



ELLUMINATION

MAY 28, 2008

AMERICA'S OIL CRISIS

CNBC has been focusing their coverage of high oil prices around the headline “America’s Oil Crisis”. Prices have finally reached a point at which they hurt. There is no question about that. During the month of April American’s drove less than any recent month on record. We are starting to hear about “demand destruction” in the USA. In other words we are using less oil. Demand is actually declining in the USA for the first time in decades. People simply can’t afford to pay for gasoline (refined oil).

The debate now rages as to whether or not oil prices are going higher or if they have reached their peak and are therefore about to decline. If demand was being destroyed around the globe as efficiently as it is in the USA there would be no debate. Prices would be declining. But it is not that simple. Demand is still growing at approximately 1.5% per year on a global basis and that complicates the pricing structure enormously.

At this point almost every other decision that K&A makes related to investing revolves around the direction of oil prices. High oil prices, and whether or not they stay high, are simply the tail that wags the dog. From 2003 until very recently oil prices have risen and so has the stock market. That direct correlation seems to be breaking down. Lately if oil prices rise, then stocks prices fall; and visa versa. We have clearly reached a breaking point.



There are no easy answers to questions regarding the short term direction of prices and velocity of price movements during the next one to six months. K&A believes the picture is quite clear for the longer haul. Prices will continue to rise.

But relative to the short term many market participants have simply taken the stand that prices have moved up too far and too fast and therefore current rate of change is not sustainable.

Here is a weekly chart that clearly shows that prices have more than doubled since early 2007, following a significant retreat in the second half of 2006. The move from the low \$50's to over \$133 has been relentless. Take a look at the two blue circles at the top of the chart. The circle on the right indicates that crude oil is now “significantly overbought” just as it was back in

October 2007. Many are staking their forecast for lower prices on this “overbought” condition. When markets get stretched this much they do tend to correct. The only problem is that we don’t know how that

correction will take place. It is theoretically possible that we could see a big sell off like the one that took place in 2006 that moved oil prices from near \$80 back down to just over \$50. That is what many are hoping for. We are hearing calls for prices to fall back to at least the low \$90's. We are also aware that some analysts believe prices will fall back to the \$70 range within the next 12 months.

On the other hand, the "overbought" condition that existed in October 2007 was rectified by prices simply chopping back and forth in a relatively tight range for several months, only to move up again, and at a faster rate than they had previously (notice how the slope of the rising price line has gotten steeper). We therefore remind you that Goldman Sachs is now making the case for \$200 before the end of the year. Others are calling for at least \$150.

The bottom third of the chart shows the MACD trend lines (Moving Average Convergence Divergence). You can see how they have also trended upward since the bottom in early '07 and that the upward trend is clearly still in place. If there is one simple thing that we know about trends it is that they remain in place right up until the minute they change! Therefore, for now the trend is up. You don't have to be an expert to see that on the chart or at the gasoline pump for that matter.



Experience reading charts, and a best guess, would indicate that this picture of rising oil prices is significantly over extended and it would be reasonable to expect some kind of pull back, even if it is only temporary.

We can offer you another perspective by looking at the monthly price chart to the left. Relative Strength (RSI) (at the top part of the chart) is more overextended that at any time in the past six years. (See the blue circle at the top, over the RSI line.) The trend line of rising prices has spiked to nearly vertical and the MACD trend lines at the bottom have also gone nearly vertical. This is clearly an extended trend. It is also a trend that has shown NO sign of reversing; at least not yet.

Prices may retreat and should retreat, at least temporarily. But we do not expect them to retreat dramatically. Traditional technical analysis, using Fibonacci retracement patterns, would indicate that downside targets come into play at \$103, \$92, and \$90, \$82, \$76 and \$63 and that these would be key support levels on the path back down, should prices begin to fall significantly.

K&A is in the camp that prices could and should back off a bit. But we believe that for the next one to six months \$110 is the new floor. We think that a traditional technical regression is extremely unlikely. We also firmly believe that the longer term path for oil prices is upward, not downward. Therefore even if there is a temporary reprieve and prices do fall, a longer term downward regression is not sustainable.

Let's examine the upward trend and look at its causes. We believe that once we have done that you will agree with us that there is very little possibility of ever seeing low oil prices again. We will consider three factors that are widely discussed as the causes of rising oil prices. They include speculation in the financial markets, monetary policy and supply and demand of oil itself.

