

## The View from Here...



The first 5 months of 2005 has been financially tattered by a slowed GDP, flatter consumer spending (except on housing), mixed inflation signals, and modest rate hikes. All tolled, the lack of a real economic recovery has caused most indices to be “down” so far this year. While the losses in equities have not been deep (-10%) they have been widespread with only a few exceptions. Only the Energy and Financial sectors and certain “story” stocks have outperformed in this choppy environment.

Very often history has shown that a market dealing with fears of rising inflation and interest rates will get “stuck”, translating in to a “range-bound” market. This is the famed “rut” syndrome which we have been experiencing since New Year’s. But, even “no where” markets have good moments and, if you have the right selections (including some high yielding stocks) you can achieve positive returns and enjoy some nice income. In this issue we will identify some of our current favorites, but before we do let me share a few relevant thoughts about oil.

Is Wall Street in denial and clinging to wishful thinking when it comes to oil prices? Will crude oil prices come down in to the low 30’s and will prices be able to stay down permanently?? A few large and well –regarded Wall Street firms have believed since last Fall that oil prices will normalize at levels for below today’s. OPEC, let me note is currently pumping 24/7 (at 100% of capacity) at a time of the year when “seasonal” demand is at its lowest. Year after year, oil prices take a “seasonal breather” during the April-June timeframe. It is very likely that the current reprieve will be short-lived and not constitute a lasting downward trend.

Let’s briefly examine some facts. For the last 50 years, this downturn in U.S. energy demand occurs two times a year like clock-work. As a result, energy prices pause and back off as depleted reserves are rebuilt, thereby causing prices to ease. We are experiencing this phenomenon right now... in fact, every Spring (no more winter and freezing temps) oil prices dip. The oil reserve surplus, for example in the U.S. was seven days after February, fifteen after March, and twenty two days of reserve after April 30<sup>th</sup> ... this rebuilding of reserves after the winter wind-down is quite typical. But, the number of reserve days the U.S. enjoyed last year as of April 30<sup>th</sup> was 95 (vs. twenty two days here in ’05)... we shouldn’t feel so comfortable in having only ¼ the amount of reserve this year.



After schools get “out” and vacation traveling sets in and the air conditioning/cooling systems go “on”... energy demand increases over the Summer... the data catches up with this in July and August only to see demand fade in the September/October timeframe (“Indian Summer” to us) before the furnaces go on in November/December. These seasonal cyclicalities are fairly regular for us and we have been conditioned to think this way... however, domestic supply/demand issues aren’t the whole story.

The point being missed (most likely) is the increasing demand for oil and gas for the nations of China, India, and the Pacific Rim, and even Africa which are growing faster than the U.S. This demand is for ongoing supplies and defies cyclicalities. In quick summary: Energy stocks are no where near their eventual highs. How to profit: Continue to stay the course with an overweighting in Energy stocks and use the current pullback as a buying opportunity. Many pundits believe that oil prices will reach \$60 and hover in the 50’s and low 60’s next winter.

Obviously we can not do adequate justice to all our favorite picks in a general Newsletter like this, but here are some of our best “Buy and holds”:



E	Arch Coal (ACI)	\$47
E	British Petroleum Royalty Trust (BPT)	\$63
E	Chevron Texaco (CVX)	\$53
E	Conoco Phillips (COP)	\$104
E	Dominion Resources (D)	\$70
E	Energy Plus Resources (ERF)	\$35
E	Florida Power and Light (EPL)	\$40
E	Frontline (FRO)	\$43
E	Kinder Morgan (KMP)	\$48
E	Magellan Midstream (MMP)	\$31
E	Petro China (PTR)	\$63
E	Prime West Energy (PWI)	\$23
E	Schlumberger (SLB)	\$68
E	Valero Energy (VLO)	\$68
F	American Express (AXP)	\$53
F	Allied Capital (ALD)	\$27
F	American Capital Strategies (ACAS)	\$34
F	Citigroup	\$47
F	Wells Fargo (WFC)	\$61
S	Air Products and Chemicals (ADP)	\$60
S	E-Bay (EBAY)	\$38
S	General Electric (GE)	\$37
S	Hilton Hotels (HLT)	\$24
S	Phelps Dodge (PD)	\$85

S	Pitney Bowes (PBI)	\$45
S	United Health Group (UNH)	\$97
S	Viacom (VIA/B)	\$35
S	Wallgreen (WAG)	\$45
S	Zimmer Holdings (ZMH)	\$77

Key: (E) Energy, (F) Financial Sector, (S) Special Situation (story) stocks.

In terms of technology stocks take a further look at Pixar, Lucent, Dell, Time Warner, and Apple Computer.

In closing, let me say that the 2<sup>nd</sup> half of the year offers tremendous promise and a continued need to keep a close eye on developments. I, no doubt, will be talking with you over the upcoming Summer months. As always, feel free to call me anytime. With best regards.



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