Energy Market Update:
Focus on Exchange-Traded Funds

June 2011

Jim Joyce
Tim Simard

NATIONAL BANK
FINANCIAL GROUP

NBC Commodities

- 14-person Calgary-based team focused on client-driven risk management activity
  - Concentration on energy to serve our Canadian oil and gas producer clients
  - Largest lender to the small cap O&G producer community in Canada
  - Collective team experience in excess of 250 years in the field of energy trading and risk management
- Largest trader of financial energy derivatives among Canadian banks
  - For last 12 months, top-10 rank in NYMEX natural gas volume and top-20 rank in NYMEX crude oil volume
  - Average total daily futures volume traded by National Bank Financial over past 12 months:
    - NYMEX WTI 1350 contracts, NYMEX NG 4,050 contracts
  - strategic trading activities undertaken largely to support client-driven business
    - Total desk value-at-risk limited to $2.5 MM
    - Q1 2011 average daily VAR usage - $0.8 MM (Goldman Sachs $37 MM, JPM $13 MM)
- NBC Commodities trading desk selected by Horizons BetaPro in 2007 to provide the underlying hedges to their suite of commodity ETFs listed on Canadian equity exchanges
  - NYMEX WTI crude and natural gas, COMEX gold, silver and later copper
  - Long and short ETFs, single leverage and 2X leverage
  - Peak Assets Under Management for largest ETFs:
    - HOU (2X leverage oil bull) $0.67 billion, HNU (2X leverage nat gas bull) $1.05 billion
- Embryonic coverage effort of institutional investors with respect to direct commodity structures, but as yet no traction (outside of ETF-related activity)
  - No passive index activity on behalf of clients to-date

Jim Joyce and Tim Simard

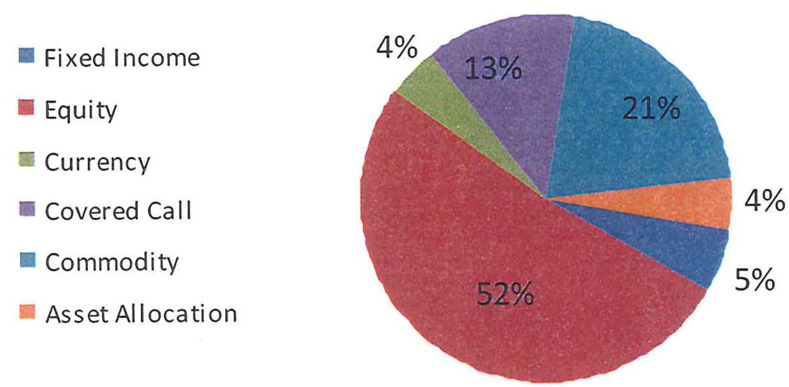
- Co-heads of NBC Commodities
  - Jim Joyce – head trader, (including ETF execution activity)
  - Tim Simard – client coverage
- Both have over 20 years' experience specifically in the field of energy risk management
- 1995 -2005: co-founded RiskAdvisory, independent energy risk management consulting firm that provided advisory services to over 200 energy clients in the US, Canada and New Zealand
- Expert witness experience in regulatory hearings pertaining to energy risk management practices:
  - Jim Joyce
    - Regis du Quebec – Gaz Metropolitain
    - Nevada PUC – Sierra Pacific, Nevada Power
    - FERC – Sierra Pacific
  - Tim Simard
    - Idaho PUC – Idaho Power
    - Ontario Energy Board – Consumers Gas/Enbridge (twice)
    - Nova Scotia Utility and Review Board – Nova Scotia Power
    - Manitoba Public Utilities Commission – Centra Manitoba/ Manitoba Hydro
    - Alberta Energy and Utilities Board – ATCO Gas

National Bank Financial and ETFs

- NBF's role as structurer and Market Maker for ETFs has allowed it to gain expertise across all asset classes. These asset classes include:
  - **Equity ETFs**
  - **Commodity ETFs**
  - **Fixed Income ETFs**
  - **Currency ETFs**
  - **Asset Allocation ETFs**
  - **Hedge Fund ETFs**
  - **Covered Call ETFs**
    - Recently assigned Designated Broker on 4 AlphaPro and 4 XTF Capital covered call funds

- NBF is designated broker for 91 listed ETFs, touching each major asset class, as illustrated below:

ETFs By Asset Class

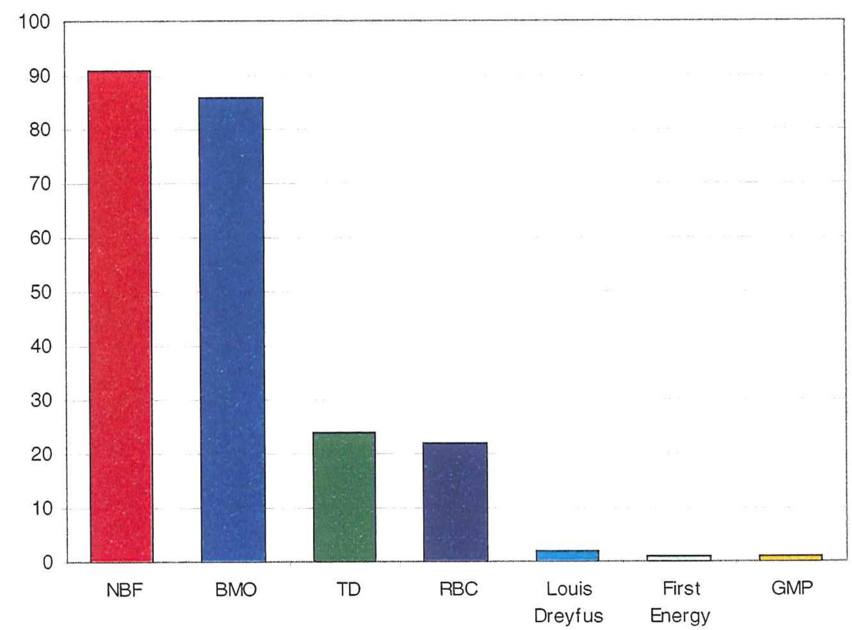


National Bank Financial and ETFs

- NBF is the market leader acting as Designated Broker and Registered Trader for 40% of the ETFs listed in Canada
- As Designated Broker/RT, NBF has provided seed capital and maintained minimum spreads for over 70 Canadian ETFs.

	Designated Broker	Market Share
NBF	91	40.1%
BMO	86	37.9%
TD	24	10.6%
RBC	22	9.7%
Louis Dreyfus	2	0.9%
First Energy	1	0.4%
GMP	1	0.4%
Total	**227**	**100%**

Designated Brokers for Canadian ETFs



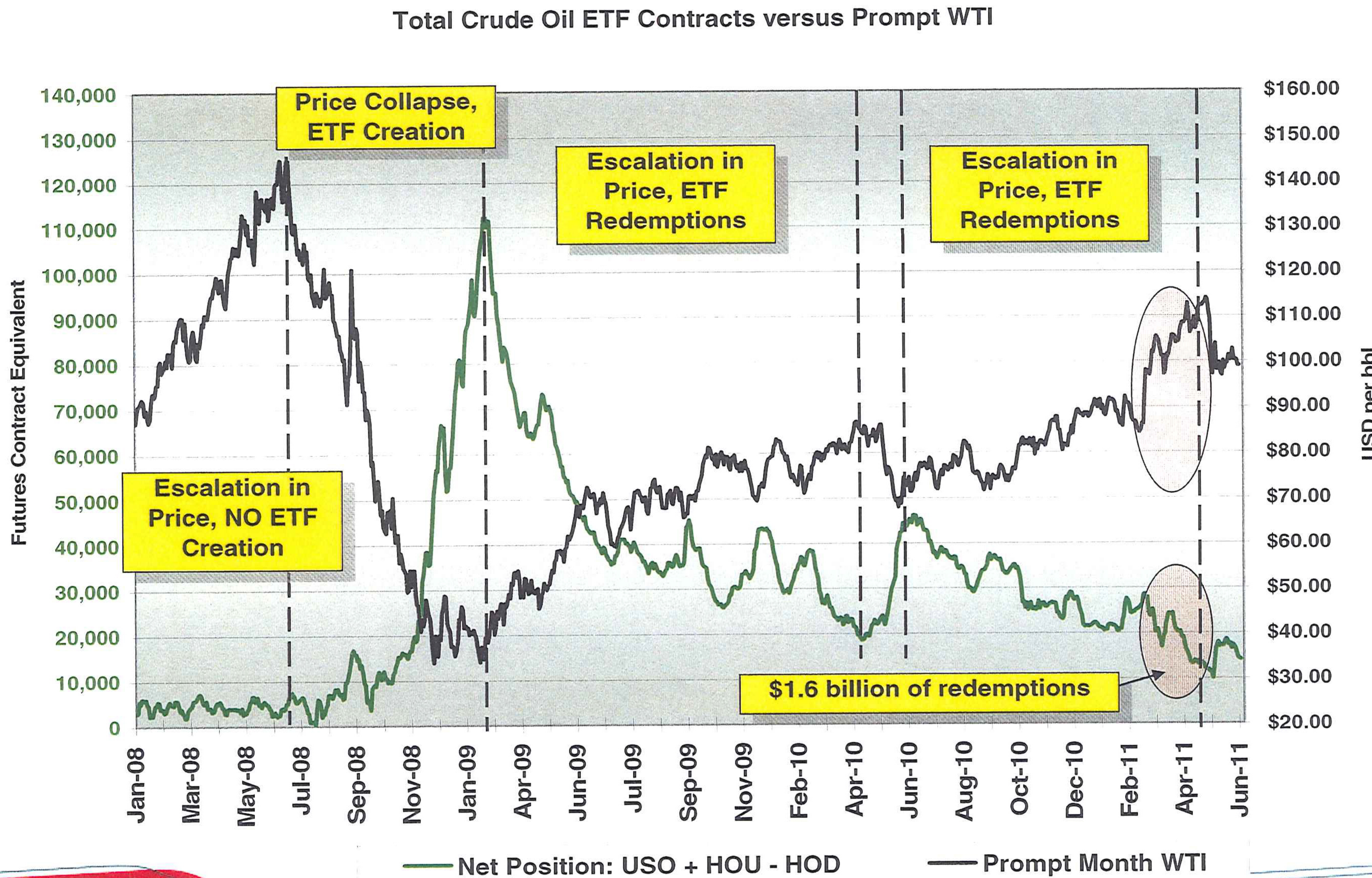
General Thoughts on CFTC Rule Changes

- Fully supportive of most of the initiatives:
  - Centralized clearing
  - Swaps repository
  - More open disclosure
  - Spot month limits
- Encouraged by the clearing exemption for end users
  - None of our producer clients are required to post margin
    - Credit comfort from the “right-way hedging” argument
  - Many clients would abandon their prudent risk management programs should they be required to post margin
- Major concern: inclusion of ETF futures hedge positions in position limit calculations either for ETF managers or their intermediaries