How much has speculation been a factor in rising prices?

Our answer to this question may surprise you, but we find no credible statistics that demonstrate that speculation has been a significant factor. We find much in the way of accusations and innuendo, but no substance behind either.

For example, it is now common place for OPEC to site speculation as the reason for high prices. **Global Money Trends** reported on May 18th that Kuwait's oil chief Mohammad al-Olaim stressed that oil prices were driven by speculation rather than market fundamentals. "*Speculation in the market is the most important thing. The prices keep going up, but these are not real prices,*" he said.

"OPEC chief Abdullah al-Badri added on May 22, '*the oil cartel can't lower oil prices in a crazy market, dominated by big financial institutions.*' He blamed record prices on geopolitical tensions, speculation and the weak dollar -- and not on OPEC output levels, yet he pledged that the cartel would boost supply if it sees any shortages in the market. '*Even if we increase output tomorrow, the prices will not come down because of speculation and because of a weak dollar. When we see there is a shortage of supply, we will act,*' he said.

While there is plenty of discussion and finger pointing about the impact of speculation on prices, K&A has seen NO reliable data, or credible theory, on how much of a role speculation plays in the movement of prices. It is our belief that the overwhelming majority of price movement is related to two factors, those being supply and demand factors for oil and monetary policy by U.S and global central bankers. We will get back to both in a minute. But we can't help pointing out the esteemed Alan Abelson's column in **Barron's** this weekend, regarding the impact of speculation (or the lack of impact) related to oil pricing. Here is part of that column:

"...Michael Masters, proprietor of a hedge fund unsurprisingly called Masters Capital Management, testified last week before a Senate subcommittee. The burden of his presentation was that such deep-pocket investors as corporate and government pension funds, sovereign wealth funds, university endowments and kindred institutions are in no small measure responsible for the spectacular run-ups in commodities, particularly food and, of course, oil.

He dubs this motley group "index speculators," and he feels quite strongly that Congress should act pronto to curb their pernicious practices. He offers a kind of tutorial on commodities speculation, replete with graphs and charts and other quasi-scholarly trappings.

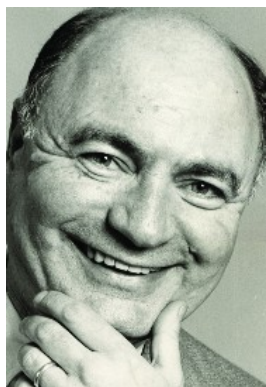
Mr. Masters seems well versed in the fine points of commodities trading, and he's passionate in his belief that the major stimulus for the fiery gains in oil and food are those big-bucks players. His testimony created a bit of a buzz in the Street, and it's certainly worth a read. That speculators -- especially in the past five or six months, when their normal haunts, the equity markets, were frequently in the dumps -- have been active in the futures arena is no secret. Ironically, we recall a similar plaint -- but in reverse -- made to us by a prominent Texas oil guy who beefed bitterly that speculators were behind the then sharply depressed price of oil.

*We suspect that Mr. Masters gives rather short shrift to the impact of both exponential growth of demand not only from China but from India and other emerging countries on the price of oil, and reasonable and growing concern about prospective supply. **For all his worthy effort, we found his case not entirely persuasive and, at best, as the old Scotch verdict has it, not proved.** (Emphasis added by K&A)*

This doesn't mean obviously that we think oil is a slam dunk to reach \$200 a barrel. Nor, having just forked over \$4.25 a gallon to keep our jalopy going, that it and its most prominent derivative are immune to the effects of spiking prices especially in an economy as stressed as this one.

***IN OUR BRIEF EXEGESIS OF WHY OIL** has been acting as if some practical joker gave it a hot foot that has sent it in panicky flight to the moon; we deliberately neglected to mention the dollar as a leading suspect. In the main, we suppose, because it's both so evident and widely recognized as a causal agent, but also because we've cited it long and often as the root of so many of our ills that it might seem just a tad repetitious, which it is.*

Yet we can't resist taking still another swipe at the dark forces that have conspired to debase the ragged greenback and, in the process, contrived to make life miserable in so many ways for the denizens of this fair land. As Peter Schiff, who runs Euro Pacific Capital, tartly observes in his latest epistle, it's too bad that the Supreme Court, in ruling that U.S currency is unfair to the blind, failed to also declare it unfair to everyone who buys gasoline.



