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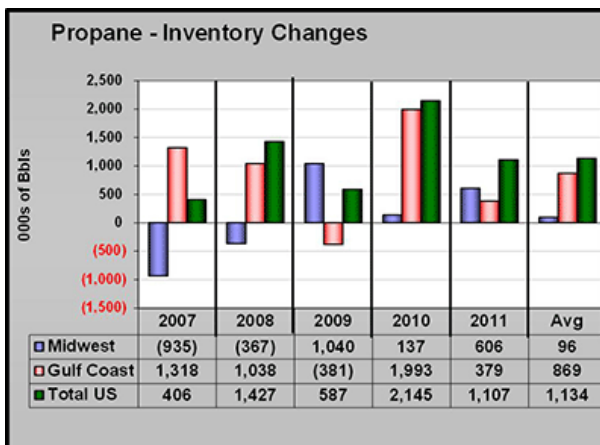


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#### Trader's Corner

This week's Trader's Corner discusses the draw on Midwest propane inventory.

Were you surprised by the draw in Midwest propane inventory this past week (week 31 of the year)? Over recent weeks, Midwest propane inventory has had very light builds, and finally this week inventory actually fell slightly. The table of propane inventory changes for week 31 of the year below shows light builds and even draws on the Midwest are the norm, not the exception.



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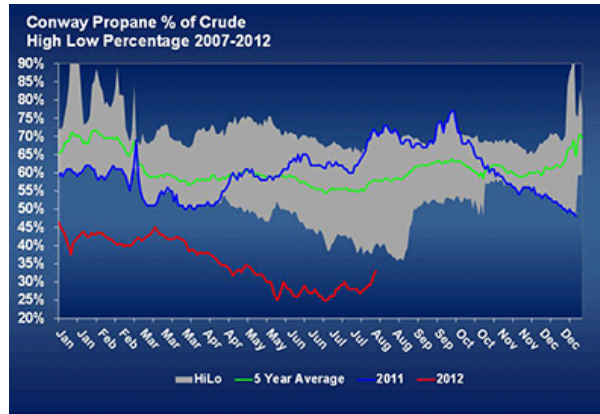
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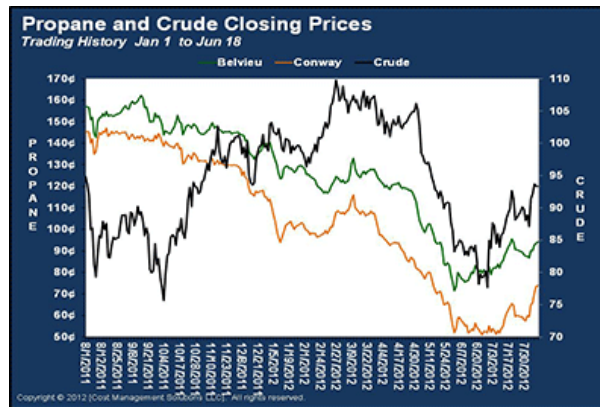
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However, we all know the Midwest is in the middle of a drought, causing expectations that crop-drying demand would be near nonexistent. So why wouldn't this year be the exception, when inventories build more than normal? That is an excellent question, one we have considered a lot.

We think this draw occurred at least partly because of propane pricing conditions at this time last year.



The chart above shows Conway's relative value to WTI crude. Last crop-drying season, Conway propane was a high-valued Btu, running at about 75 to 80 percent of WTI crude, but this year it was as low as 25 percent last month and even with the recent rally is still just 33 percent of WTI.



From an absolute value perspective, Conway prices have plunged. On Aug. 1 of last year, Conway closed at 144.75 cents; it was at 60 cents on Aug. 1 of this year.

Last year, a farmer would have had little incentive to fill his propane tanks. We have no survey to prove this, but logically one can conclude that farmers bought and used only the propane absolutely necessary in 2011. We expect that most farmers finished the crop-drying season with propane inventory at very low levels.

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Fast-forwarding to this year, farmers are highly incentivized to fill their tanks, even if they are not sure they will need propane, because of low prices. The result could be an initial surge in demand (price driven), as farmers fill tanks that were pulled low last year, followed by a lag if actual crop-drying demand is low.

