



What's New?

Feddern Financial Consulting Group Newsletter

October 20, 2009

KEYS TO THE BEGINNING OF A RECOVERY:

- 1. The Real Estate market must stabilize. If not reversing, at least not continuing to fall. *NEW HOUSING STARTS UP this past Spring and Summer because of seasonal factors but inventory still huge! The Nationwide COMMERCIAL COLLAPSE IS JUST BEGINNING!***
- 2. Unemployment must stabilize. If not reversing, at least not continuing to rise. Last report was lower! *IT'S ACTUALLY WORSE as a "%," Back to near 10% - BUT IT CONTINUES TO MOUNT @ OVER 500,000+ weekly.***
- 3. Corporate Earnings (profits) must stabilize. If not reversing, at least not continuing to fall. *A FEW POSITIVE SIGNS but mainly in TECHNOLOGY.***
- 4. Banks must begin to make loans again (especially to small businesses and potential home owners...albeit under ancient premises of buyers being qualified and of all things, a down-payment! Lots of "hoopla" from the mega banks, but it appears that there's no real progress. They're "hoarding" any cash they can get their hands on. And now here comes the Regional problems compounded by PRIME loan and Alt-A resets!**
- 5. The DOLLAR has to decline. *It's started for REAL!***
- 6. Auto sales must stabilize at some NEW level. *Maybe started!***
- 7. The consumer must get "back in the game of consumin'" *NO WAY!***

ANALYSIS OF THE ABOVE: No Real Hope YET! -10/20/2009

An Update on Peak Oil (Yes, It's Still a Problem)

As you know, if you've been following our missives over the years, we have been writing about the phenomenon of "Peak Oil" and how it will play-out during our lifetime.

Byron King of Whiskey and Gunpowder quotes Marcio Mello, the former explorationist from Petrobras (PBR: NYSE) and now independent petroleum consultant, as he electrified the Denver meeting of the Association for the Study of Peak Oil & Gas (ASPO).

In a riveting talk that lasted well over an hour, Marcio detailed the immense petroleum potential of offshore Brazil, as well as the Amazon Basin. If Marcio's estimates are correct, Brazil may be the location of near 200 billion barrels of additional petroleum resources. That's well within the range of current resource estimates for Saudi Arabia.

For good measure, Marcio described the petroleum potential of offshore West Africa — another 130 billion barrels — as well as the Congo region, with 50 billion barrels or more.

Finally, Marcio described the “unknown potential of the US back yard, the Gulf of Mexico (GOM).” Marcio offered remarkable insight into the deep regions of the GOM, 100 miles and more offshore Texas and Louisiana. He showed early work he performed on a number of GOM areas, including the site of BP's (BP: NYSE) recent billion-plus barrel find at the Tiber site.

It was clear from the reaction of many in the ASPO audience that Marcio hit nerves. If his analyses of the South American, African and GOM petroleum systems are right, then in the future the world has access to much more conventional oil than people previously believed. But it's not the same as saying the nothing has to change in modern habits of energy use. Getting this oil will require a trillion-dollar level of offshore, deepwater investment. It's a 50 to 100 year project.

The new thinking about deep petroleum systems may allow the world's energy thinkers to back off from raw geologic concerns about the where and how-much of resources. But like a game of “whack-a-mole,” the reduced worry about geology now translates into a new emphasis on exploration and development technology, as well as capital, skilled personnel, political issues, environmental safety and climate alteration.

In the past 20 years, Marcio has pioneered the idea of detailed geochemical analysis of “petroleum systems” in the Southern Hemisphere. The goal of the work is to identify and locate deeply buried oil-bearing zones. Marcio's work led directly to dozens of oil finds by Petrobras, both onshore and offshore. His work has also led to significant oil finds in the Caribbean region, Colombia and Peru.

Some Bad News

After Marcio Mello offered his ebullient view of future oil supplies in the world's deep waters, the next day was a return to earth for the assembled throng at the Denver meeting of the Association for the Study of Peak Oil & Gas.

The day was filled with well-informed viewpoints on the looming issues of energy scarcity in a capital-constrained world. Among other things...

Geologist Art Berman offered a decidedly negative view of the latest "big thing," which is obtaining large volumes of natural gas from tight shales. In a comprehensive review of production and flow rates from several thousand wells drilled in the past decade in the Barnett Shale of Texas, Mr. Berman has a gloomy forecast.

