CYCLES RESEARCH- The Original Energy Bull

Comments from past issues:

September 2003 Cycles Research

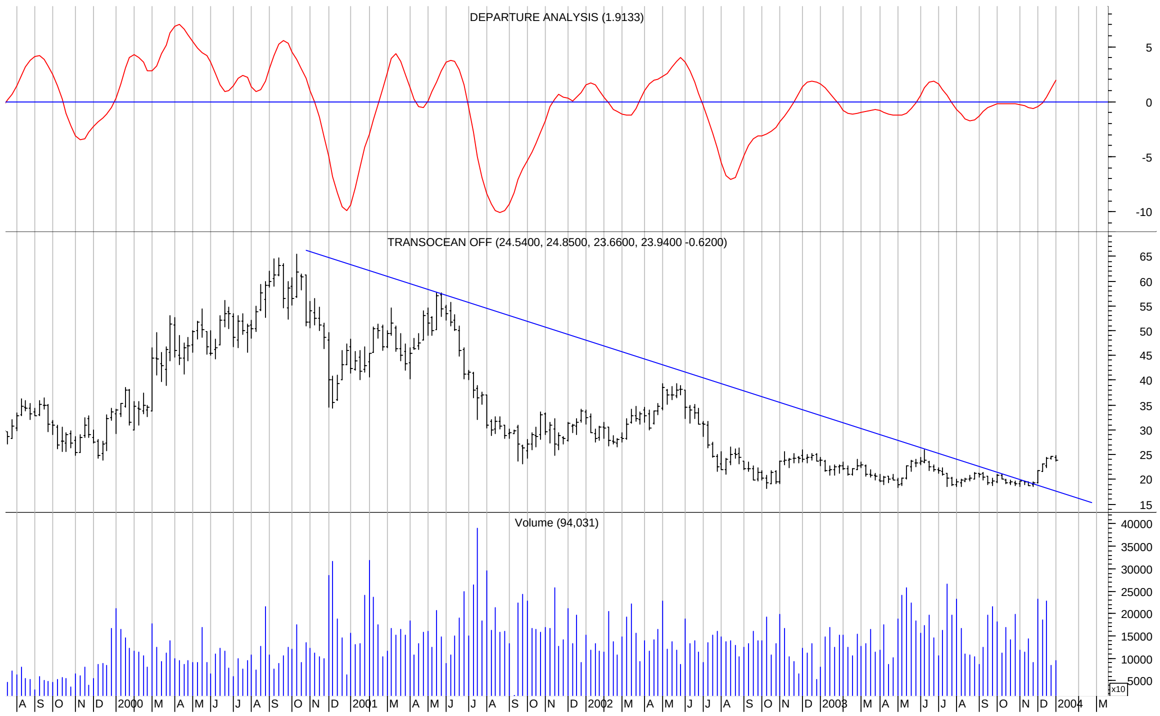
The oil decline has been in the 15% to 20% range, far less than anyone expected. Given the situation in Iraq and strong demand from China, I doubt that crude will trade lower than $29 a barrel.

