

PRICE RISK ISSUES REGARDING NATURAL GAS INVESTING

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As most of you know, I am convinced that the price of natural gas could remain in the \$4.50 to \$5.50 mcf range for the foreseeable future. It is possible that the trading range could slowly work its way \$1 higher to between \$5.50 and \$6.50. In the past, I provided charts which indicate to me that the weighted average or median price of natural gas could hover around \$5.25 for the foreseeable future. With regard to crude oil, the approximate price range adjusted for inflation over the last 30 years, has been as low as \$24 and as high as \$49, and averaged \$35 per barrel. A \$5.25 natural gas price is equivalent to \$33 per barrel of crude. At present, the price of crude is \$38 and the natural gas price for current delivery is \$6.20. (For winter delivery, it is close to \$7.)

As with any investment, there are many risks. Some are cosmetic, some are real, some are imagined, and some will always remain unknown. Here, the most significant issue at hand is the price for natural gas and other energy resources such as coal and crude oil. Between Alaska, Russia, US Mountains, Canada, Arab states, and deep waters of the ocean, long-term scarcity in energy resources hardly seems a worry. However, when one considers environmental issues, terrorism concerns, transportation infrastructure needs, and balance of payment problems, the landscape changes drastically. With “not in my backyard” thinking and concerns for the environment, we limit the use of coal which, although cleaner than ever, is still not clean. We also limit the use of nuclear energy which, although clean, is especially vulnerable to terrorism and decommissioning liabilities. When considering the construction of new natural gas terminal facilities we are restrained by our fear of terrorism and concern for safety. In short, we have established our own politically-imposed scarcity.

So what's the investment risk concerning the price of natural gas? The risk, in my opinion, is not necessarily that natural gas and crude will fall to the low levels of the late 90s. A new and strong demand from China and India along with revitalized economies in the United States and Japan will probably help to stabilize prices at high levels for the foreseeable future. The real risk, in my view, is if prices get too high governments could be forced to abandon their self-imposed limitations on production and compromise their considerations for the environment and terrorism. Efforts to substitute and conserve will grow more aggressive. If the US decides to drill in ANWR (Arctic National Wildlife Refuge), build new nuclear power plants, construct new liquid natural gas terminals, and reduce the clean air regulations relative to coal, energy scarcity will disappear and prices could settle at the low end of their recent range for a very long time. Nonetheless, Americans are still willing to tolerate limits on energy production as long as prices are not so high as to spawn massive unemployment. As a prosperous nation, the US can afford to be idealistic and environmentally minded. However, when push comes to shove, if unemployment rises due to the pressures of high prices, all qualms will be set aside and the nation could be more proactive in its efforts to increase energy availability no matter what the social or environmental cost. Thus, it is very

high energy prices that we should fear most, certainly not the modest declines that we expect (and hope for) this summer.

Looking at the 30-year average adjusted for inflation, crude can trade between \$28 and \$49 per barrel and natural gas can sell between \$4.50 and \$8 per mcf without presenting any undue pressure on the economy. This could be the most ideal of circumstances for the environment, consumers and producers alike. Exceeding the \$55-\$62 dollar per barrel of crude and \$10 mcf of gas would, in my mind, be more negative than positive, as that might result in the abandonment of our self-imposed restraints on energy production. Unfortunately, this point reminds me of the well-known story of how to properly boil a frog. If a frog is placed into boiling water immediately, it will jump out; however, if the frog is placed in luke-warm water and the heat is turned up slowly in small increments, the frog will remain still through the boiling point and begin to cook. Thus, like a 'frog in boiling water,' it would be best for gas producers if prices slowly ratchet higher and have enough momentary declines to keep consumers from reacting too drastically.

In order to best participate in what could be an eighteen year secular bull market in the energy complex that began between 1998 and 2000, I recommend the following four investment vehicles:

- Oil and Gas - common stock NASDAQ listing (growth)
- Partnerships A-B-C-D as a general or limited partner investor (income)
- Energy as a limited partner (income)
- LLC as a limited partner (growth)

Just as we have endeavored to diversify within the asset class of real estate, we are also attempting to diversify within the asset class of commodities through our commitment to energy investing. All four of the above investments differ in their objectives, structures, tax treatment, etc. They provide, in my view, a balanced way to participate in what I believe will be a continuing bull market for natural gas specifically and for the commodity asset class in general - all the while providing overall portfolio diversification and a possible terrorism hedge.

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