To Peter, the big move in crude and gasoline is symptomatic of the bill that has come due for years of reckless consumption and dollar devaluation that have priced us out of markets to which we once held "unchallenged title." Signs of America's falling standard of living are everywhere, he laments.

And he posits that the current round of belt-tightening is "simply the down payment on the government's massive bailout of Wall Street investment banks and mortgage lenders." And he morosely predicts, "As the Fed creates money to buy bad mortgages and other shaky securities held by banks and brokerage firms, the value of the savings and wages" of us poor slobs will continue to shrivel.

That means that the cost of a good many more of the things that we take for granted will shoot up. "Four dollar gasoline," Abelson warns, "is just the beginning."

I must personally interject here that I have been a die-hard fan of Alan Abelson since he was editor of **Barron's** in the early 1980's when I first started reading the publication.

Alan Abelson, former editor of **Barron's**, the Dow Jones business and financial Weekly, from 1981 to March 1993, writes the weekly column "Up & Down Wall Street" that he started in 1966. Alan Abelson joined **Barron's** in 1956, editing the Investment News & Views section and writing corporate and industry features. In 1965 he was named managing editor of the magazine, and in 1981 he became **Barron's** editor. He has been called the "most eloquent" financial columnist in the English speaking world. He is now 83 years old.

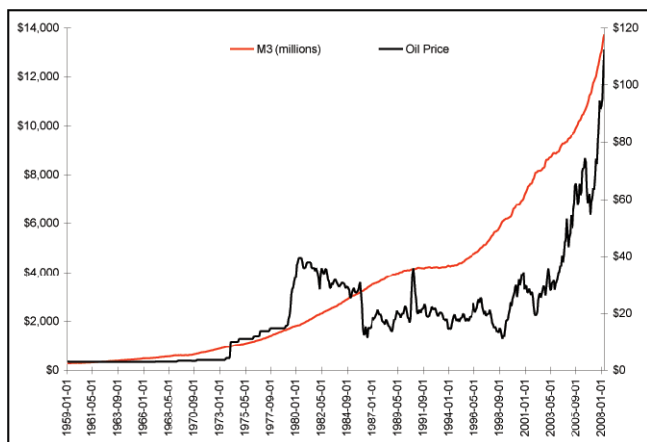
So if Master's can't convince congress or Alan Abelson and if K&A is unconvinced about the impact of speculation on prices, what has gotten us in this mess?

Monetary Policy

OK, first of all, what is "Monetary Policy?" *It is the process by which the government, central bank, or monetary authority of a country controls (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy.--Wikipedia*

OK, now that you are with me here is a very simple chart that is very easy to interpret. The red line is M3 U.S. money supply. The black line is the price of oil. (Chart provided by Paul Van Eeden). As this broad measure of money supply has gone through the roof, so has the price of oil. As the supply of dollars has exploded their value has imploded. It is not the price of oil that is being manipulated. It is the price of the dollar! It simply takes more dollars to buy the same amount of oil today because they are worth so much less.

The “monetary policy” of the USA has been expansionary (inflationary) for decades. But that policy started to get dramatically exaggerated as the Fed prepared for Y2K (remember that?) We got ready for it like we were preparing to break the sound barrier. Who knew what was on the other side? It was an

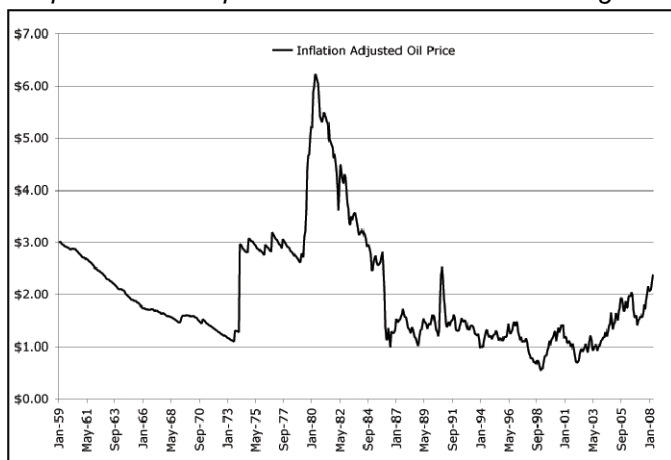


amazingly stupid process in retrospect that included accelerating money supply growth rates. Money supply growth has been on fire ever since for reasons well beyond “Y2K”.