January 2004 Cycles Research

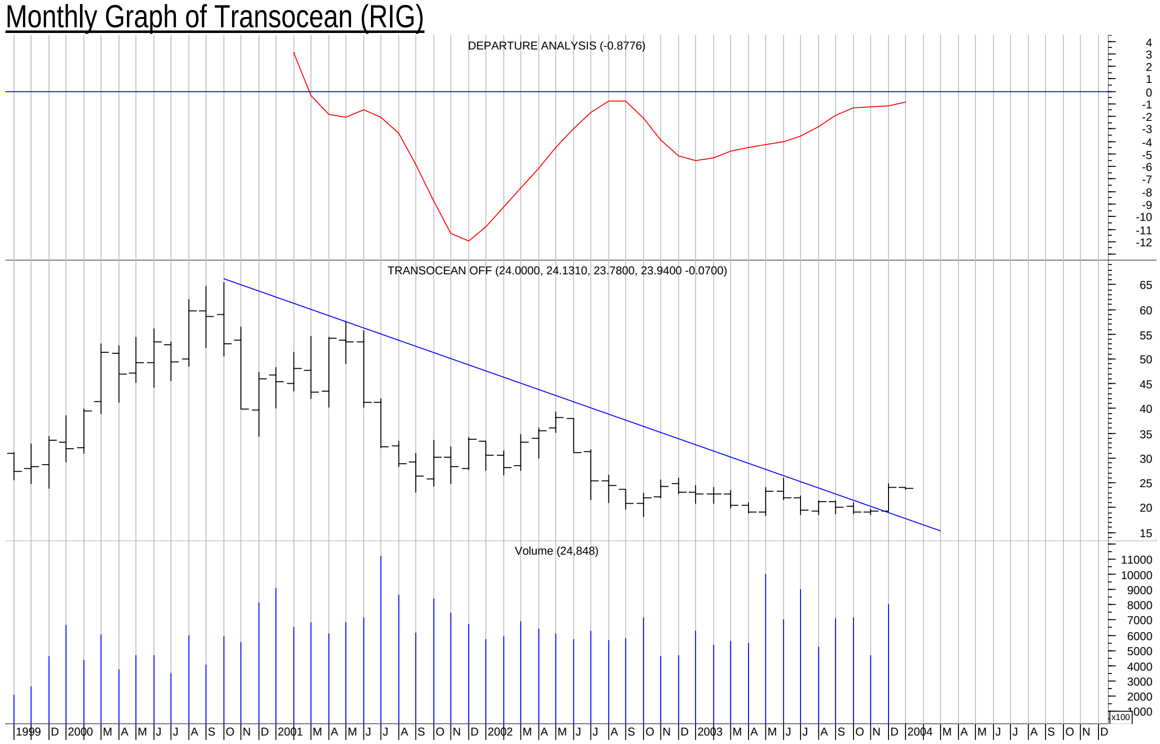
An Unfolding Energy Bull Market

The weekly and the monthly graphs of Transocean (RIG) are depicted below. Note the series of higher lows in the red momentum indicators in both graphs. Also note the breaking of long downtrend lines. This suggests much higher prices in 2004. The daily pictures are overbought, and January will likely bring a retreat, but I think that the long-term trends are intact. This breakout is consistent with my longer-term view of a commodities bull market. I could fill this report up with similar bullish energy charts, so the buy signals are not limited to RIG. Other bullish patterns are Anadarko (APC), Atwood Oceanics (ATW), and Noble Energy (NE).
I spoke to the fellow who handles equipment rental for the Abu Dhabi National Oil Co., one of the world's largest companies. He told me that he has to look as far away as the Balkans to find equipment to rent. Noble Energy is running at full tilt and cannot spare any drilling capacity. This is to be expected after a 22-year bear market in commodities. Why would one bother investing in infrastructure when commodity prices had been very low?

