

Natural Gas Market Update

10/26/06

Natural Gas Review and Outlook

The market continues to pretend that no storage surplus exists and continues to push higher. This market has, over the past few years, taken the attitude that it will assume the worst and wait to be proven wrong. Such was the case all summer with prices holding higher than they should based on the fear of a hurricane and in spite of record high storage levels. It wasn't until its hand was forced at October expiration that the front month finally gave it up, with the October contract expiring at \$4.201.

So here we are two days away from November expiration and it settled at \$7.693 on the 25th, \$3.492 higher than October expired because the assumption is that we are in for a colder than normal winter. Never mind, that there are as many forecasters calling for normal or slightly above normal winter, the worst case scenario assumption will remain in place until proven otherwise.

With this backdrop in mind, let's take a look at some price levels to watch. The market is up overnight, with November trading as high as \$7.91, so an assault on the \$8.00 mark appears imminent. With so little behind this rally from a fundamental standpoint, I have a difficult time believing that it will be successful in breaking the \$8.00 mark, so as of right now I'd lean toward it holding, although with the market psychology being what it is, as discussed above, I could just as easily be wrong. If I am correct and \$8.00 holds, support could then be tested. With the contract expiring Friday, it doesn't leave a lot of time for testing the downside. First support comes in at \$7.60 with a sterner test at the \$7.40 area.

Fundamentals

Storage

The overall storage situation remains bearish. The only suspense left to this injection season is by how much the industry will break the previous record end of season storage level. The market has already broken the previous all-time high so each week's report simply adds to the record.

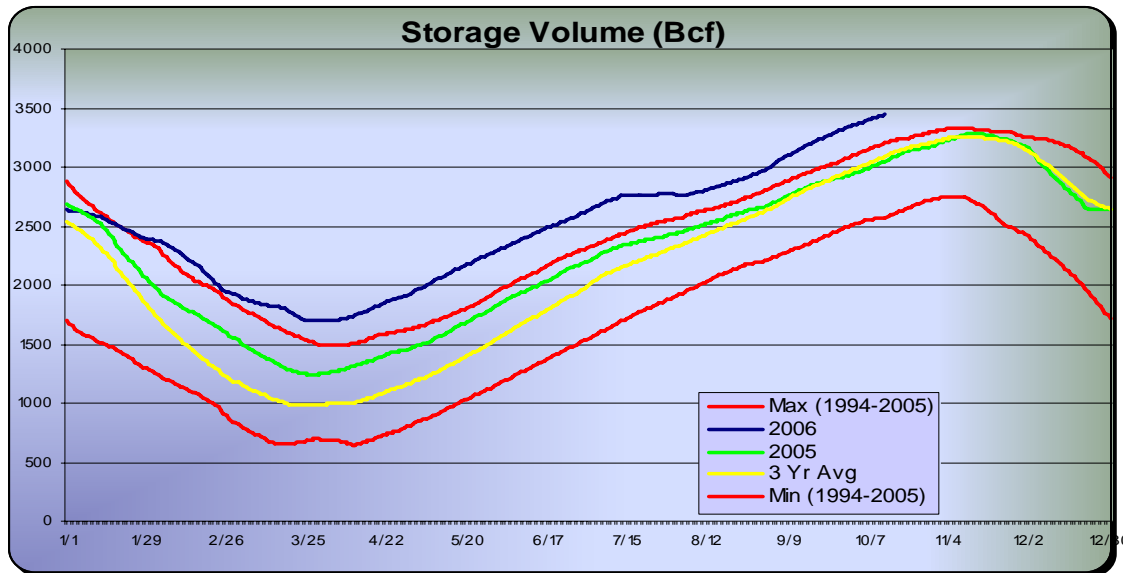
The column labeled 'Difference-Record High' in the table below calculates the percentage above the high for the specific date in question. For example, on September 29th there was 8.4% more gas in storage than on any other September 29th since they have been reporting weekly numbers. The most gas reported, regardless of date *had* been 3,327 Bcf. As of October 13th, the industry had broken that record by 3.5%.

The Reuters survey is predicting a storage injection of 31 Bcf to be reported later this morning.

EIA Weekly Natural Gas Storage Report

For the Week Ending	Total Inventory	Weekly Change	Difference – Prior Year	Difference – 3-Yr Average	Difference – Record High
09/29/06	3,327	+73	+13.8%	+12.8%	8.4%
10/06/06	3,389	+62	+13.8%	+12.3%	7.9%
10/13/06	3,442	+53	+12.8%	+11.4%	7.4%

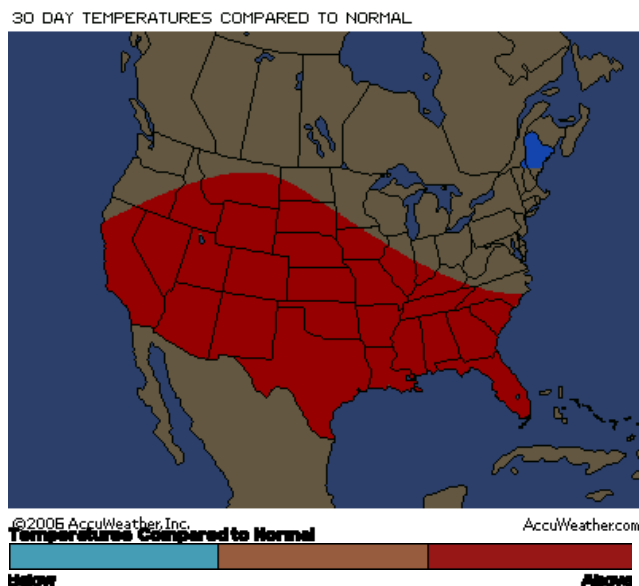
The graph below shows the current level of storage as compared to history.



Weather

For the five-day outlook, AccuWeather is predicting below average temperatures for the eastern half of the country with normal temps elsewhere, except for south Texas and the extreme Northwest which are predicted to be above normal. Days 6-10 restricts the colder than average temperatures to the upper Midwest and Northeast, with a wide swath across the country having normal temps and the Southwest and extreme Southeast having above normal temps.

Below is AccuWeather's 30-day temperature anomaly map, not exactly what I was expecting given the recent run up in prices. I have read reports blaming the recent price increase on colder winter forecasts. I guess AccuWeather didn't get the memo as their 90 day forecast (not included) only shows below average temperatures in extreme Northeast.



Baker Hughes Rig Count			
Report Dated 10/20/06			
	Current Year	Prior Year	Increase (Decrease) over Prior Year
U.S. Gas Rigs	1,442	1,253	189
U.S. Oil Rigs	291	216	75
Total Rigs – North America	2,194	2,041	153

Crude Oil

It appears that with the help of OPEC's announced quota reductions that the crude oil market has established a short term bottom with good support at the \$58.00 area. Yesterday's surprise draw in crude stocks coupled with OPEC's announcement days earlier was enough to spur a rally, pushing prices up \$2.01 yesterday to \$61.40. There is resistance about a dollar higher at \$62.60. The \$64.00 mark is important as well, a close over \$64.00 would switch the outlook to neutral from the current bearish scenario and indicate that a longer term recovery is underway.

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