Paul Van Eeden recently wrote, “*For those who cannot fathom that it's as simple as this, inflation of the money supply directly affects the value of the dollar, consider these words from Ben Bernanke, the current Chairman of the Board of Governors of the Federal Reserve Bank of the United States, in a speech he made on November 21, 2002 before the National Economists Club in Washington, D.C.: "Like gold, U.S. dollars have value only to the*

extent that they are strictly limited in supply. But the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services.” (Emphasis added by K&A)

Aside from the fact that the assumption that inflation can create economic activity is entirely false, the idea that OPEC is somehow to blame for the rise in the oil price is absurd. Look at the chart below that shows the oil price in US dollars and the increase in the supply of dollars as measured by M3. We see that the oil price is trying desperately to catch up with the dollar's inflation. In fact, if anything, oil companies and oil producers have been subsidizing American gasoline consumers for the past 22



years...

“Another way to look at the same data is to adjust the oil price for inflation, by dividing the oil price by the increase in the supply of dollars (M3), as I've shown in the chart (to the left). Now you can see that while the oil price is certainly not constant, there has been very little in the way of a real (inflation adjusted) increase in the price of oil since 1959, aside from the spike in the oil price during the dollar crisis of 1979 and 1980. In fact, on an inflation adjusted basis, the oil price is lower today than it was in 1959. From this chart we can again clearly see that it is not OPEC, or the oil companies, that are to blame for the

rising price of oil, but the government's irresponsible inflation of the money supply...”

*“Notwithstanding anything said thus far, the oil price had a good run and so in the short term a pull back in the price of oil should be expected. But this would merely be normal market volatility, as we are currently seeing in the gold price. **Over the long term the price of oil is going up. The days of \$50 or \$55 oil are gone forever.**” (Emphasis added by K&A)*

“The only thing sadder than the general lack of understanding of basic economics among politicians is the severe lack of knowledge among the voting population that compels them to vote, time and again, for candidates and policies that ensure the deterioration of their living standards while simultaneously sacrificing their civil liberties “in the name of freedom.” Paul Van Eeden

All this begs the question of why has the U.S. government chosen the path of inflating money supply while deflating the value of the dollar. K&A has contended for a very long time that they had no choice. It was this path or depression. Without the expansion of money supply and the devaluation of the dollar the USA would have rolled over into recession years ago. K&A first started writing about the inability of the consumer to keep the economy going back in 2004. It mystified us when the country didn't roll over into recession. What we didn't know at the time was that “subprime” was going to be the next big trick to keep the USA afloat. We know now! While money supply growth rates accelerated originally to ward off the evil spirits of Y2K, they kept accelerating to ward off recession, if not depression as early as 2004. We now know that to be absolute fact, given perfect 20/20 hindsight.

U.S. central bankers and legislators are schooled from day one to avoid depressions at all costs. The memory of the 1930's is seared into the collective American consciousness. It is anathema to go there again. That leaves our central bankers and legislators with only one choice—inflate or die and that means the decline of the U.S. Dollar. We have been consistent in reporting this theme since it became crystal clear to us what was going on:

“The bulls are counting on the fact that the global economy has escaped the threat of deflation. Massive fiscal and monetary stimulus in the U.S. and the secular expansion of the Chinese economy are acting as “super fuel” to inflate the global economy.”

Ellumination, January 2004

“Do the OPEC nations hate us and simply want to make us pay higher prices for oil? Is the latest production cut among OPEC nations part of a conspiracy to unseat George W. in the upcoming election? I've heard both theories lately. But the answer probably lays elsewhere-- in the tumble of the value of the U.S. dollar. The dollar has lost of third of its purchasing power over the past three years against the euro. The dollar has also collapsed vs. the Japanese yen. OPEC takes payment for its oil in dollars. So as the dollar's relative value has fallen, OPEC is getting paid in a currency that has less and less purchasing power elsewhere in the world.”

