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Oil, Natural Gas and **YOUR FUTURE**

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In our near future, the cost of oil and natural gas will increasingly be measured in more than dollars and cents. We will measure their costs in the effects on our quality and comfort of life as well as our financial and individual health and safety. We in the United States enjoy a high level of creature comfort, relative safety in a well ordered society and good health. All of these benefits, either directly or otherwise, depend upon the ready availability of a relatively inexpensive source of energy. Even today with oil hovering around \$80 dollars a barrel, the true cost of our dependency on foreign sources of energy and their rising costs have not fully been tallied or even fully realized. And, the possibility of those costs, both monetary and societal, going higher and our suffering setbacks to our way of living in the coming decade are significant and real.

Argue what you will about energy conservancy and weaning the nation off fossil fuels, the hard reality is that conservation and alternative fuels are in no way ready to displace oil and gas as America's chief source of energy. Although conservation will lesson our dependency upon fossil fuels and alternative sources of energy will one day supplant oil and gas, just as crude oil once supplanted whale oil in the United States, that day is not upon us, nor is it likely to occur in the foreseeable future. If our near future, let's say the next decade, by necessity includes the continued use of oil and natural gas as our primary source of energy, what should the educated investor know? And more importantly what is it that they should do?

Demand and Depletion

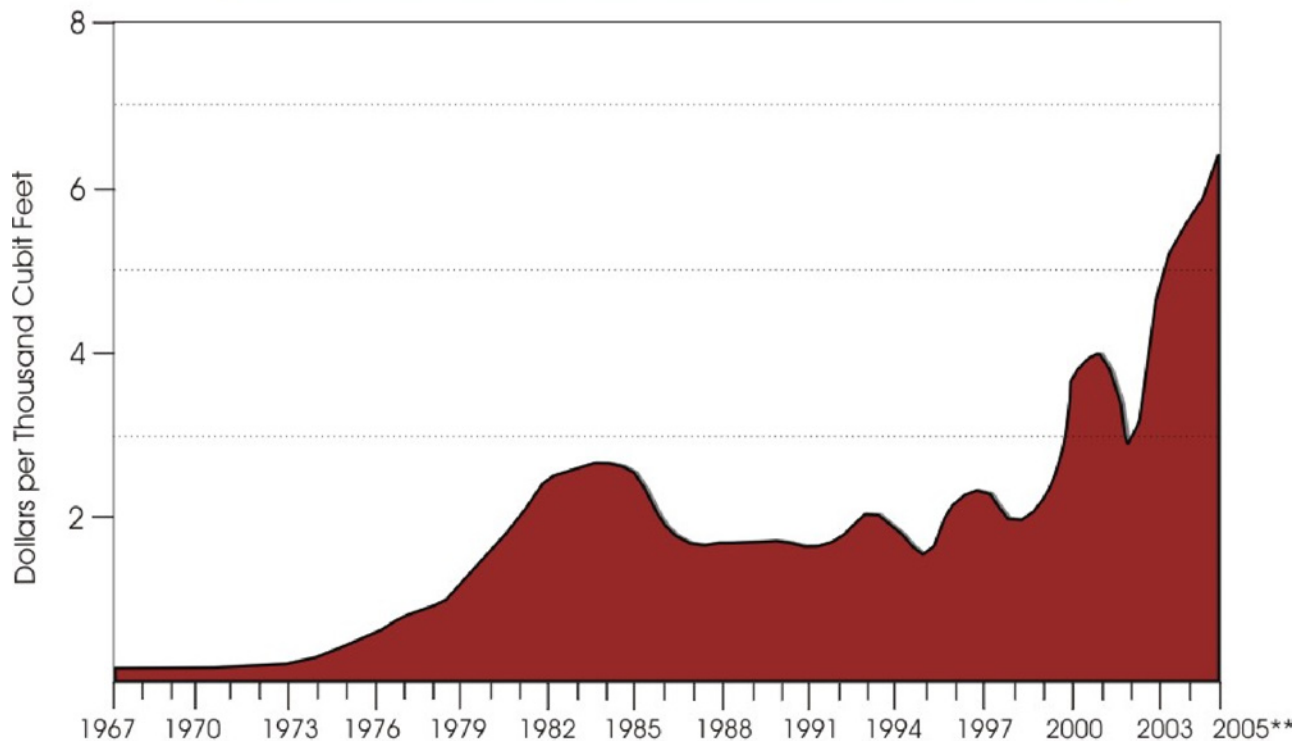
The socio-economic complexities of the developing world, and in particular China and India, will continue to place huge demands upon the global energy market. As heavy industry and manufacturing increase in these developing nations, so too will the demand for energy to feed their foundries and build their infrastructure. At present, the average person in China only uses about 2 barrels of oil a year, the average American, on the other hand, consumes 25 barrels of oil a year. The flowering affluence of a nascent middle class in populous developing countries, like China, will drive demand for greater amenities, goods and services. All of which depend upon oil and gas either directly or indirectly so. Even modest increases in per capita consumption in India and China will continue to propel world-wide consumption at a breathless pace, in turn, pushing the price of energy ever upward.

