

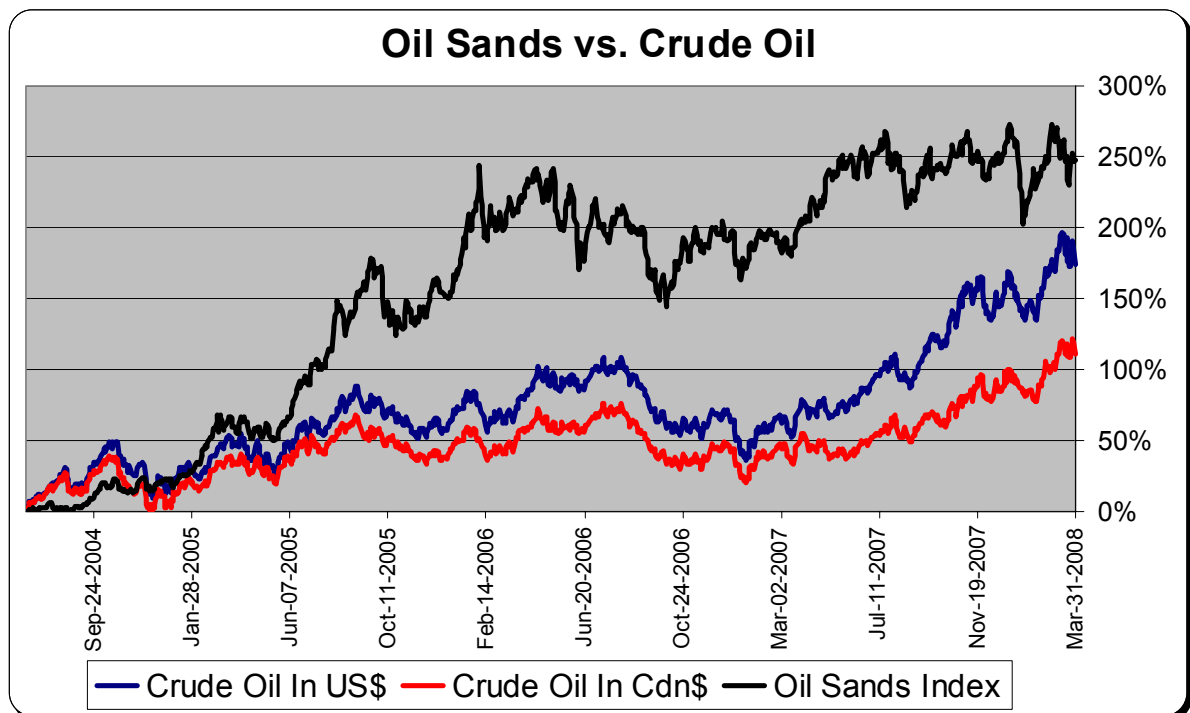


## Disconnect: Crude Oil and Energy Company Stocks March 31, 2008

Since mid 2004, oil sands stocks have been the best way for investors to benefit from the rise in crude oil prices. The reasons for this are numerous but the key points in my opinion are as follows:

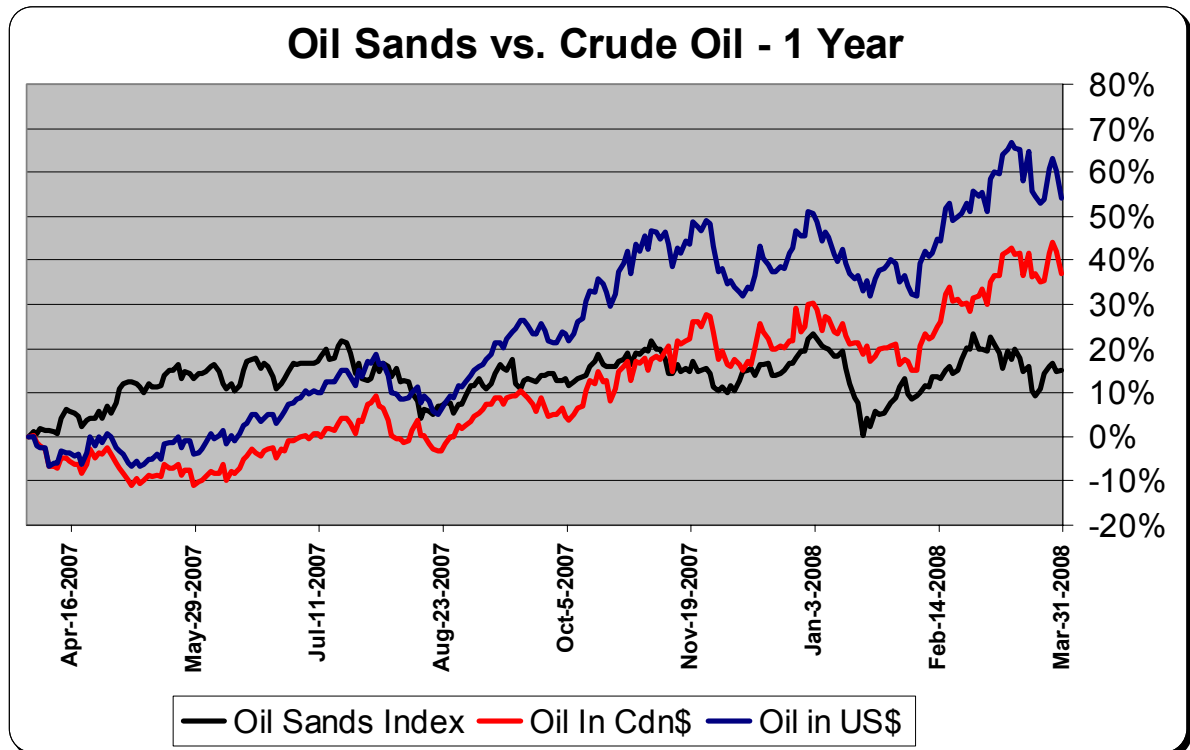
1. Oil Sands production is climbing rapidly
2. Oil Sands reserves are enormous
3. Oil Sands producers are highly leveraged to rising oil prices

Below is a chart of how the Oil Sands Index I founded in June 2004 has performed vs. West Texas Intermediate (WTI) crude oil in Canadian and US dollars.





Generally, owning oil sands stocks has rewarded investors more consistently over the long term, gaining over 247% since inception vs. 111% for oil in Canadian dollars. Recently, that trend has been reversed and I believe this will have a profound impact on the Oil Sands Index in the near term.



Since the third quarter of 2007, crude oil prices have been on a tear, gaining 54% in US dollars, 37% in Canadian dollars while oil sands stocks have gained only 15.1%. This is substantially better than the Canadian energy sector's gain of 8.7% but still a major disappointment given the rise in the commodity prices. There are many explanations for this trend such as institutional investor's preference for pure commodity exposure, operating and environmental risks associated with oil sands stocks and recently an increase in government royalties and regulations on the sector. What's more important to consider is what we can expect going forward.





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## Seasonality

As you can see from last year's chart, crude oil prices tend to be weak during the spring while oil stocks tend to perform well. This pattern has repeated frequently in the past several years and I expect the same to occur this year. Already we have seen crude oil prices peak in the \$112 range in mid March and are currently showing weakness at the \$100 level. The strength in the Canadian oil sands stocks in the spring is related to the annual report distribution and investor presentation cycle that usually attracts a lot of attention to the sector. If the past is an indication, you can expect gains in the sector over the second quarter even if crude oil prices decline or stay flat at these levels.

## Historical Support

A good example of a rising trend in oil sands stocks while crude oil prices retreated was in 2004 and 2005. Starting in the summer and fall of 2004, crude oil prices gained as much as 50% while energy stocks were flat. Not only was the gain in oil substantial, it also resulted in a breakout over the \$40 barrier which had been intact since the previous peaks in 1981 and 1991. This time the prices kept on climbing above the \$40 level, stunning most energy analysts who didn't believe the rise was sustainable. It took until the spring of 2005 before investors believed that the rally was worth putting some money in the energy stocks. Those that did were rewarded with over 100% gains in oil sands stocks even though crude oil was mostly flat between 2005 and early 2007. I expect the same scenario to develop again in 2008 and investors should consider switching out of the pure commodity exposure into the equity exposure to capture the new trend.

## A Note of Caution

I recently heard that China's stock indices are down an astonishing 34% since their Oct 2007 highs. The slowing US economy will have global implications and will hurt energy demand. It is worth being conservative in your expectations in this environment however astute investors should consider investing in oil sands stocks if they prove to be resilient during a downturn in crude oil prices. Oil sands stocks will lead the energy sector when the economy recovers and will be the chief beneficiary of any supply shocks that occur in other oil producing regions.

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