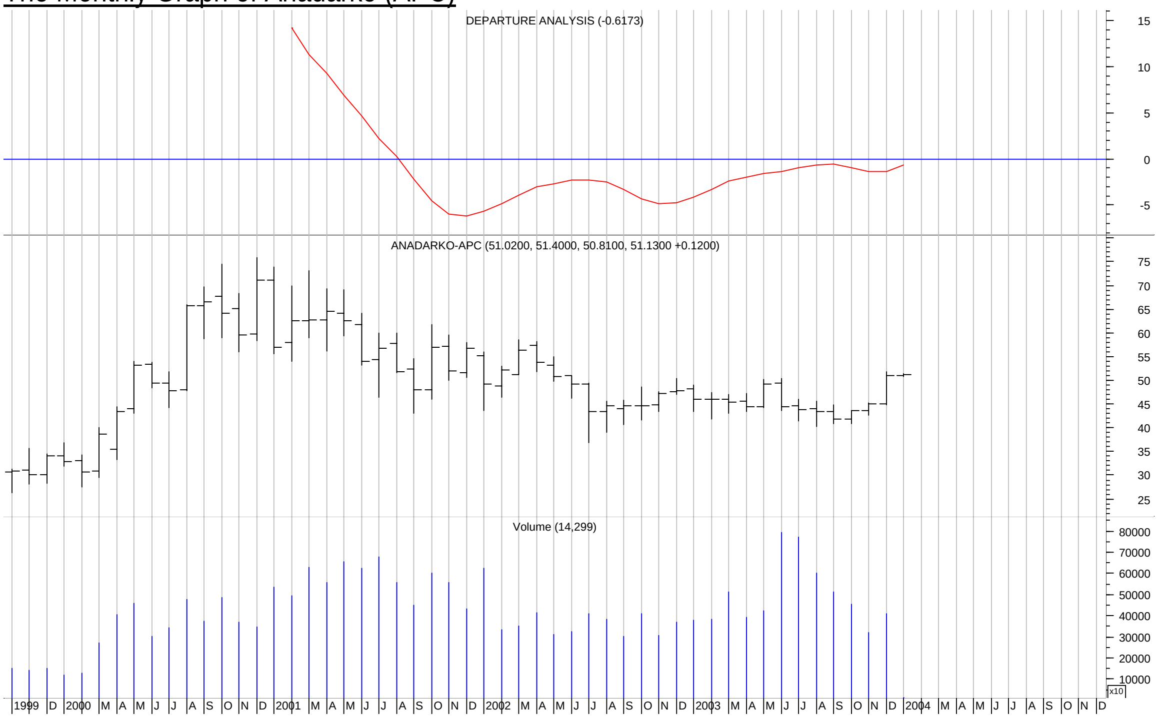
Weekly Graph of Transocean (RIG)



Monthly Graph of Transocean (RIG)



The Monthly Graph of Anadarko (APC)



February 2004 Cycles Research

Energy Update

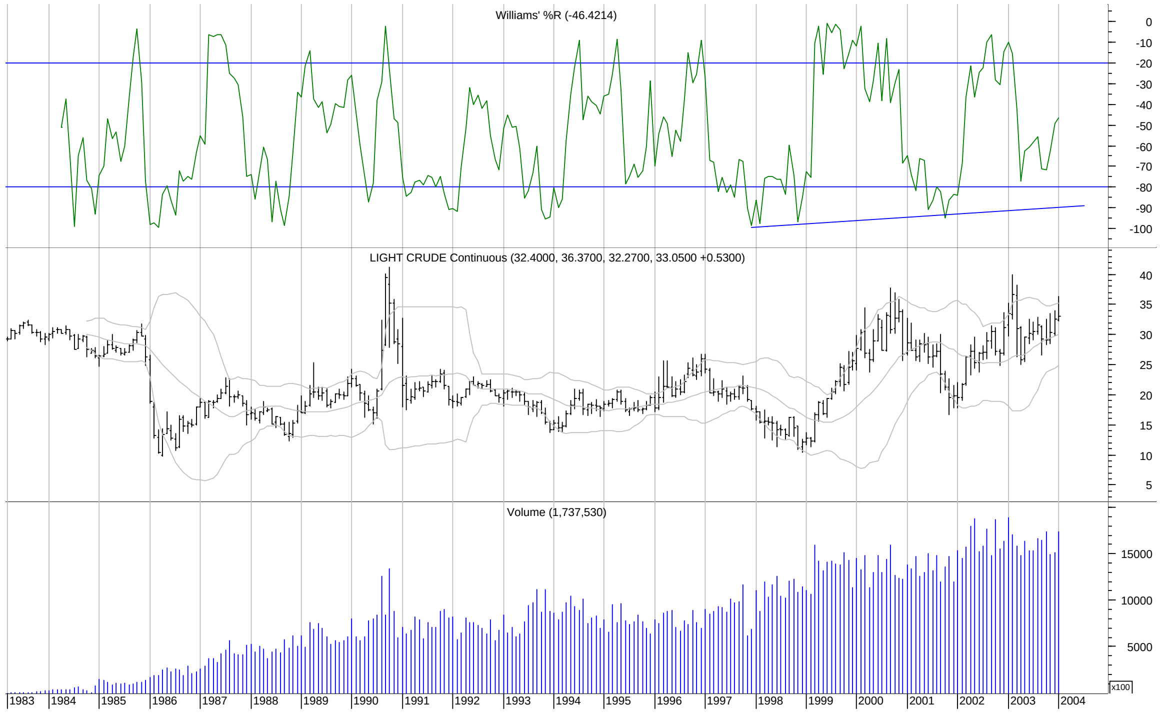
The fundamentals of the emerging energy bull market are becoming more obvious. As my old friend Teddy Butler-Henderson used to say, one must comprehend the fundamentals of any situation in order to truly understand it. This came from Teddy's 80+ years of experience in the investment world. I have noted the bullish technical patterns across all three time scales-daily, weekly, and monthly. In addition, this applies to almost every stock in the drilling, exploration, and refining groups. When the buy signals are this widespread, there must be some very bullish situation under development. Previously, I have cited my friend at the Abu Dhabi National Oil Co. who told me that he has to go as far as Serbia to find oilfield equipment to rent. Since that time, I have spoken to friends at the International Petroleum Institute. IPIC invests Abu Dhabi money in the energy infrastructure outside of the UAE. They tell me that demand for energy is simply strong and growing, and that demand-driven energy bull markets tend to last. There is a need for new refineries, storage facilities, drilling equipment, etc. Strong demand from China plus strong demand from Indonesia have been the main drivers. Add to this the recovering USA economy. After 20+ years of falling prices, there has been little investment in energy infrastructure, and it will take some time to bring more capacity on line, thus leaving demand ahead of supply for years to come.