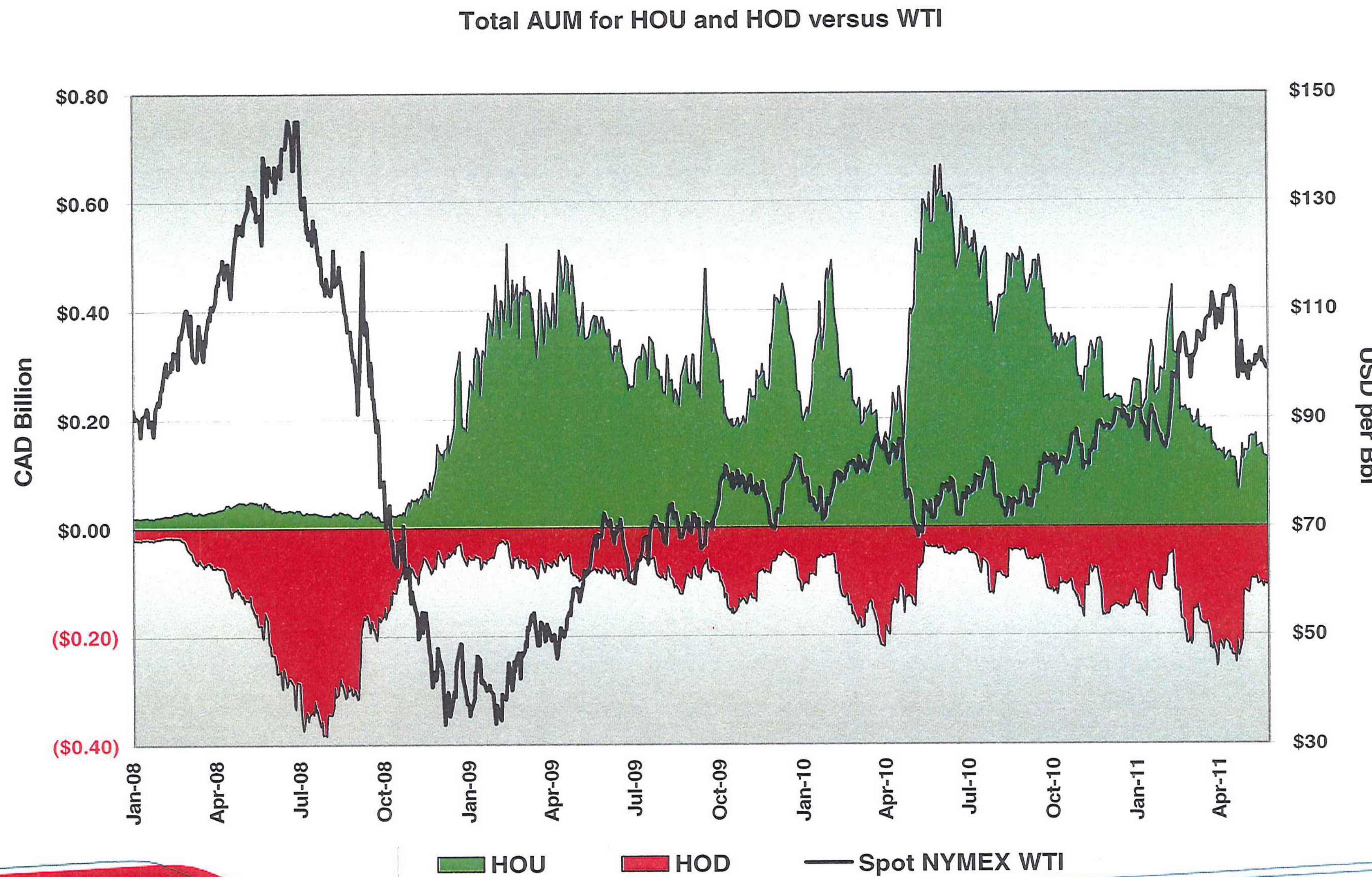
Why Should ETF Positions Be Excluded from Position Limit Calculations?

