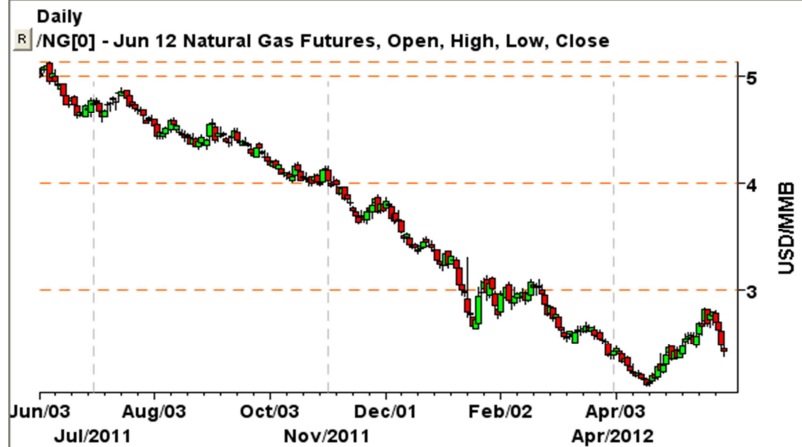


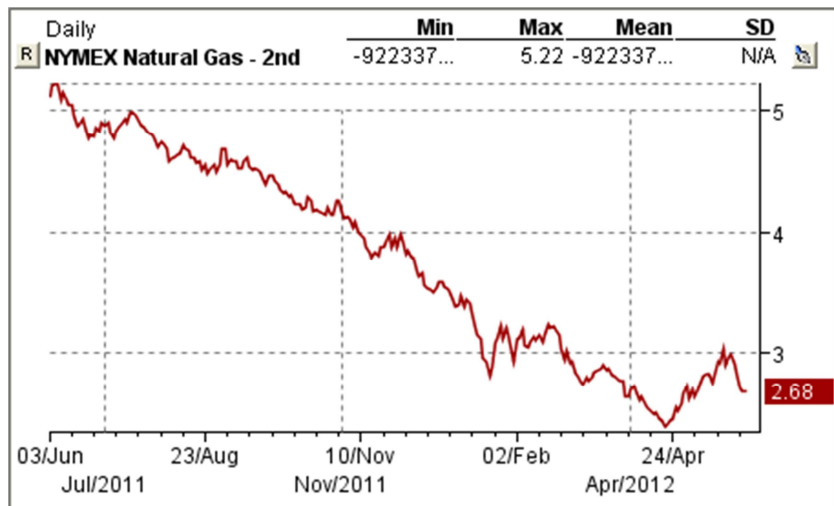


**Overview**

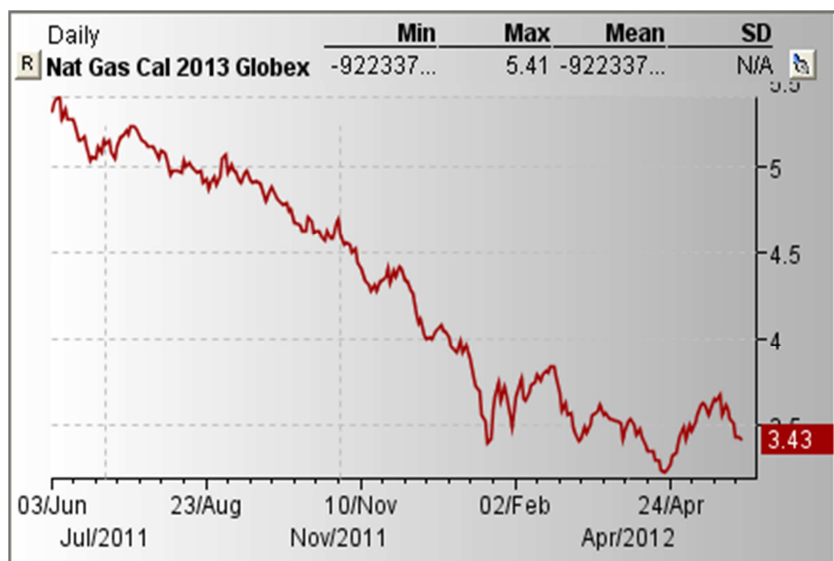
- On Tuesday 5/29/2012, the June 2012 NYMEX natural gas contract expired at \$2.429/MMBtu, \$.321/MMBtu lower than on 5/18/2012.



- 2nd half (July - December) CAL 2012 closed \$0.31/MMBtu higher.



- CAL 2013 closed \$0.24/MMBtu lower.





