SISR Strategic International Securities Research Inc.
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Price of Gasoline Expected to Rise to $4.00

Summary:

We are recommending the accumulation of Major Integrated Oil and Gas companies and the Major oil & Gas Refining and Marketing companies because we believe that the crack spread or the refining margins are likely to improve significantly in the coming months. We expect that the price of gasoline will increase relative to the price of a barrel of oil. Last year when Crude oil broke through the $70 barrier, gasoline at the pump was selling at $3.50. Today when Crude hit $90 a barrel, gasoline is selling in the $2.90 range. As a consequence, even though crude oil is selling at $90 per barrel, a record high, oil companies are warning that their earnings for the current quarter may be weak. This report will attempt to explain this disparity with the political indicator that we have been using for over a year. We will also justify our recommendation for the overweighting of oil companies, based on this political indicator.

We are recommending an accumulation despite the fact that yesterday ConocoPhillips (COP) reported a 5% fall in third quarter earnings, because of refining margins, and on October 10th both Chevron Corp (CHV) and Valero Energy Corp (VLO) warned that they expected to report third quarter earning short of expectations, also because refining margins have not kept up with the price of oil. We believe that any negative impact of these weak earnings should be seen as a buying opportunity.

We will argue that the reason for this compression in the price of gasoline relates to the fact that the 2007 Energy Bill is stalled with the formation of a conference committee to join the two versions of the 2007 Energy Bills passed by the House and the Senate. On June 22, 2007 the U.S. Senate passed an energy bill 65 to 27 that increases the CAFÉ (Corporate Average Fuel Economy) on the auto industry. On August 4, 2007 the U.S. House of Representatives passed an energy bill that did not include the CAFÉ component, but did repeal the tax deduction for income from oil or natural gas (Section 13001).

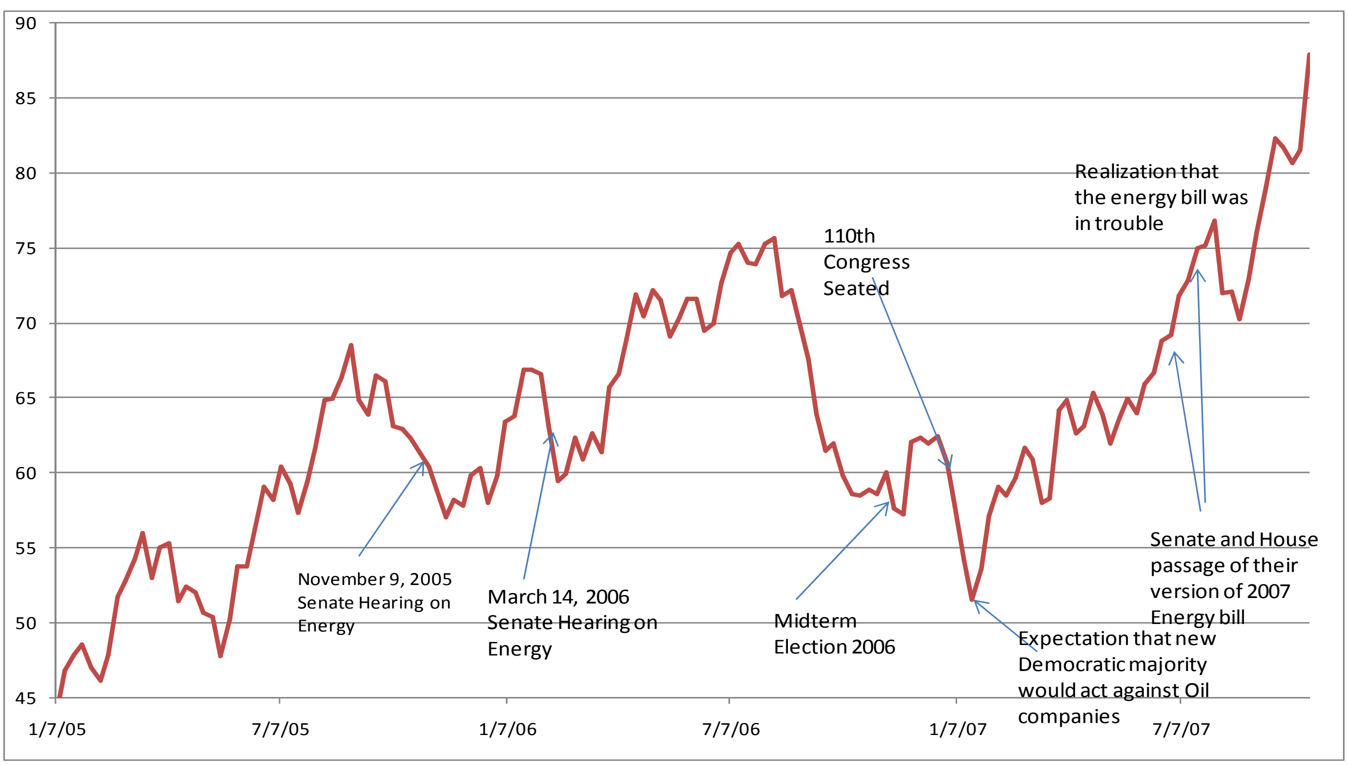
From July of this year the price of crude oil has been increasing at a rapid rate, but the price of gasoline has remained flat or stable compressing the refining margins. We believe that the public would be much more vocal with respect to the Energy Bill if the refining margins were more equal to the historical relationship, which would indicate a $3.50 to $4.00 price at the pump. We believe that speculation in the

