SIS Strategic International Securities
An Independent Research Firm

Politics and Stocks July 22, 2007

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Politics and Oil III

Introduction

We believe that given the current situation in Washington the price of Crude Oil could reach $90 a barrel by year end. On June 24th 2007 we wrote that: "we continue to believe that **politics** and not **supply and demand conditions** are the best predictor for the future price of oil. Based on the Senate vote on the Energy Bill on June 21, 2007 we stated that: "the price of oil had not yet reached it intermediate peak and… we believe that the price of oil will continue to go higher and possibly even test it's all time high of $77.05, despite that fact that on Friday June 23, 2007 the price of oil closed at a year to date high of $69.15" (*Politics and the Price of Oil,* SIS Research June 24, 2007). We based our argument on the fact that the U.S. Senate had just passed an energy bill that increase CAFÉ standards, but sparing the oil industry of any impact" (SIS Research *Oil and Politics* June 24, 2007). On Friday July 19, 2007 crude oil closed at 75.74, a dollar from its all time high and was over 76 on an intraday basis.

On October 18th 2006 our first Report using politics as a forecasting indicator, when crude oil was at $60 a barrel, we argued that following the election the price of oil would "rise testing the tolerance the new Congress" (NYGS, *Speculation in the Oil Market and the U.S. Midterm Elections*). This led us to believe that the necessary political condition for the price of crude oil to decline had not been met and that until there is "**fear in the speculative oil market that Congress will take action against the oil companies**." (SIS Research *Oil and Politics* June 24, 2007) the price of oil would continue to achieve new all time highs. **Last week** after the price of crude oil closed within $1 of its all time high, some additional clarity to **the political impact on the price of oil emerged.**

The U.S. House of Representatives had been working on the passage of the same Energy Bill that passed the Senate; however, a major stumbling block was reported by the New York Times in their article entitled "Veteran Democratic Bulldog Guards House Turf on Energy" *New York Times* p. A1 July 21, 2007). The Times argued that Congressman Dingell of Michigan was trying to block the bill's passage in the house by preventing it from getting to the floor of the house. Dingell like Carl Levin in the Senate both Liberal Democrats were opposed to the bill that increased CAFÉ standard on the Auto Industry, both being from Michigan, with Dingell in the house having more leverage on this issue than Levin had in the Senate, with Levin adamantly voting against the measure.

This is not an illogical position for leading Michigan Congressman, irrespective of their political bias. What they were protesting to was that the Senate bill essentially spared oil and gas companies and major utilities" while placing the entire burden on the Auto Industry for bring down the dependency on foreign oil (New York Times June 23, 2007 p. A11).

It is here in this unlikely confluence that liberal congressmen are opposed to a bill that is believed to be a major benefit for the consumer and the environment that we may find the key to predicting to the future price of oil, in their ability to find a compromise bill. It is here where the future price of oil may be determined, whether it's current high will be a long term high over the next several years, or we will see the price of crude go to $90 a barrel by year end.

We believe that the risk of a compromise bill, with both the house and the senate using some form of tax and/or reduction of tax incentives to the oil companies and giving those incentives to the auto industry and alternative energy industry to help pay for some of the technological costs that the auto industry or alternative energy industry will incur with the increase in CAFÉ standards**, is logical, but we believe in the current environment, rather remote. It is only this type of compromise that will cause a top in the price of oil and limit much higher prices in the future. Barring a compromise of this nature, which we currently believe is remote; we expect to see the price of oil continue to increase to $90 per barrel by year end.**

Analysis

We continue to believe that politics and not economic conditions are still the best single variable predictor of the intermediate change in the price of oil, despite the fact that the press and other analysts continue to look for demand and supply factors to determine the price of oil. Yesterday for example the New York Times in their Sunday edition July 22, 2007 on the front page headline stated that: "Record Failures at Oil Refineries Raise Gas Prices" (*New York Times* P. 1). We have all read about Hurricanes, Riots, Protests, Strikes, Fires, Wars, and a host of other explanations. Over the past two years however, while these factors clearly do affect the day to day changes in the price of oil, we have found that the single best intermediate indicator has been the tolerance of the U.S. Congress for the high price of oil. We continue to believe that oil will continue to rise until there is fear in the speculative market that Congress will take action against the oil companies.

The only near term possibility that we see as this condition of fear in the speculative market that Congress will take action against the oil industry emerges from the possibility of an unlikely compromise lead by Congressman Dingell and Senator Levin's both of Michigan. As Michigan congressmen their biggest industrial constituency is the Auto Industry, and with the current Energy Bill before congress impacting this industry with increased CAFÉ standards it is understandable that they would react negatively against the bill. However, both as liberal congressmen it is conceivably that they can push through a compromise bill that helps the auto industry pay for the technological costs of the increase in CAFÉ standards with money coming from the oil industry in some form of reduction of oil industry incentive.

We believe that this is a very unlikely outcome, mostly because the appeal of this bill to the Republican Party was that the bill does not affect the oil industry, and puts some additional pressure on the auto industry, which is one of the last successful industries with a powerful union worker base. It is for this reason that this compromise is deemed to be so unlikely. Barring such an unlikely compromise, though logically plausible, we expect that the Senate version of the Energy bill will pass over the objections of the Michigan auto contingent. In the event that this occurs with an Energy bill passing the house and the senate during this session of Congress with no real impact on the oil industry, we can envision oil hitting $90 a barrel by year end.

Over the past year we have written several pieces arguing that Politics and not supply and demand conditions have been the single most informed indicator for determining the intermediate price of oil. Based on these factors we expect that the price of crude oil will continue to rise again using our guide that the price of oil will continue to rise until there is fear in the market that Congress “will take action against the oil companies.” At present, barring a Dingell and Levin compromise which would be able to bring some pressure on the oil industry we envision a continuation of the increase in the price of oil.

However, we will need to watch these hearing and actions very closely to see how Congress works its system because there are many factors now in play, the Michigan auto contingency, the oil industry supporters, the oil independence group, the global warming advocates, along with the consumer advocates, just to mention some of the dominant players. Based on what we are currently seeing out of Washington, we expect that Oil will in the next few weeks hit a new high and approach $80 dollars a barrel, with $90 being possible by year end.

Summary

We expect that the price of crude oil will go past its all time high of $77 a barrel and approach $80 in the very near term future, going as high as $90 by year end. We continue to believe that at this juncture Politics and not Supply and Demand conditions are the best single indicator as an intermediate forecaster for the price of crude oil. We will need to watch very closely what happens in the house and how the Michigan auto contingent maneuvers this bill. We expect that they will lose and no compromise will be found which puts some form of pressure on the oil industry.

In the unlikely event of such a compromise we would expect to see an immediate decline in the price of oil, but believe that this even has a very low likelihood. We expect that a bill will pass with no new taxes or reductions of incentives on the oil industry. If all this is correct, we would expect that we are nearing a new all time high for the price of oil, and that the CAFÉ bill will pass over the objections of the Michigan auto contingent, and not affect the oil industry, leading to oil hitting $90 a barrel by year end.

Risk Factors to the Current Analysis

We have made various forward looking statements about the price of oil that are not based on any demand and supply considerations and or any other economic factors. We based the entire analysis on one market the United States, and on one indicator, politics. We have not factored in any kind of national or international considerations that may affect the price of oil, such as a breakdown in a pipe line, political unrest in a country or region, or any other factors that might affect the price of oil.

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