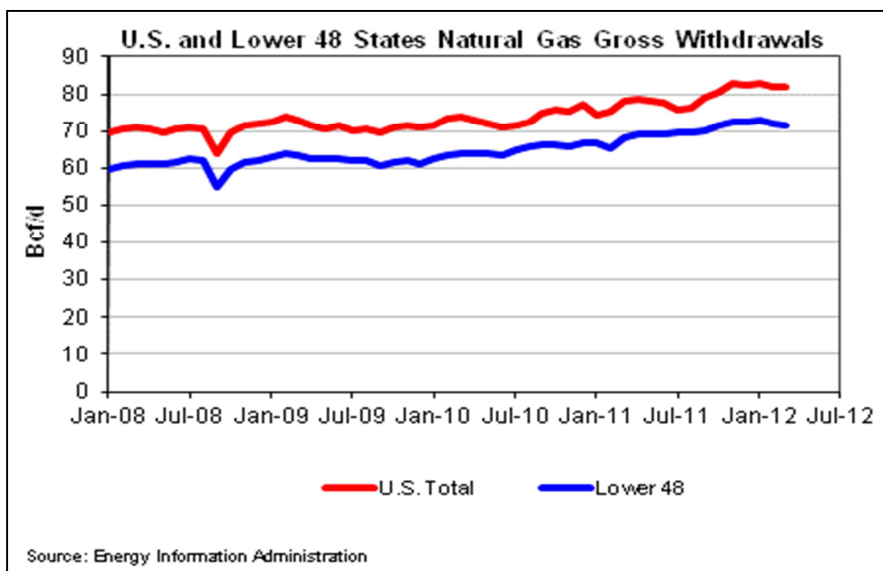
### Closing Thoughts

**NATURAL GAS** – After reaching \$2.75/MMBtu on 5/18/2012, price action for the June-2012 contract seesawed up until Thursday 5/24. Since then, NG futures have tumbled almost as fast as they rose. The decline showed that sustained prices above \$2.50/MMBtu likely would inspire some switching back to coal.

To explain what factors have contributed to the recent changes in NG prices, below is a breakout of the major forces that have tightened the market.

#### Supply:

- On 5/31/12, EIA reported that from Feb-2012 to Mar-2012 production in the Lower 48 States decreased by 0.4%. This is the 2<sup>nd</sup> consecutive month that production has decreased; however, production continues to be at record high levels (see chart below).
- The injection for the week ending on 5/25/2012 underperformed for the 7<sup>th</sup> consecutive week. The actual injection number of 71Bcf was slightly higher than analysts' estimate of 69Bcf.
- Even though the actual number was in line with analysts' estimates, the number was below the 89Bcf injection for the same week last year and under the 100Bcf five-year average injection for the week.
- Baker Hughes data on Friday 5/25/2012 showed the gas-directed rig count dropped by 6 to 594.



#### Demand:

- NOAA's current 6-10 forecast is calling for above normal temperatures in the Midwest and South, and normal to below normal temperatures in the East and West coasts. Considering that the coasts are major consuming regions this report seems to be neutral at this point in time.
- Traders will closely monitor cooling demand as a function of weather in the coming weeks.
- As prices have fallen below \$2.50/MMBtu level, we expect coal-to-gas switching to increase as the economics again favor burning natural gas.



In summary, there is a trend that NG production is declining at a slow pace as a result of dry gas production cuts. We are not seeing a steep reduction due to associated gas from more profitable Oil production. Regarding demand, this is a weather driven market that will be very sensitive to changes in weather forecasts. We expect that future injections will continue to underperform compared to historical builds as long as coal-to-gas switching is in play. Even though demand keeps trimming the excess surplus, we are still 35% above historical levels, and currently the Lower 48 states storage is at 69% of capacity. Below we show the "Percent Full" for the regions that comprise the Lower 48 states:

- East- 60%
- Producing- 81%
- West- 74%

The July-2012 contract will most likely move within the \$2.30/MMBtu to \$2.50/MMBtu trading range. The recent decline in prices took the market out of the overbought range, so we expect some consolidation in this area. It is clear that the supply overhang will continue to weigh in the market, so buying the dip will continue to be a good strategy for 2012 open exposures. We have a neutral outlook for the near future.

**ERCOT Heat Rates** - 2012 summer heat rates (July & August) have come off during the past couple of days; however, we expect to see an increase in forward heat rates volatility after the Brattle Group Inc. releases a report tomorrow, 6/1/2012..

In March, ERCOT selected the Brattle Group Inc., to examine factors that incentivize investment in new generation and other initiatives related to improving ERCOT's resource adequacy goals.

The Brattle Group has been working with investors and other stakeholders to determine what incentives or other adjustments could improve the outlook for future electric generation and other resource adequacy solutions. ERCOT and the PUCT will explore the report's findings with market participants and other stakeholders to find solutions that will bolster reserve capacity margins in the coming years.

Contact your Acclaim representative to further discuss your cut situation.

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