markets has driven down the price of gasoline relative to the price of oil for fear that more aggressive action may be taken against the oil companies in the energy bill, if gasoline was selling at those levels. As of this writing, the Energy Bill as of this writing appears to be in trouble, with Congress still not having created a conference committee to iron out the major differences in the two versions of the bill. We believe that the Energy Bill will die in committee and once this fact becomes clear, we expect that the refining margins will radically increase, leading to $3.50 to $4.00 per gallon of gasoline by the driving season next year, 2008. An increase in the refining margins will help the oil companies' profits even if the price of oil per barrel does not go any higher. As a consequence, we are recommending the accumulation of the Major Integrated Oil and Gas companies such as: Exxon Mobil (XOM), Chevron Corp (CVX) and Conoco Phillips (COP), and the Major Oil & Gas Refining and Marketing companies such as: Marathon Oil (MRO), Valero Energy Corp (VLO) Hess Corporation (HES) and Sunoco (SUN).

Analysis

On August 14, 2006 we argued that the price of oil no longer can be determined by demand and supply conditions. On October 18, 2006 we began a series of reports that demonstrated that U.S. political events have strongly impacted the price of oil. On June 25, 2007 we published a report arguing that we expected to see the price of oil reach a new all time high above $80 per barrel. On July 22, 2007 we argued that: "given the current situation in Washington, the price of Crude Oil could reach $90 a barrel by year end." Last week the price of oil briefly hit $90 per barrel and closed today at $90.46. Chart I plots some of the key political events that have influenced the price of oil leading to today's high of $90 per barrel, and was the primary indicator in each of our earlier projections.

Figure I: Weekly Price of Oil and various Political Events, January 2005 to Oct 2007