Looking at a large sampling of Barnett wells, the overall data reveal that initial gas flows decline rapidly. With some wells, the drop-off is as much as 70% in the first year, with further declines of 20% in the second year.

This hardly dovetails with the happy talk about how "shale gas" will supply U.S. energy requirements for the next several decades, if not a couple of centuries. It appears that most Barnett wells are short-term money losers, with a few prolific wells carrying the bulk of capital expenditure.

Across the industry, according to Mr. Berman, the whole process stays afloat due to liberal application of borrowed money, as well as dilution of existing shareholders by production companies issuing new stock.

According to Mr. Berman, the picture is not much better in other shale plays, such as the Fayetteville and Haynesville shales. And similar gloomy data are just now starting to come in on the embryonic gas play in the giant Marcellus formation of Pennsylvania.

And Peak Oil Is Still Looming

Matt Simmons gave another of his famous talks about the specter of Peak Oil. The only things that are changing, according to Mr. Simmons, are that things are getting worse for future energy supplies. It's difficult to say with specificity how bad things are, because the data are so poor on a worldwide basis.

“Look at what happened with the bad information we had, or didn’t have, with the financial institutions over the past couple of years,” said Mr. Simmons. “With our energy data, it’s worse. We’re in for some shocks that will change our lives in ways that’ll rival Pearl Harbor.”

Expect to see oil at \$200 per barrel by the end of 2010, according to Mr. Simmons. Also expect to see net oil exports from Mexico simply vanish within 24 months or less. This will play havoc with U.S. refiners on the Gulf Coast.

Mexico has simply delayed for too long its effort to explore, drill and rebuild its fast-depleting oil resources. Mexico is going to have to scramble to salvage something from its looming energy disaster. These die are cast.

Things could go wrong with energy supplies in any of a dozen places, according to Mr. Simmons. For example, there’s a stealth “Twitter revolution” in Iran that’s slowly shutting down that country’s oil production. Shutting down the oil industry was the straw that broke the camel’s back and brought down the Shah in 1979. There’s some thinking that it may work to rid Iran of its mullahs.

In Venezuela, the output of the state oil company PdVSA is declining at alarming rates due to political interference and underinvestment.

In Nigeria, the low-grade civil war could quickly morph into a large-scale civil war. In Iraq, according to Mr. Simmons, “They’re in the dark about how to rebuild their oil industry.”

And of course, a lucky terrorist shot could take down any of hundreds of major oil installations worldwide, wreaking havoc through the following ripple effect.

Mr. Simmons admires Brazil’s Petrobras, calling it “the finest large oil company in the world today.” But the offshore success of Petrobras will simply not be able to make up for the multitude of other problems with the global energy industry. There won’t be enough oil, and it won’t arrive in time.

Longer term, Mr. Simmons expects to see oil at \$500-700 per barrel. “People need to understand how expensive it is to obtain oil,” said Mr. Simmons.

Much of the world’s energy infrastructure is old and rusting and will require several trillions of dollars to replace — if it can be replaced. (Is there enough steel, for example? Where will the money come from?)

Add the aging work force, within which many new hires were laid off in the past year. There’s a serious lack of skilled talent across the board, and no amount of clever management and automated “expert systems” will make up the difference.

Finally, new technology is coming on line slower than most people anticipated. The deeper, more challenging environments are sucking down technology and money, and yielding less than expected in many cases.

According to one study, only eight out of 100 major energy projects came in on time, were within budget and yielded the expected volumes of oil and natural gas. Thus are high costs, delays and reduced cash flows hurting the ability of the energy industry to maintain adequate levels of capitalization.

The stark fact is that oil is going to get a lot more expensive and the bull market in oil will be firmly in place for a long time. Smart investors would take advantage of any corrections or dips to get themselves set for the ride.

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www.fedderngroup.com

We continue to receive more and more inquiries about our Down-side Risk Management disciplines along with our group of recommended money managers. We appreciate your “referrals.” It’s the main way we continue to build our business.

Call us anytime: 502.442-0363 Direct 800/258-1502 Toll Free 502/442-0365 Fax 502/552-2049 Cell

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