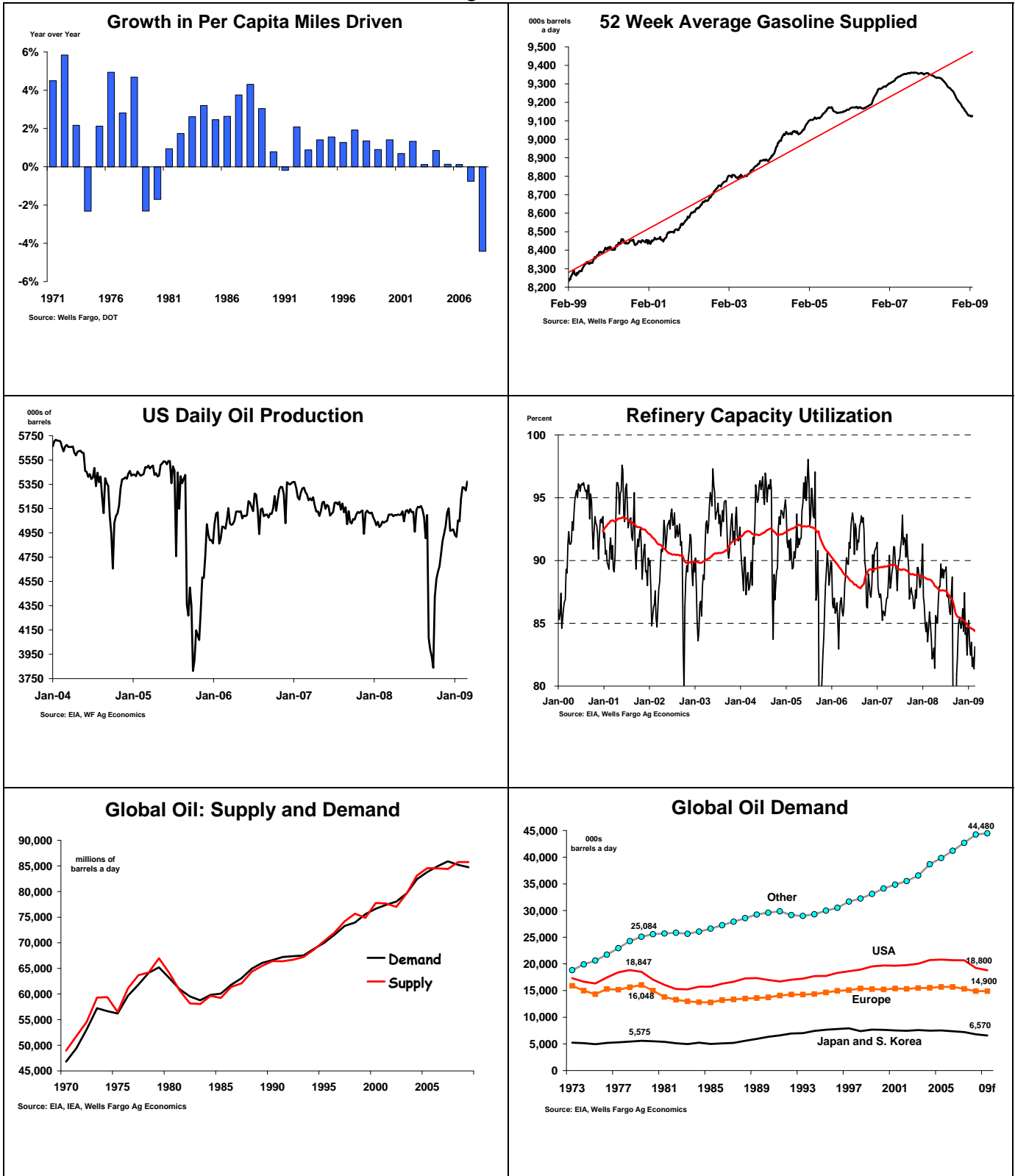
- Slow demand growth in the US
 - Reduced driving
 - Poor GDP growth
- Slowdown in Chinese GDP growth