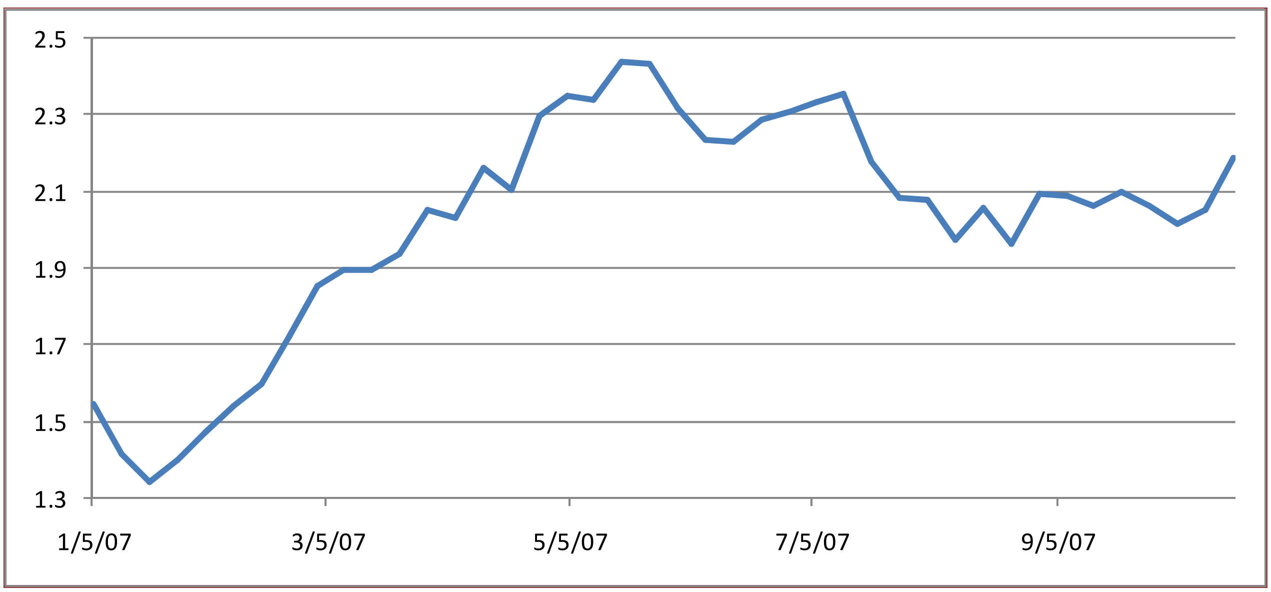
Source: U.S. Department of Energy, Energy Information Administration, CSPAN, SISR Inc.

Presently, we expect that the price of oil will stabilize at this plateau with the price of gasoline increasing to its historical parity with oil. The crack spread currently is below those levels, with gasoline being relatively inexpensive in relation to the price of oil.

For the past year, we used our understanding of major political events as an indicator for projecting the price of oil. This indicator appears to currently still be effective however, in order to fully understand the power of the speculative influence on the energy market it is necessary also to understand the current dynamics between the price of gasoline and the price of crude oil. It is interesting to find that the price of oil is currently hovering at the $90 per barrel level but the price of gasoline has not participated in the current rise in the price of crude oil.

From Figure I we observe that the price of oil has gone almost straight up from a low of $53 in mid January to a high of $90.46 today. Ironically, from June of this year when the Senate and House Energy versions of the 2007 Energy Bills were debated and subsequently passed, the price of gasoline, as seen in Figure II has actually gone down.

Figure II: Weekly Price of Gasoline January 2007 to Oct 2007



Source: U.S. Department of Energy, Energy Information Administration, CSPAN, SISR Inc.

