



E-illumination July 11, 2006

Oil prices remain at record levels while oil stocks retreat. What gives?

The chart below and to the left is the price of light crude over the past six months or so. Notice that it peaked at just over \$75 in April 2006. It has bobbed up and down since, but has visited the old high three more times since first establishing it in April.



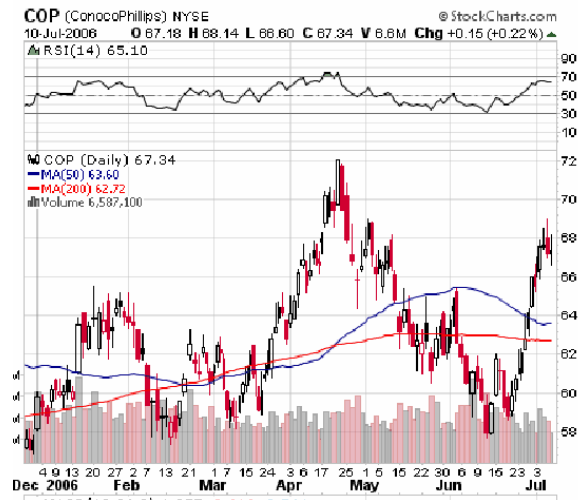
Pick almost any oil stock or oil services related stock and you get the same picture. The chart below is Nabors Industries (NBR), a premier drilling services company.

Its price has dropped off considerably, even though drilling activity, and revenues from drilling activity, are accelerating.



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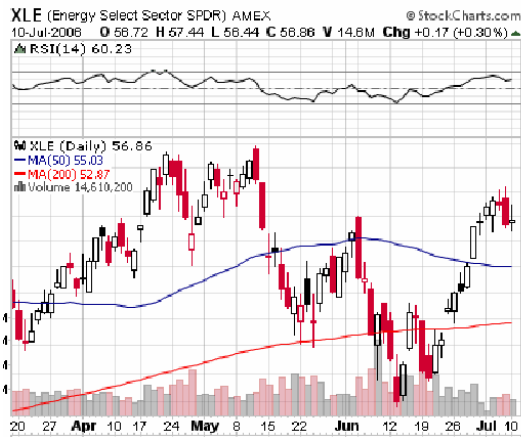
While it hasn't been able to break above \$75-and-change, it hasn't really dropped either. Now check out the chart below. It is ConocoPhillips (COP) stock during the same period of time. Note that it hit an all time high in the same late April time period, but despite the fact that oil prices have held up, the stock has not. It now trades well below its old high.



The next chart is on the following page. It shows the Energy Select Services SPDR (XLE), which is widely held in the Halifax and Bonavista model accounts. You can see that it made a follow up attempt to maintain its old high, right along with the price of oil but has since failed. It is now dropping.

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its all time high, but these stocks do not reflect that. They are trending down in the face of stubbornly high oil prices. Conventional wisdom on Wall Street is that oil will return to the \$50 per barrel region once the political instability in Iraq, Iran, and North Korea are resolved



It is often said that the stock market is a leading indicator (although I often dispute that). But let's assume for a minute that the theory is correct. Then the stock market is telling us that oil prices are going down in the future. That may be correct.

In fact some of these charts are getting pretty ugly. See the blue line that trends through the middle of all of them. That is called the 50 day simple moving average (MA 50). Stocks with strong upward price movement have MA 50's that are moving upward from left to right across the chart. These are all starting to turn downward.

That is not good!

In fact NBR has done what they call an MA 50 downward cross over the MA 200. See how the blue line has crossed below the red line. That is worse!

The downward trending blue line is telling you that these stocks are running out of steam. Notice that the blue line (MA 50) is still trending upward for the price of oil itself (first chart at the top of the previous page).

Normally we would be selling a group of stocks that looked like this. But we have been hanging on until the price of oil actually starts trending down. We have no desire to "fight the tape" as the old expression goes. But we don't think that the mainstream "mavens", nor the mainstream press know a whole lot about oil supply and demand. Throughout 2006 we have been hearing predictions that oil will drop back to the low \$60's or high \$50's. We are still waiting. In fact I spent \$65.00 filling the Lexus gas tank the other day while I was waiting.

We are not saying that the price of oil can't drop. Frankly we would love to see that for many reasons. We are just saying that it hasn't happened yet. We are also very doubtful that there is as much elasticity in the price of oil as some of the "mavens" seem to think. We have been hearing for two years now that there is a fear premium in the price. We have acknowledged that one probably exists. But we have become more skeptical about the size of the premium as the world has drifted from one political crisis to another and the price of oil stays stubbornly high.

There was big news in the oil patch this week, related to potential supply, when Shell Canada and Western Oil Sands announced that future costs of developing reserves in Alberta's oil sands may rise 50 percent over previous estimates. In other words it is going to be a lot more costly to bring oil out of the sands than previously estimated. Former Vice President Al Gore commented on the oil sands as reported by *Resource Investor*:

Runaway costs were not the only worrisome news for the oil sands either. Environmental concerns also hit the headlines, with former U.S. presidential candidate Al Gore saying oil sands production was a huge waste of natural gas and a major environmental mess.

"And they have to tear up four tons of landscape, all for one barrel of oil," Gore said in the latest issue of Rolling Stone.

"It is truly nuts. But you know, junkies find veins in their toes. It seems reasonable, to them, because they've lost sight of the rest of their lives."

Alberta Premier Ralph Klein retaliated, saying: "I don't know what he proposes the world run on, maybe hot air."

Exploiting the oil sands is expensive and not environmentally friendly. We have always been aware of that. We also know that the second largest oil reserve deposit in the world is tied up in those sands. It is the largest deposit outside Saudi Arabia. If it can't be effectively exploited the likelihood of oil prices going down diminishes substantially.

Boone Pickens is of record saying that he expects oil to hit \$80 per barrel before the end of the summer. We don't know if Mr. Pickens is right, but as we have said many times in the past, we expect to see \$80 before we see \$50.

Paul Krsek
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July 11, 2006