NYMEX Nearby Crude

Year	Min	Max	Spread
99	15	30	15
00	25	36	11
01	18	30	12
02	22	37	14
03	26	38	12
04	34	55	21
05	47	68	22
06	52	77	25
07	57	98	41
08	34	145	111
09 prj	40	54	13

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Cash/Futures Price Forecast Natural Gas and Fertilizer 1st Quarter 2009

Summary: Unlike crude oil, domestic natural gas production continues to weaken on a year over year basis. Given the recent drilling activity, it seems likely that producers are not willing to extract as much natural gas as possible at the current prices. Even with the colder than normal winter in many parts of the country, natural gas on hand has remained sufficiently high not to trigger the typical winter heating price spike.

Lower prices have been supportive of a demand recovery, but the demand growth is only strong compared to last year's very weak demand. Overall net withdrawals through December have been too mild to create any risk premium in the natural gas market.

The fertilizer market as previously predicted has weakened significantly from its record highs of last summer. This price decline has left behind many unhappy buyers and sellers who purchased too soon, or who are still stuck with overpriced inventories. It also made it very difficult to gauge what the real cost of fertilizer costs will be this year. Farmers could have up to a 200% variation in their nutrient costs depending on when they purchased.

Many parts of the country report that the spot price of fertilizer have started to stabilize as farmers approach the planting season. But, with the uncertainty on the soybean/corn price trade-off, there will probably be a mad scramble at the end to buy and sell fertilizer that will add to the cost variation.

One thing is certain. Many fertilizer retailers will reevaluate their risk management programs (basically none). Taking a position on fertilizer going forward without a high level of guaranteed sales will become a less common occurrence. The possibility of bankrupting the company has grown too high. And, farmers will need to adopt simultaneous buy/sell fertilizer/corn hedges in these markets.

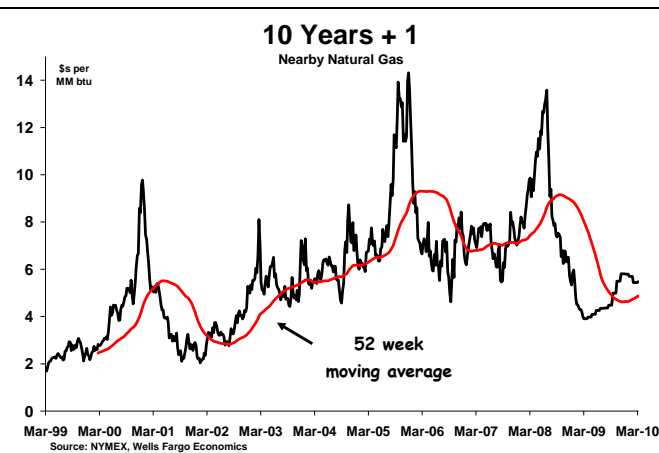
**Expected Price Range (next 12 months): NYMEX NG Futures \$4.45 to \$9.75 per MM BTU
Spot Ammonia \$225 to \$575 per ton**