- Historical evidence in energy shows clearly that ETF participants have served to reduce price volatility rather than exacerbate market volatility
- ETFs are an amalgamation of many investors rather than a single concentrated position
  - The concept of an exchange microcosm
- ETF mechanism results in fully-margined positions for most investors
- Willingness on the part of ETF managers to disclose the positions of large participants in their funds
  - These positions can then be amalgamated with participants' other positions to assess their overall position versus regulatory limits
- ETF participants in the energy markets have been providing important liquidity to commercial hedging participants

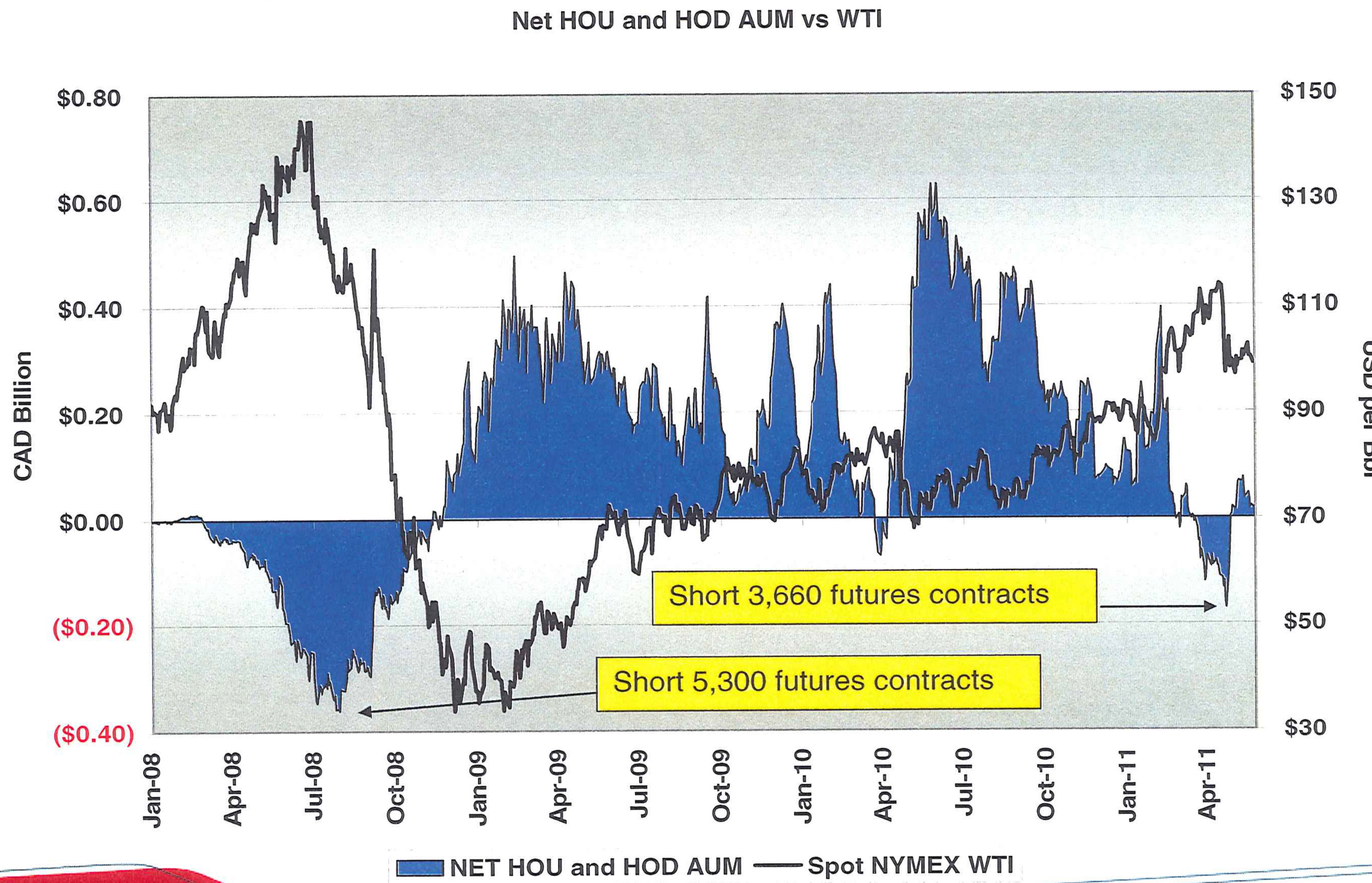
ETF Equivalent Futures Contract Positions vs. WTI Price