Ellumination, April 2004

“The U.S. dollar should continue to fall in value relative to other major currencies, especially the Euro. We have seen targets as extreme as 1.42 to 1.55 against the Euro vs. approximately 1.32 today.”

Ellumination, December 2004

We would be remiss if we tried to place all the blame for the falling dollar on the U.S. central bank and treasury alone. They have had allies in the dollars collapse in the form of willing buyers of cheap dollars.

“Since oil has been trading in the \$50 range, a new wave of petrodollars has been flooding into the U.S. Treasury market. With world oil consumption at 84 million barrels a day, the amount spent on crude by consuming nations has jumped from \$900 billion to \$1.5 trillion in the last year. We suspect much of that additional \$600 billion in petrodollars has made its way into Treasuries.”

Ellumination, June 2005

“We believe that during 2006 the FED is going to fool you by making you focus on what they do with interest rates while they flood the globe with an increased supply of U.S. dollars. They can’t afford a recession and will “error” towards favoring inflation. Inflation is likely to go higher than the pundits currently expect, not related to the magnitude of movement of interest rates; but because the globe is being flooded with U.S. dollars.”

Ellumination, January 2006

“Our long term thesis, has been, and continues to be that the longer term pricing trend in oil is upward, and the longer term pricing trend in the U.S. dollar is downward.”

Ellumination, December 2006

“If you are a long term reader of these forecasts you know that we have a secular bias that is bearish toward the U.S. Dollar. We still believe that it is in a long term bear market relative to the Euro and also the Chinese Renminbi (RMB).”

...“The oil producing nations are literally awash in cash reserves from the huge profits they are making. We all know the China and India stories by now. There is just a “whole lotta” money available to invest and this is one of the major reasons that almost all asset classes remain more expensive than they might be otherwise. We do not see this condition changing any time soon.”

Ellumination, January 2007

“This report is to tell you about the demise of the U.S. dollar as the world’s reserve currency this is happening as I write, and the potential investment implications. It is also for the purpose of making you aware that this inevitable change is coming. If you haven’t thought about it, or started to prepare for this change—you should.”

Ellumination, April 2007

“The consequence of interest rate cuts will be a greater disparity between interest rates in the U.S. and much of the rest of the world. Therefore the dollar will be falling against the Yen and the Euro.... The collapse of the dollar is likely to accelerate thanks to actions the FED will be taking to obliterate the “sub-prime” crisis.

Money supply for the U.S., formerly measured as M3, will be exploding upward. It already is and that will not change immediately. Global Money Trends reported on August 26 that U.S. M3 money supply is currently growing at a 13% annual rate; and may accelerate to 17%. That would be the fastest growth rate of money supply in U.S. history and match recent growth rates in Australia and China.

The rapid increase in money supply in the U.S is being matched by many countries around the world and that is highly inflationary. That is why we will be seeing higher inflation rates and higher commodity prices at the same time interest rates in the U.S. will be dropping. Money supply

growth rates in Europe are now at 28 year highs. Eighteen of the top twenty economies in the world are currently growing their money supplies at rates exceeding 10 percent per year. (See Global Money Trends, August 2007)

Ellumination, August 2007

So enough already; if you have been reading **Ellumination**, you have been forewarned! The dollar is in a long term secular decline that is not over. Therefore things that are priced in dollars had to get more “expensive” to adjust. Therefore just as we pointed out in 2004 it is not OPEC that has jacked up oil prices.

The answer probably lays elsewhere-- in the tumble of the value of the U.S. dollar! The dollar continues to lose its purchasing power. OPEC takes payment for its oil in dollars. So as the dollar's relative value has fallen, OPEC is getting paid in a currency that has less and less purchasing power elsewhere in the world.”

Much of the reason for upward pressure on oil prices, and other commodities for that matter, has been the downward pressure on the dollar. Period, end of story!

Oil Supply and Demand Fundamentals

In March 2006 I wrote K&A's first paper on “Peak Oil Production”. After two years of study related to supply and demand data we published the following statement:

K&A Asset Management, LLC has reached the conclusion that “it is more likely than not” that the world has either reached “peak oil production” or will within the next few years. We have spent hundreds of hours researching this topic. We have not treated the topic superficially or lightly. We believe that “peak oil production” will have serious economic ramifications including the probability that oil prices will continue their upward trend.