Higher Prices

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Lower Prices

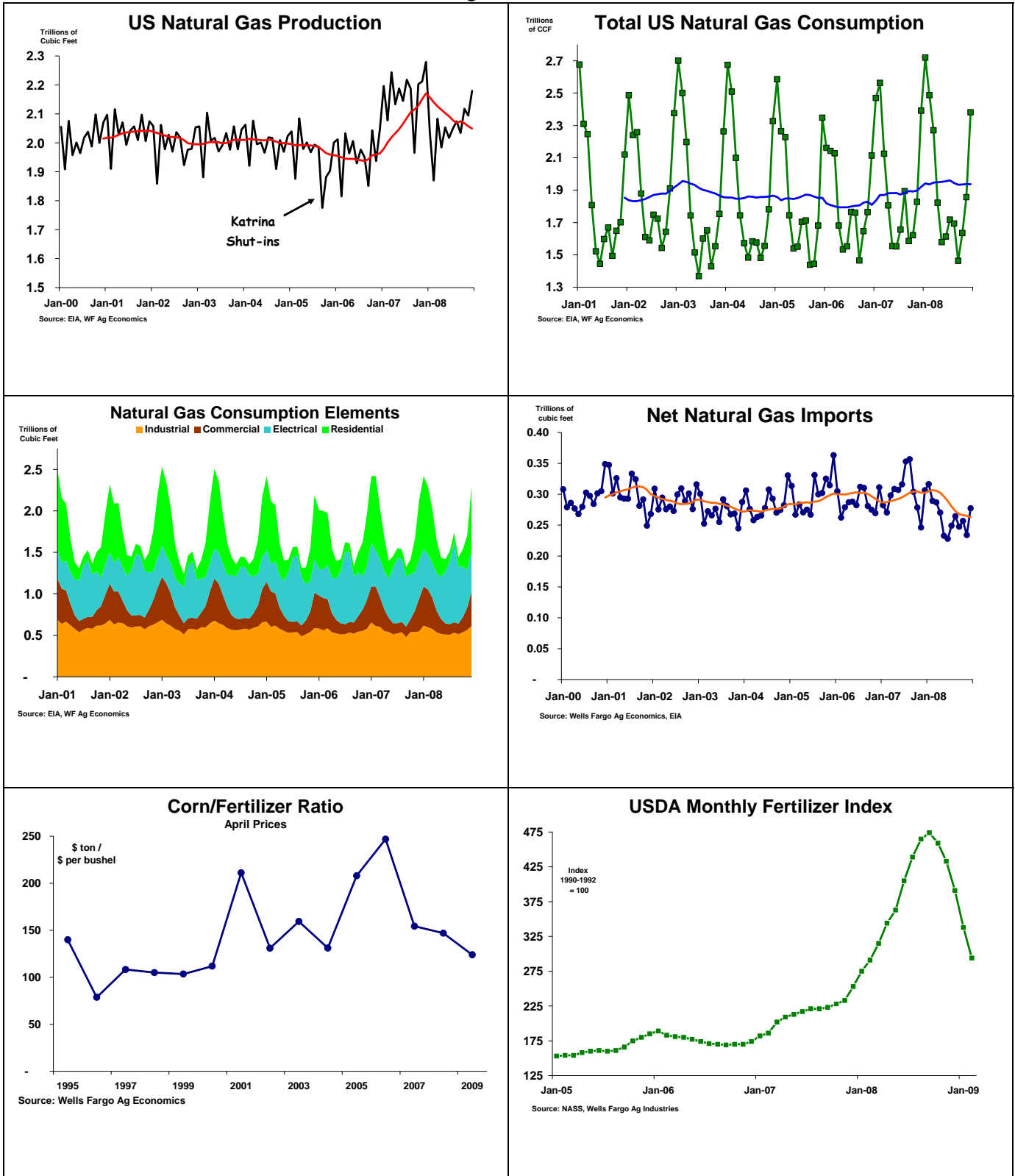
- Demand restrained by higher prices
- Growth in domestic production
- Stronger dollar – weaker foreign competitors
- Lower corn prices hurt demand



NYMEX Nearby Natural Gas

Year	Min	Max	Spread
99	1.70	3.07	1.37
00	2.53	9.78	7.24
01	2.10	7.26	5.15
02	2.04	5.54	3.50
03	4.43	8.10	3.67
04	4.57	8.73	4.16
05	5.91	14.31	8.40
06	4.63	9.28	4.65
07	5.47	8.42	2.95
08	4.52	13.58	9.06
09 prj	3.91	5.81	1.90

Cash/Futures Price Forecast Natural Gas and Fertilizer 1st Quarter 2009



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Cash/Futures Price Forecast

Ethanol

1st Quarter 2009

Summary: What a mess the ethanol market has become. 2009 February's estimated blend usage was 907 million gallons which annualizes only to 10.9 billion gallons. Obviously, February is a month with a low driving rate, but given the economic uncertainty and declining miles driven it might be too high to annualize.