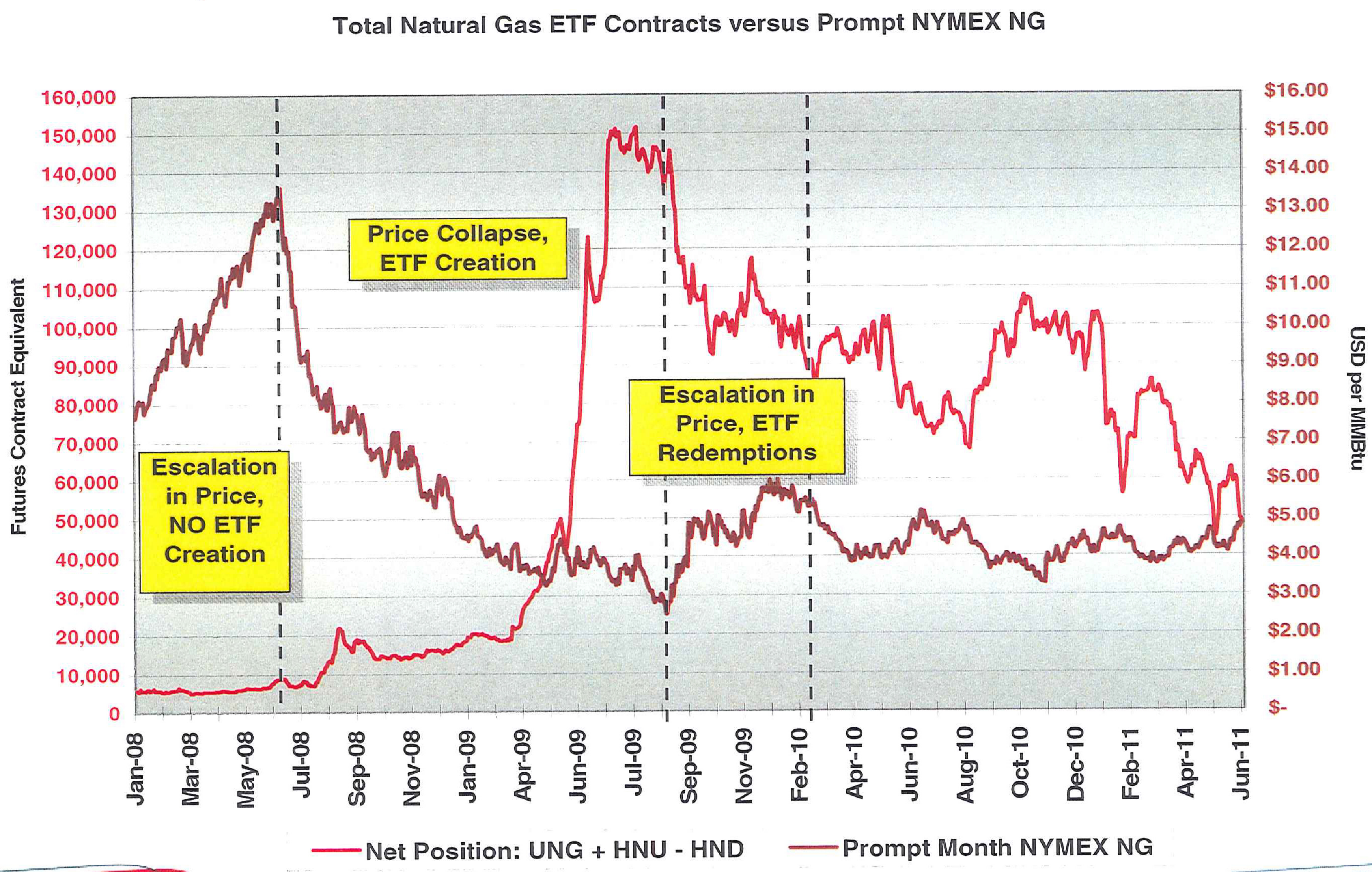
Relative Long/Short AUM For Horizons BetaPro WTI ETFs