We published that statement in the face of rhetoric like this (which has been extracted from the same paper dated March 12, 2006):

“Saudi Arabia, the biggest oil producer, and Exxon Mobil, the largest oil company, yesterday declared that the world had decades' worth of oil to come, in an attempt to calm fears about the record prices experienced in recent weeks.

Forming a powerful alliance, the Saudi oil minister Ali al-Naimi said, at an industry conference in Johannesburg that the country would soon almost double its “proven” reserve base, while Exxon's president, Rex Tillerson, spoke of 3 trillion or more barrels of oil that are yet to be recovered.”

It is now more than two years later and we are still waiting for either the Saudi's or ExxonMobil to announce major new discoveries of oil. For the record, neither of them have done so.

We now know that as far back as the year 2000 that Saudi Aramco's head of exploration and production, Sadad I. Al Hussein, was officially questioning Aramco's forecasts for future production. From 2000 to 2004 he was studying data and was sounding alarms to the industry and his bosses at Aramco as “he realized that many oil experts were either misreading global reserves and oil-production data or obfuscating it.”

National Geographic reports that, *“Saudi oil minister Ali al-Naimi took a dim view of Hussein’s report, and in 2004 Hussein retired from Aramco to become an oil industry consultant.”*

It has been four years since Dr. Hussein “retired” from Aramco, but you can Google his name and find transcripts of interviews that he has given all over the world. He still thinks supplies are constrained by many factors including politics, geology, insufficient global refining capacity and growth in demand. His views are not static, as you would imagine. He consults in a dynamic industry. But his views might be fairly summarized in the following statement from an interview in late 2007:

“I think, perhaps, they’re just not looking realistically at prices because the equation has three factors: supply, demand, and price. If you assume that you have an endless supply to meet demand, then price would stay reasonably low. If you assume supply is constrained - which is what I’m saying - and has a ceiling, then the only way to balance the equation is to assume that prices will increase significantly, and I think that’s a more prudent and realistic outlook.”

The entire transcript of this interview can be found at <http://globalpublicmedia.com/transcripts/2851>

One of the most significant barriers to accurately forecasting oil prices is the abysmal state of supply data. Comprehensive data that is reliable probably doesn’t exist. The International Energy Agency (IEA), which annually forecasts supply and demand on a global basis recently admitted that their supply side data is hopelessly out of date. They are in the midst of a several month study of the production capacity and depletion characteristics of the 400 largest oil fields in the world. Their updated statistical report will be available in November 2008.

Business Week recently ran a story called “Oil’s Murky Outlook “. In it they said: *“It is hard to predict what prices are going to do in the next month, much less five years, if you don’t have a handle on current supply and demand. The problem is that analysis requires data on production, consumption and inventories—and those numbers are largely unreliable. The situation is only getting worse. China, the world’s fastest growing oil consumer is also one of the most opaque. Regrettably, the world oil market is no more transparent than a barrel of extra-heavy Orinoco crude”.*

In June 2005 I wrote the following paragraph for Ellumination:

“I have personally been following the goings-on in the oil patch since 1984 and it has never been easy to decipher the truth about oil supplies, and therefore future pricing. Besides oil has always been the stuff of politics, embargos and wars as well. That has added all the more intrigue and guess work to solving the puzzle.”

We fully expect that when the IEA issues their new supply side report in November that global reserves will be adjusted down. We believe that because all the data we see indicates that oil fields around the world are being depleted much more rapidly than previously expected. We will be waiting for the report and make it available to you in November.

We also speculate that Saudi Arabia DOES NOT HAVE the “excess capacity” that everyone else seems to believe that they have. We candidly admit that this is speculation on our part, but it is speculation based on at least some respectable research and inquiry.

For example, check out these quotes from an interview with Dr. Hussein from late 2007:

Interviewer: *“As you say, the international agencies and the energy departments of the big consuming nations do assume in their forecasts that Saudi Arabia and the Middle East “Big Five” are going to*

continue to make good all the demand growth in the future, and you've cast doubt on that today. How safe are those assumptions, then? It's a rhetorical question, I guess, but how safe do you think those assumptions are?