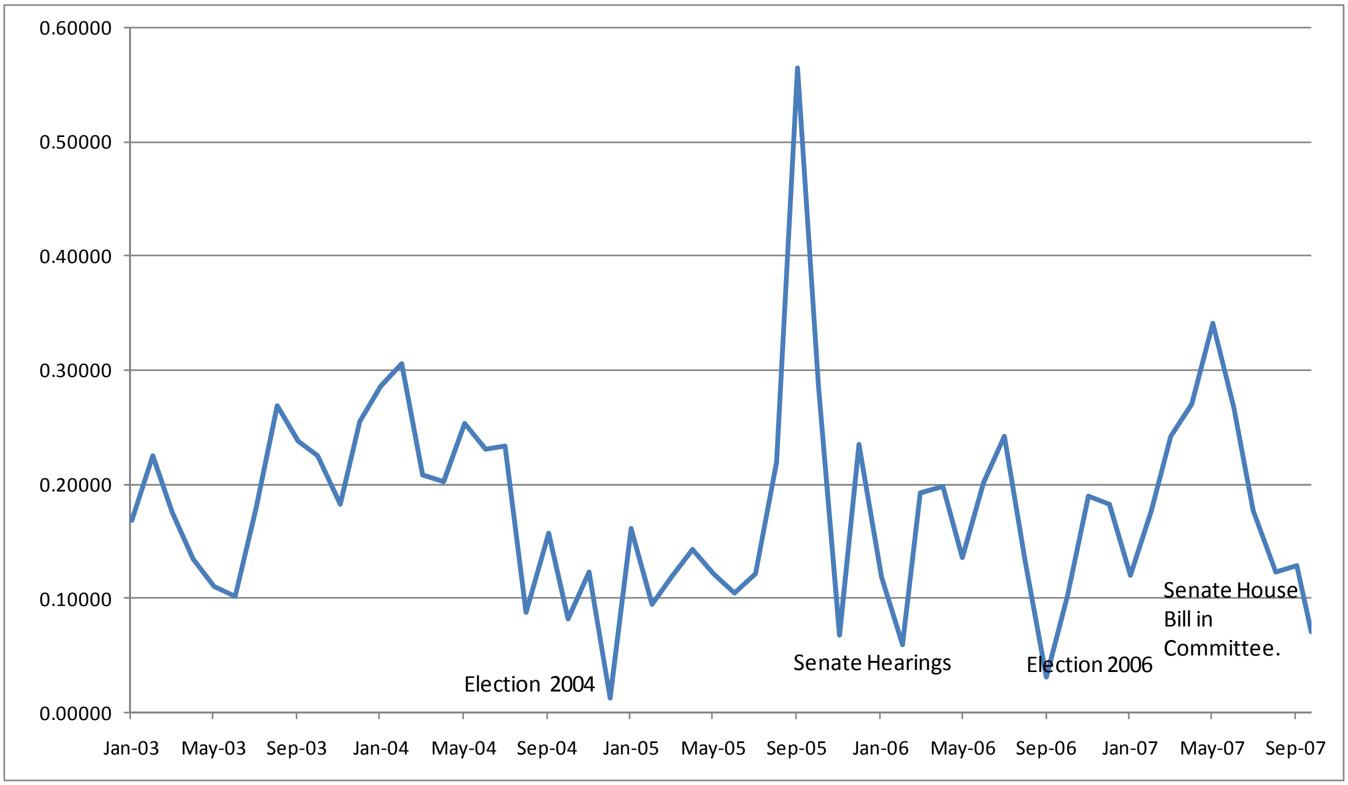
Looking at this relationship in a more nuanced manner we calculate in Figure III the refining crack spread as a percentage of the price of oil, seasonally adjusting the crack spread given the strong seasonal variations. The seasonal adjustment underweight's the increase common during the driving season and overweight's the non driving season lows. In essence, the October and November lows are boosted while the April and May highs are reduced. From Figure III we find that there are five periods from 2003 to the present when this refining percentage was particularly low. These five instances were:

1. The Election of 2004
2. The Election of 2006
3. The Senate hearing in November of 2005

4. The Senate hearing in March of 2006
5. The current period after the House and Senate versions of the 2007 Energy bill

Each of these low points coincides with a major political event. **This leads us to the conclusion that the intermediate period major inflection points in the price of gasoline and/or crude oil are not a product of demand and supply, a hurricane, or a war, or some strike in a particular country that has caused this relationship they simply reflect political events in the U.S. that appears to affect the price of oil in relationship to the price of gasoline, in the U.S.**

Figure III: The refining crack spread as a percentage of the price of oil from Jan. 2003 to Oct. 2007



Source: U.S. Department of Energy, Energy Information Administration, CSPAN, SISR Inc.

If we are correct that political events and the speculators are adjusting the risk factors for these events, then we would expect that if the Senate and House Bills dies in committee, or passes without any impact on oil the companies, then the price of gasoline would likely go up.

We expect that prior to Thanksgiving 2007 this bill will either pass with a version more similar to the Senate Bill, leading to higher CAFÉ standard for the auto industry, or die in committee. Our current expectation is that it will die in committee and that by the next driving season the price of gasoline will have increased significantly. We would not be surprised to see a price of $ 3.50 to $4.00 per gallon for gasoline at the pump by spring of next year.

Actionable Recommendations

The obvious commodity trade would be to go long gasoline, the alternative would be to go short oil relative to gasoline going long, or even to go long the crack spread. The security trades would be to purchase the stock of the major oil companies now that they are weakened by the earnings warnings with the expectation that as soon as the refining margins improve by Thanksgiving these companies will have excellent quarters going into the winter, spring and summer of next years.

Certification:

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Price Chart:

A price chart, with changes of ratings and price targets in prior periods, is included above, for all securities covered in this report.

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