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Time To Focus On Energy

Crude oil is taking a well-deserved breather, but this is only another technical correction in an ongoing commodity bull market. There is evidence that positions held by ETF's and hedge funds will have some influence in this correction, but all the monkey business in the world cannot create a bear market out of bullish fundamentals. Speculation can increase volatility - especially in the short term - but crude oil prices are high due to supply and demand dislocations. You will hear a lot of rhetoric about declining demand and supply backing up the pipelines, but that is all twaddle.

Global production is, in fact, decreasing. As their fields become depleted, exporting countries will begin to hold back more of their production for their own use. New drilling will be welcome, but production from those efforts is many years away. Global tensions in delicate, producing regions are growing more tense rather than less. Fundamentally, the world has run out of cheap oil; and although there are substitutes for some oil derivatives, there is no substitute for crude oil.

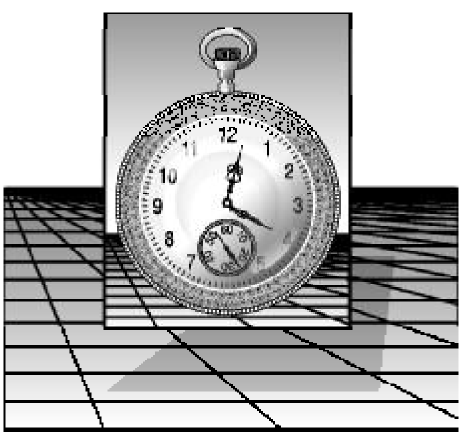
The U.S. recession is going to surprise the majority, including Congress. The surprise is that it is going to last longer than expected. This may be due in part to faulty statistics from Washington bureaus. For example, I note that housing foreclosures are included as "sales" in the statistics if someone is living in the house at the time of foreclosure. No wonder recent home sales figures look so good! The down side is that business and the public react accordingly rather than appropriately to such news. There are going to be more financial institutions going the IndiMac route before this is over, and public sentiment is going to get more pessimistic in the process, regardless of trumped up statistics.

In the process, the growth of U.S. energy consumption will abate some, but not enough to offset energy growth in emerging economies. Although China's economy may cool off from white hot to red hot, Asia is still on the economic growth fast track. The big push is on to build badly needed infrastructure. Creating infrastructure is energy intensive, and the use of infrastructure demands energy. The next to emerge will be Africa.

Now that prices are backing off, it is time to rekindle our interest in energy. In the last letter, I took **Blackrock Global Energy** (BGR-NYSE-$31.65) off its hold rating and put a downside buy price on it at $30.00. Another recent change on the July 17 online update was to pull **Baytex** (BTE-NYSE-$29.76) off hold and recommend purchases at $30.00 or better - which it is under now. If you would like a deep price, put orders in at $26.00.

The next issue will be published August 7.

- **Now that prices are backing off, it is time to rekindle our interest in energy.**



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We will be buying into weakness, and prices may well dip under our buy prices temporarily. I will be updating the energy issues on our list over the next several weeks. As I see new buy prices develop, they will be reported in the online updates. We will also summarize them in the August monthly letter.

I am particularly interested in our coal issues - **Fording Coal** (FDG-NYSE-$80.51) and **Alliance Resources** (ARLP-OTC-$45.90). I am pulling the hold recommendations off of them and am advising purchase at $59.50 for Fording and $39.85 for Alliance. These prices may seem a bit deep, but I am looking to take advantage of short term, negative momentum here as crude corrects. Put your open orders in and sit tight.

Coal has a huge future in supplementing this nation's energy appetite - as well as that of the rest of the world. The U.S. military is financing "coal to fuel" research now, and coal prices have increased 200% to 300% over the last couple of years depending on the type of coal involved.

I am still not big on the Canadian energy trusts since the Canadian government broke their promise to not tax them. However, since they made the announcement in October 2006, the trusts have had ample time to shake out and adjust. It is more apparent now who the long term winners will be. Baytex is one, and I am adding **Arc Energy Trust** (AETUN-TSX-C$31.00) to our list. I want to buy this one right, and the current correction may just give us that chance. Buy Arc Energy Trust at C$25.85 or better. Note this is in Canadian dollars. Please review the first and last paragraphs on the buy-and-hold list for further comments on buying Canadian stocks.

I should briefly mention the refiners. I am still going to hang on to them although they have been beaten pretty badly of late. These are very unique properties in a business that is a virtual monopoly. If they get much cheaper, I think you will see the foreigners come in and buy them out. The consequence of a weak dollar and a huge trade deficit is that our trading partners will end up owning our best assets. From a technical standpoint, **Valero** (VLO-NYSE-$35.26) should have decent support at $30.00 and **Frontier** (FTO-NYSE-$19.21) at $15.00.

Bottom line, we are going to see further weakness short term in the energy complex, and it may get a bit scary. I have had a downside of $108.00 for some time; and although it is a long shot, we could see prices tip that level. With the influence of hedge funds and ETF's holding huge, speculative futures positions - erroneously allowed through their bogus status as hedgers - crude oil could display vicious momentum. A more likely downside is $115.00 basis August. My advice is to turn off the T.V. and throw away the paper. Steel your resolve against the energy bears. The bears will prove once again to be wrong.

A brief comment on gold. It is very likely we will see a final break in gold over the next four weeks. The recent low at $913 should be tested; and if the bears get the upper hand, there is an outside chance prices could fall as low as $875 basis the August futures. My mantra is the same as it is for energy. Although you will hear plenty of bearish arguments as prices pull back, weakness will be a buying opportunity.

It seems that some folks cannot wait to buy when prices are making new highs, but all they want to do is whine and sell when prices are falling back. The market naturally cycles, and you cannot make money buying high and selling low. Some will ask why we don't sell the highs and then buy back at the lows. The answer is that buy and hold is just that – buy and hold. Most investors simply will not buy back in, and the objective of our longer term positions is to hold for the long term and take advantage of periods of profit-taking to accumulate additional shares. You must follow your strategy. Never convert long term investment positions into short term trading positions. If you do that, you will simply end up left out of the bull market.

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