Dr. Hussein: "Some of those assumptions, for example, assume that OPEC will go from about 30 million barrels a day - which is what it produces now - to well over 45 or 47 million barrels a day. Other companies - oil companies - have even shown a high of 60 million barrels a day. That's what I'm calling unrealistic. Staying at 30 million barrels a day is not a small feat - that's a lot of oil - that's half of the exported (sold) oil in the markets today, and to stay there requires a sustained investment program which is quite massive, and a lot of resources. I think that's realistic - staying at 30. But going to some of these numbers - 47, 48, 60 million barrels a day - I think that's quite unrealistic."

Think about the question we keep asking ourselves. Saudi Arabia is about one-third the size of the continental United States. It is not small, but it is not really all that big either. Drilling has been going on there since the 1940's. That is over 60 years. They have had the complete cooperation of the USA, the oil majors, and the finest discovery and drilling technology on the planet. They have unbelievable amounts of money to throw at the problem and frankly they have only one product—so there is not much to divert them from the effort. Wouldn't you think that they would have a COMPLETE understanding of their reserves by now? We think they do. They just aren't telling. We also believe that it is extremely unlikely that they have "excess capacity".

The big issue, that so many people seem to completely misunderstand, is that the entire oil industry is throwing more money at exploration than at any time in the past. The dollars are HUGE. New oil is being discovered. But discoveries that have taken place in the past couple of decades are not even replacing what is being depleted by current demand.

Now you tell me, have you heard of any BIG, I mean really BIG oil discoveries lately? No? What a coincidence; neither have I. THAT IS THE PROBLEM.

Exploration and drilling technology has been improving for over 30 years, but to what end? You can count on one hand the significant oil discoveries that have taken place in that time. Despite tremendous advances in technology we simply aren't finding the oil required to replace reserves that are depleting around the world. That is a simple and irrefutable fact. I would take on all comers who want to argue that point with me and would unequivocally welcome the data that would demonstrate that I am wrong.

Let's take on the topic of the one oil field upon which the optimists are currently relying to turn the tide of discovery. It is true that Petrobras announced in November 2007 that their newly discovered Tupi field probably held 5 to 8 billion barrels of recoverable light sweet crude. The Tupi field lies under 2,140 meters (7,060 feet) of water, more than 3,000 meters (almost 10,000 feet) of sand and rocks, and then another 2,000-meter (6,600-foot) thick layer of salt. No commercially viable extraction is expected before 2013. Tupi was the largest reported oil find in the Western Hemisphere since the Cantarell field was tapped in the Gulf of Mexico in 1976. That is the largest field discovered in the Western hemisphere in the past 32 years. If the oil that is recoverable from the Tupi field is actually at the HIGH END of the estimated range, then there is enough oil in the field to add approximately 90 days to global supplies, at current demand levels—starting in 2013.

Petrobras later announced that the Tupi field may be just an extension of an even larger field that might encompass up to 33 billion barrels of oil. Although the report was attributed to one executive, and there has been no official follow up announcement or confirmation since. That would be a truly large discovery. But to put it in perspective for you, the world is currently consuming approximately 31 to billion barrels of

oil per year. So if even the most optimistic hopes turn out to be true, the entire Santos Basin, which includes the Tupi field, might extend our global oil supply by one year! And, this is the largest discovery in the past 32 years. Hold that thought for a minute. Ladies and gentlemen we have a long term supply problem.

Now before anyone jumps out of their chair to call me, email me, or argue with me, I am not saying we are out of oil today, tomorrow, or even next year. What I am saying is that so far, right through tonight, we have diminishing global supply and we are not making sufficient new discoveries to replace what we are using up, let alone to grow reserves.

So are we at peak oil production now? Will we be there in 2015? 2030? We frankly don't know, but it is more than two years since we wrote our original paper called Peak Oil Production, on March 12, 2006, and nothing has happened to influence us to change our minds that if we haven't already reached peak production already, that we will sooner than later. Oil was selling for approximately \$60-65 per barrel back then. It has more than doubled since.

Let's sum up this 11 page paper right now. The "supply" that has been growing is dollars, not oil. We are buying oil today with terribly deflated dollars. That is one of the main reasons for the incredible rise in prices.

In the mean time global demand for oil continues to rise, even though at a slower pace than two years ago. New discoveries of reserves are not keeping up with depleting resources, let alone rising demand.