In addition to this possible pent-up demand on Conway propane from farmers, the 30-cent spread between Conway and Belvieu is having an impact as well. During the last few weeks, when Midwest inventory has been experiencing light builds and a draw, Gulf Coast inventory has been building at an above-average pace.

As a result of this price spread, Midwest propane is pushing deeper into areas traditionally supplied by the Gulf Coast. We also suspect that some natural gas processors that might normally send their production to Conway are loading it in railcars and shipping directly to the Gulf Coast. A 30-cent premium in Belvieu would logically draw plenty of interest from producers. One thing we know is that the market is very astute in finding the best netback.

Perhaps the biggest factor affecting Midwest propane inventory has been the low value of ethane in the Midwest market. As we showed just a few weeks ago, Midwest ethane fell to 1.5 cents per gallon, causing producers to begin rejecting it, not taking it out of the natural gas stream but instead selling it with methane to natural gas companies.

Prior to rejection, Midwest ethane, along with butanes, was taking up the bulk of the pipeline space between the Midwest and the Gulf Coast. As wide as the price spread between the two hubs was for propane, it was even wider for ethane and butane.

Now that ethane is being rejected, there is more line space for propane to move from the Midwest to the Gulf Coast.

As you consider the inventory picture and anticipate what may happen going forward, consider the following:

1. The surge in demand from farmers may be short-lived.
2. The spread between Belvieu and Conway has been cut from 30 cents to 20 cents. As the spread closes, traditional Belvieu markets may get relief from the Midwest propane supply that has been invading its turf.
3. Midwest ethane prices have recovered from 1.5 cents to nearly 20 cents. That could encourage its extraction and once again take up valuable pipeline space.

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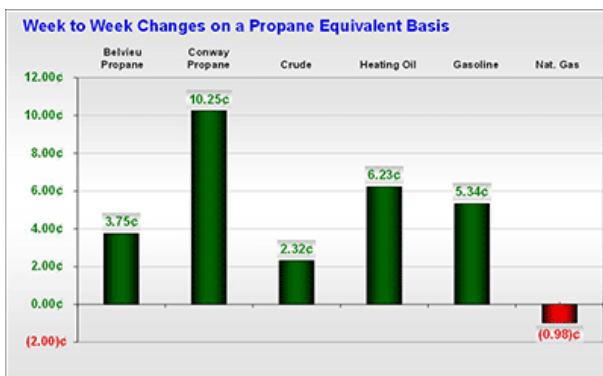
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**WEEK IN REVIEW**

Crude had carryover momentum from the previous week, but couldn't hold it. Despite many supports, traders became concerned crude might be overbought, limiting its upside.

Conway propane continued its surge following a draw on Midwest propane inventory. Fundamentals were not as supportive for Belvieu, limiting gains.

We go into this week neutral. Crude has plenty of supports, but issues with the economy will not go away. Gains in Conway may be harder to come by now that its discount to Belvieu has been sharply reduced.



**LAST WEEK'S DAILY HIGHLIGHTS**

**Monday:** Crude continued higher, bolstered by Friday's better-than-expected U.S. jobs report and hope the European Central Bank would take measures to lower Spanish borrowing costs. Belvieu struggled to follow crude up, but Conway remained strong.

**Tuesday:** Low North Sea crude production and threats to Middle East crude supply pushed crude higher. Propane surged on heavy trading in Belvieu and tightening Midwest propane supplies.

**Wednesday:** Conway propane moved sharply higher again after the EIA reported a draw on Midwest propane inventory. Crude had a volatile day, eventually slipping lower on late profit taking. Crude had moved higher after a bullish EIA report for crude and refined products, but traders became worried that crude was entering overbought territory.

**Thursday:** Crude traders continued to take profits despite many supports for crude. WTI finished only a penny above Wednesday's close. Propane remained in its bullish mode, though upside momentum drastically slowed.

**Friday:** Propane shrugged off sharply lower trades to start the day and once again posted gains in Conway despite

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an off day for crude. Belvieu traded lower with crude.

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- Evening Report with Executive Summary, Trader's/Hedger's Corner, Weather maps and complete review of energy prices that are based on Propane's Btu Equivalent

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