Net Long/Short AUM for Horizons BetaPro WTI ETFs

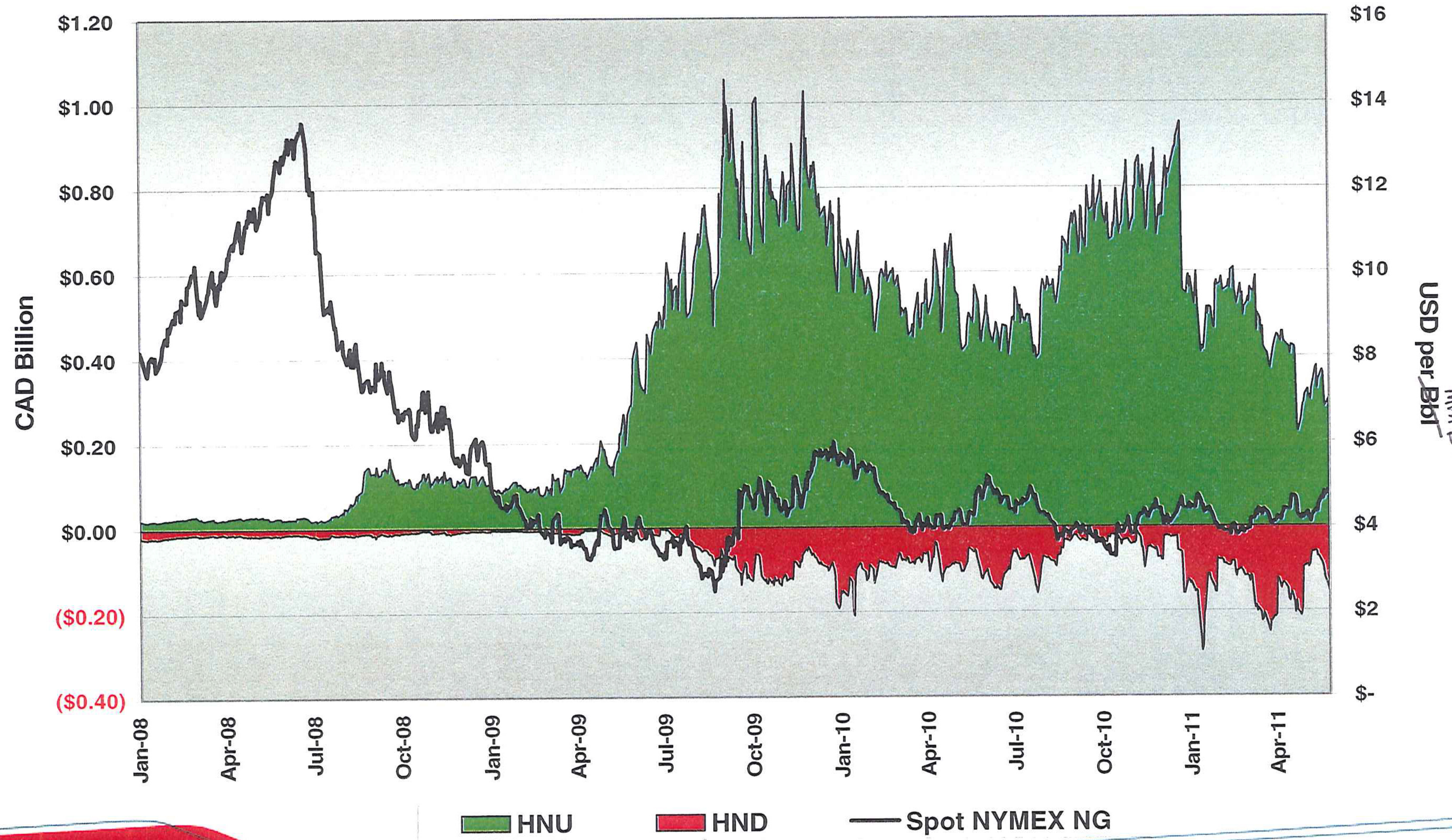


ETF Equivalent Futures Contract Positions vs. NYMEX NG Price



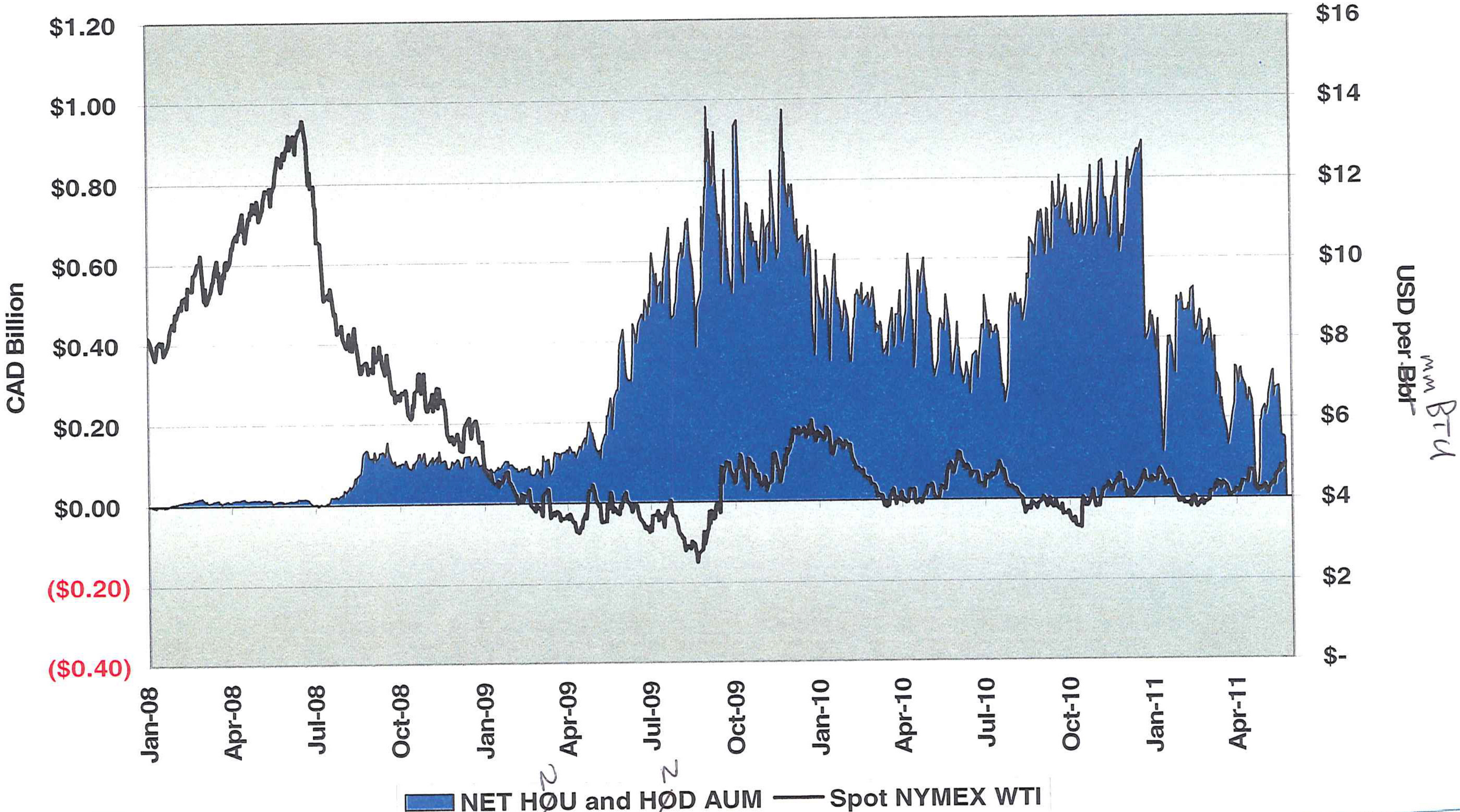
Relative Long/Short AUM For Horizons BetaPro NYMEX NG ETFs