Prices have certainly become stretched, but not any more than the depreciating dollar and supply/demand characteristics would dictate. Unless the dollar turns around, which we frankly are not expecting, or unless huge new supply comes on line, which we are also not expecting, it is hard for us to see why oil prices should retreat much from where they are now.

Over the long term we believe oil prices are going up and so is the price of gas at the pump. A "fin" a gallon is the next stop.

Sincerely,

Paul Krsek

For K&A Asset Management, LLC

Disclosure and Disclaimer:

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Paul Krsek is the primary author of ELLUMINATION. While the views and representations found in the newsletter generally reflect the attitudes and opinions of the K&A Asset Management, LLC members and staff, Krsek often writes without editing and therefore is primarily responsible for the content and opinions contained in ELLUMINATION.

Effective February 1, 2008 Lee O'Dwyer has started to edit some portions of Ellumination. He also works closely with Krsek in the formation of investment policy so his influence is felt in the content of Ellumination.

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The investment portfolio models or management services mentioned in ELLUMINATION may or may not be available in some states, and they may not be suitable for all types of investors.

K&A manages accounts with various histories and investment objectives. Various accounts may be managed differently from time to time.

Krsek makes frequent reference to the model portfolios called Hatteras, Mendocino, Halifax, Bonavista, Fresnel and The New World. During 2005 Paul Krsek was appointed Chief Investment Officer of K&A, and as such is responsible to make all trading and management decisions for all client accounts which are being managed according to a specific portfolio model. A description of each of our models can be found on our website at <http://www.kaassets.com/choices.htm>.

As of July 3, 2007 Lee O'Dwyer joined K&A as a portfolio manager. Paul Krsek and Lee O'Dwyer frequently discuss investment ideas, model portfolio strategies and the investment policies of K&A. But when it comes to the implementation of those policies Krsek is primarily responsible to manage the accounts that fit into each model portfolio description. He generally makes all final investment and trading decisions relative to those accounts that are considered to be "modeled." However, in Krsek's absence O'Dwyer does have the authority to trade all client accounts. He has been actively trading accounts in the various models since joining K&A. Krsek and O'Dwyer are striving to reach a point in the management of the portfolios where they are likely to share more equal authority over the models. O'Dwyer has proven to be an excellent addition to the management team and is already having significant influence over the models.

Not all accounts managed by K&A are "modeled" accounts. We strongly urge our clients to understand which model, if any, are being used to manage their accounts.

Much of the content of Ellumination does not apply to K&A clients who are not invested through the models.

From time to time K&A receives requests from clients to purchase securities that are not included in the model portfolio to which they are assigned. Effective May 24, 2006 K&A has encouraged clients to hold such securities in a separate account for the client. Because K&A is a "fee only" registered investment advisor" it charges its normal management fee for monitoring such securities in the separate accounts in which they are held.

K&A makes every effort to exclude securities that are 'requested by the client' from the modeled portfolio accounts.

The investment objectives of various accounts and models may be substantially different from one another. Therefore topics or investments mentioned in E-Illumination may or may not apply to specific managed accounts and/or models.

Trades or adjustments to accounts mentioned in ELLUMINATION may or may not happen in every account managed by portfolio managers at K&A.

If you are not satisfied with the investment results in your account it is your responsibility to inform Krsek or Andreae and to discuss possible changes that can be made to the account to accommodate and satisfy your needs.

The assets held in managed accounts at K&A Asset Management, LLC may include stocks, bonds, cash, commodities, foreign exchange or mutual funds or exchange traded funds (ETF's), money market accounts or limited partnerships that represent the same. They are subject to market fluctuation and the potential for losses. The assets are not insured. The value and income produced by these investment products may fluctuate, so that an investor may get back less than they initially invested.

The portfolio managers at K&A Asset Management, LLC do not guarantee results.

Past performance should not be considered an indicator of potential future performance. If you do not consider yourself suitable, either emotionally or financially, to experience volatility and/or losses in financial markets, you should not invest.

From time to time Krsek lists the simple annual returns of the six model accounts in this newsletter. These accounts are "models" and do not represent the actual results accruing to individual accounts. Simple annual return does not represent "time weighted return" as reported individually to clients in their quarterly reports prepared using Centerpiece.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy any securities or other instruments mentioned in it.

Sincerely,

Paul Krsek
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