The RFA website shows industry capacity at 12.4 billion gallons, and they estimate the operating plants have 10.4 billion gallons capacity. Don't forget, the US imported 0.5 billion gallons of ethanol in 2009 making up the gap between usage and current production rates. The approximate 2 billion gallons that are sitting idle will be a key factor in the future gasoline/ethanol discounts. The owners of these facilities will bring them online at the first opportunity, but the additional ethanol will hurt the profit potential of the industry.

The ethanol industry's response has been to ask for increase in the blending requirements for ethanol beyond 10%. There has to be more to the problem than this because ethanol only accounted for 6.9% of gasoline and ethanol distributions in February 2009. Some markets are capped out, but others are using substantially less ethanol than the 10% limit. Ethanol producers and corn growers see the benefits of blending more ethanol, but crude oil refiners and livestock producers don't agree. This makes the process a political fight with lobbyists at the ready and billing their various clients top dollar.

As the political fight continues, the ethanol industry appears to be set to run at break-evens. The first week of March saw spot ethanol prices average \$1.43/gallon in Iowa. At the same time, spot corn averaged \$3.35/bushel which leaves very little margin even for a well run plant. And if margins improve, expect those idled plants to start-up pressuring margins back down to break-evens. Without a major surge in fuel demand, ethanol production will be stuck in very tough range for profitability.

Expected Price Range (next 12 months): Spot prices **\$1.25 to \$2.07 a gallon**
 CBOT Futures **\$1.35 to \$2.15 a gallon**

Higher Prices

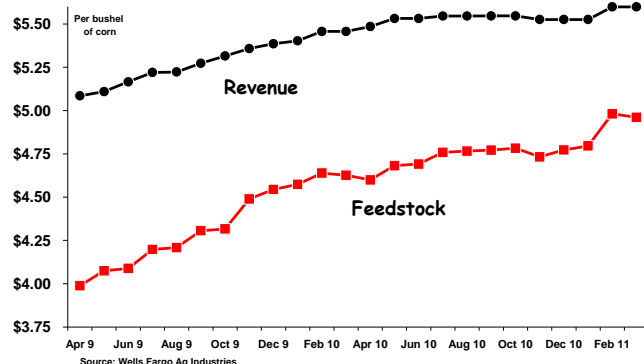
- Slowdown in expansion rate
- VEETC helps maintain spread

Lower Prices

- Falling fuel demand
- Falling gasoline prices
- Stronger dollar attracts foreign supply