We have already seen the results that today's level of demand for fuel has had on global energy markets in the steady decline of spare capacity and the scramble to increase that capacity through enhanced infrastructure and the discovery of new hydrocarbon reserves. This already complicated equation is made more so by the rapid depletion of easily accessible, cheaply produced, light crude oil, what many refer to as conventional sources of oil. Many experts believe that oil from conventional sources is going to peak within the decade, if it has not already done so. Dwindling reserves are being replaced more slowly, and often with oil that is costlier to find, extract and refine. In some cases, hydrocarbon reserves (i.e. oil) are quietly being replaced on the books of many major oil companies with natural gas acquisitions.



As a result, the price of natural gas too has climbed sharply, particularly after 2002. When compared with oil or alternative fuels, natural gas is attractively plentiful, inexpensive and clean. It is the natural successor to oil and many forecasts place it as the principle source of energy in the world as early as 2025. But it too will become increasingly expensive and by the time it becomes the principle source of energy in the world, there is no guarantee that it will not have followed the path of oil.

Average Wellhead Prices of Natural Gas, 1967-2005.*



*The chart is based upon information available from the U.S. Government's Energy Information Administration. The prices shown are the averages realized after all cost allowances were debited.

**The 2005 average does not include figures for the 4th quarter. Because the 4th quarter usually commands the highest prices during the course of the year, the figure shown is likely less than what will be realized.

The uncertainty built into the global energy market has led to a readily observable, but impossible to calculate, socio-cultural and political cost. This pattern has manifested itself recently in Russia's aggressive energy diplomacy and its resurgence as an imperialistic power in Eastern Europe, the growing specter of a militant Islamo-fascist Iranian leadership with nuclear ambitions in the Middle East, China's growing influence in the world energy market and a growing willingness to flex its new found economic and military muscle in Asia, and the garrulous Latin American government of Hugo Chavez in Venezuela. All of these are examples of how having or not having much needed oil and gas reserves greatly effect a nation's conduct in the world theatre.

With a world-wide push by every major industrialized or developing country to either secure oil and gas reserves or leverage their reserves on the world political stage at today's level of global consumption, presently pegged at between 80-85 million barrels a day, what can we expect geopolitical and economic conditions to look like in a decade when global demand is expected to reach an estimated 135 million barrels of oil a day, a figure that many feel will significantly outstrip production? The growing litany of expert voices in both the financial and scientific communities that are saying that the oil and gas industry will not be able to keep up with demand in the near-future and that the world economy will suffer as a result are becoming difficult to ignore. The results of the suggested shortfall in future production, whatever the specifics turn out to look like, will be measured in economic and social costs. It is likely that when tallied those costs will be considerable. It is for this reason that one should act to mitigate those anticipated costs. The clearest way at present to do so is to invest in the domestic oil and gas industry of the United States of America.

Why Invest?

The socio-political and economic ramifications of higher energy prices on the global economy over the next decade are myriad and far reaching; however, their effect on the educated investor, from our present vantage point, can be summarized as follows:

- **One, the rising cost of oil will mean a shift to a less expensive energy source.** Despite the various energy alternatives, both green (solar, wind, bio-fuel, etc.) and otherwise (coal and nuclear), natural gas holds the most promise for meeting the world's voracious demand for energy over the next decade. Because natural gas is relatively inexpensive, highly versatile and clean, it will likely become the transitional energy source of the 21st century.

- **Two, high energy prices will certainly slow the global economy.** Although it is not likely that the world will experience an economic meltdown, the world economic engine will have to change gears. Energy costs will become an increasingly important financial consideration. It will be impossible to escape its universal reach – gasoline for the car, heating and cooling costs, the added cost of transportation to both luxuries and necessities – but it may be mitigated through participation in the oil and gas industry.

- **Three, the tax benefits associated with direct participation in domestic oil and gas exploration remain one of the last great beneficial tax deductions afforded by the federal government.** The ability to write off between 70-80% of one's initial investment and the remaining amount over the next 7 years makes direct participation a greater value than indirect participation through the stock market or mutual funds.

In conclusion, as the myriad costs of oil and gas continue to rise over the next decade it is important to invest in such a manner so that one mitigates their financial exposure to what is very likely to be significant changes due to a volatile energy future.

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