Total AUM for H~~O~~U and H~~O~~D versus NYMEX NG
N N



Net Long/Short AUM for Horizons BetaPro NYMEX NG ETFs

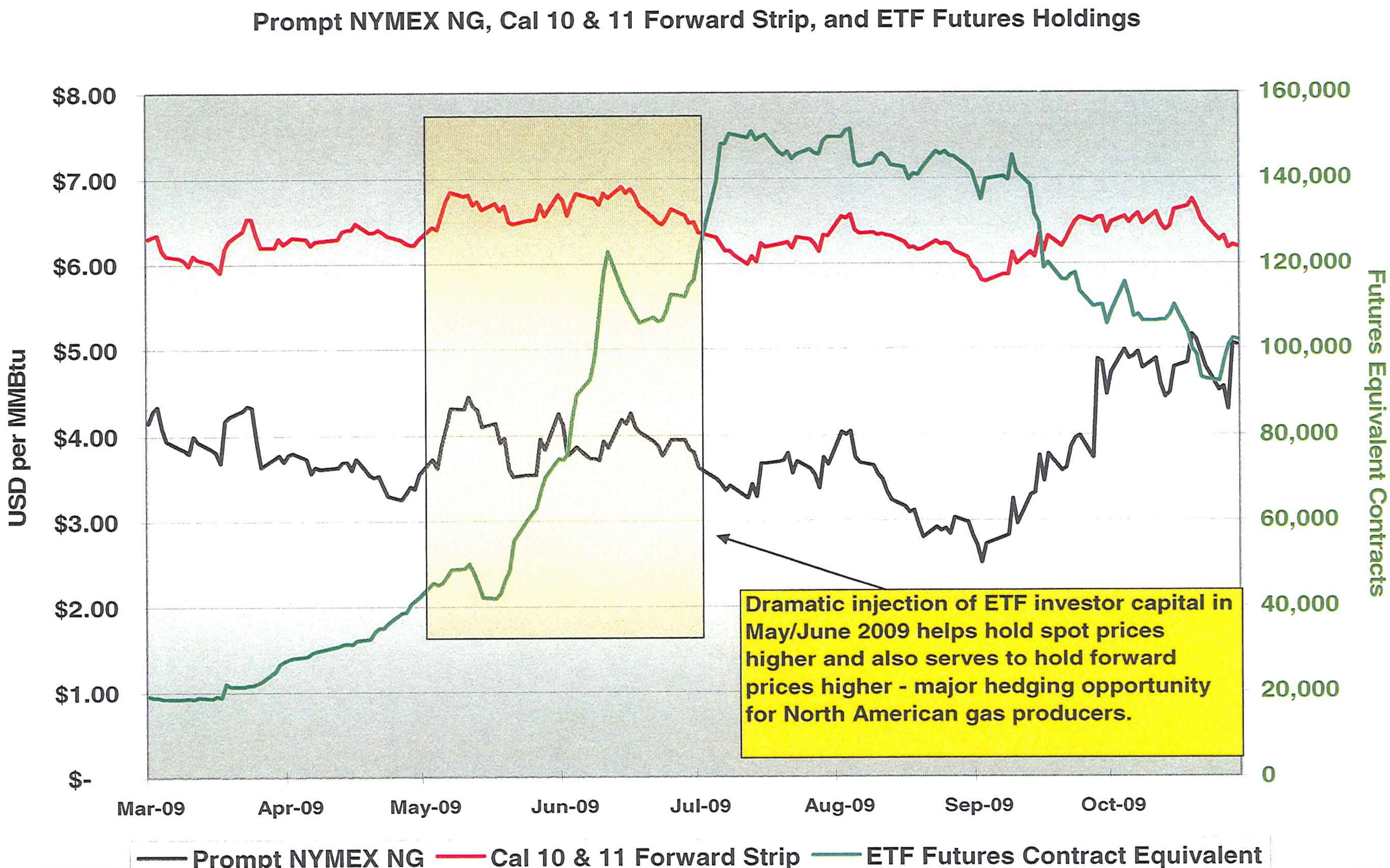
Net HØU and HØD AUM vs NYMEX NG



Positive Liquidity Impact

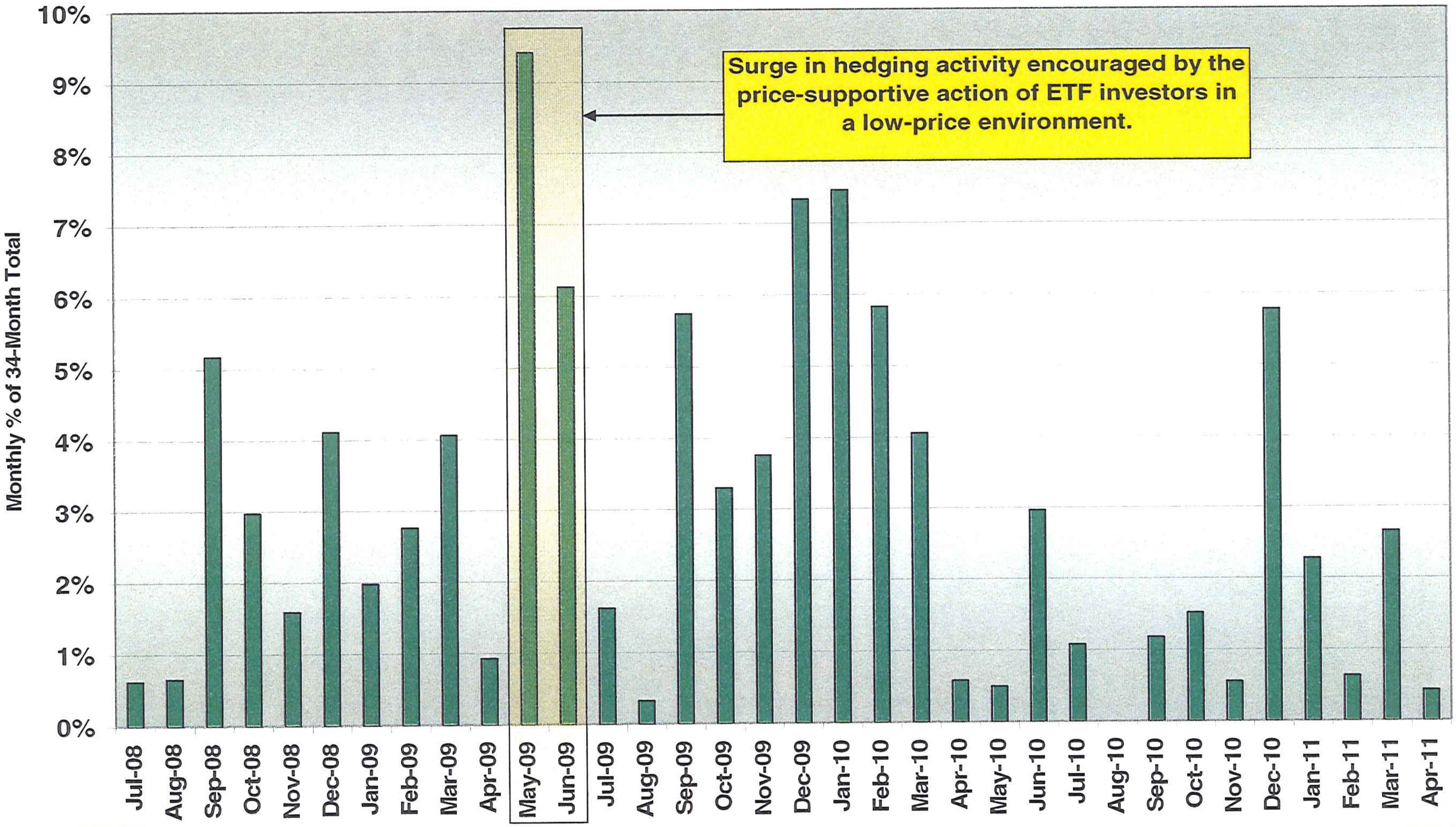
- Historical evidence does indicate that at times ETF investors have helped support oil and gas prices, BUT GENERALLY IN A DEPRESSED PRICING ENVIRONMENT
  - WTI between $35 - $50 in 2008/2009
  - Henry Hub natural gas below $4.00 in summer 2009, summer 2010 and again earlier this year
- Argument to be made that this is positive for medium-term energy security of supply
- 2009 scenario:
  - Over a two-month period, ETF investors inject close to $4 billion into the gas market, supporting both spot and forward prices
    - While ETF players are buying 1st or 2nd month contracts, their activity helps support the back end of the curve as well
  - Back-end support created an attractive opportunity for shale gas producers to hedge potential future production, enabling them to carry on with aggressive capital expenditure programs
  - End result is more gas available for North American consumers in the medium-term
  - Abundant gas and lower price environment today at least partially a function of these hedging opportunities, which in turn were heavily influenced by ETF buying support

2009 Scenario: Material ETF Inflows Provide a Producer Hedging Opportunity



Significant Uptick in Producer Hedging Activity in May/June 2009

Relative Monthly Producer NG Hedge Activity with NBC



Final Comments

- No evidence showing that ETF investors are exacerbating energy market volatility or contributing to higher prices in a high-price environment
  - In fact, just the opposite
  - In general, energy ETF investors look for low-price environments to buy and high-price environments to sell
- ETF investor action over the past three years has contributed to a healthier hedging environment for gas producers, enabling them to expand the supply available to North American consumers
- ETF activity does not represent a single trading block, but instead the amalgamated activity of myriad investors with different price views
- Willingness on the part of ETF managers to disclose large positions still allows regulatory oversight of individual position limits
- Supports the exclusion of ETF manager and intermediary futures positions from limit calculations