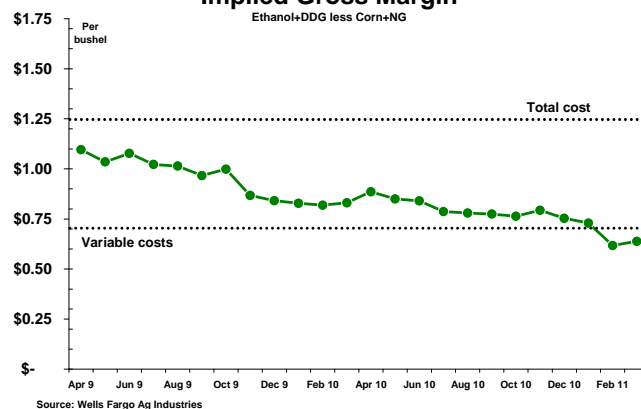
Ethanol Revenue v Feedstock Costs

Based on futures



Implied Gross Margin

Ethanol+DDG less Corn+NG

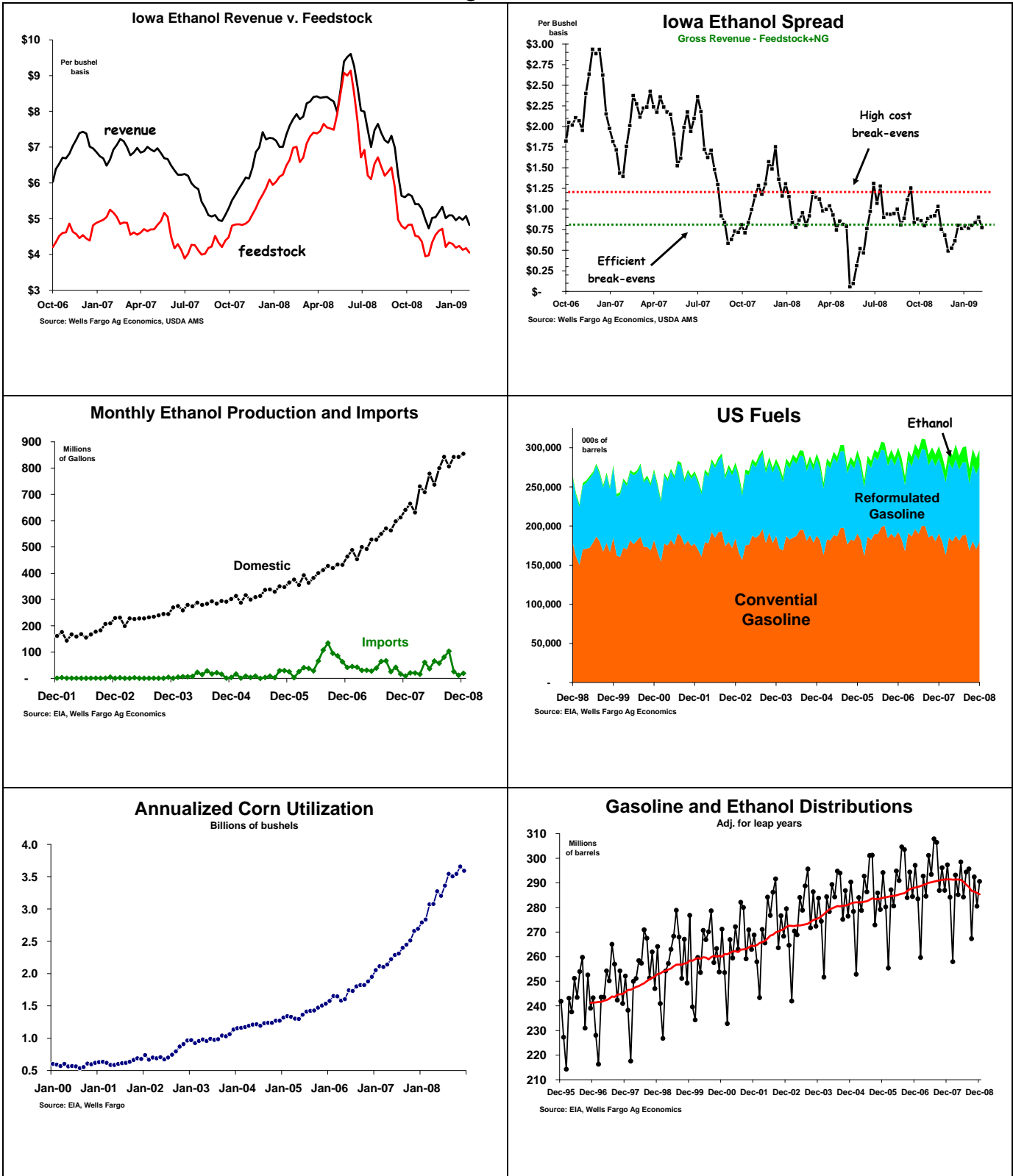


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