There is further information from Dr. Marc Faber's January 26 Gloom, Boom, and Doom Report. Dr. Faber quotes several industry specialists who state the following:

- The USA has become increasingly dependent upon imported energy. Most new electric utilities utilize natural gas because it burns so cleanly. Drilling has increased, but production has dropped as depletion rates have risen. Raymond James Associates says that USA gas production has fallen 2.4% year over year. In addition, this rate is accelerating. The situation is the same in Canada; customers are competing for limited supplies on both sides of the border. New wells in 2003 are producing at the lowest average daily rates on record.
- Demand for gas is unlikely to abate. More than half of new homes constructed in the last decade are gas-heated. These consumers cannot reduce their usage much, so demand has become inflexible.
- Alternate sources such as LNG are not sufficient to add sufficiently to supply.
- China's oil consumption has grown by somewhere between 7% and 15% annually depending upon the information source, and is due to rise. Indonesia's demand has been rising by 10%, while Mexico, Vietnam, India, Turkey, and Thailand are consuming at a somewhat lesser rate. OPEC nations are consuming an increasing percentage of their own production, leaving less available for import.
- North Sea and Australian oil production have peaked. Russian, Iraqi, Nigerian, and Venezuelan production are stalled by political strife. Caspian production has not met expectations.

Here is a confirmation from the Gulf. No one here expects energy prices to go higher. Since I arrived in the Mideast in 1990, the locals have consistently forecasted oil and gas prices on the low side. In addition, their spending habits correlate inversely with energy prices. They have been and continue to cut back expenditures and to cancel projects, refusing to believe that oil quotes will remain where they are.
These developments are what the markets were sniffing when related equities lifted off in the autumn. I think that much higher energy prices will be one of the surprise developments in 2004. How high can oil prices go? The following graph shows a reliable energy indicator tracing out a series of higher lows extending back to 1998. I would expect to see oil move to the low 40s. I stated one year ago that oil prices would fall for a while after the Iraq war, but not by much.

Monthly Oil Prices Appear Set to Move Higher



Energy Stocks

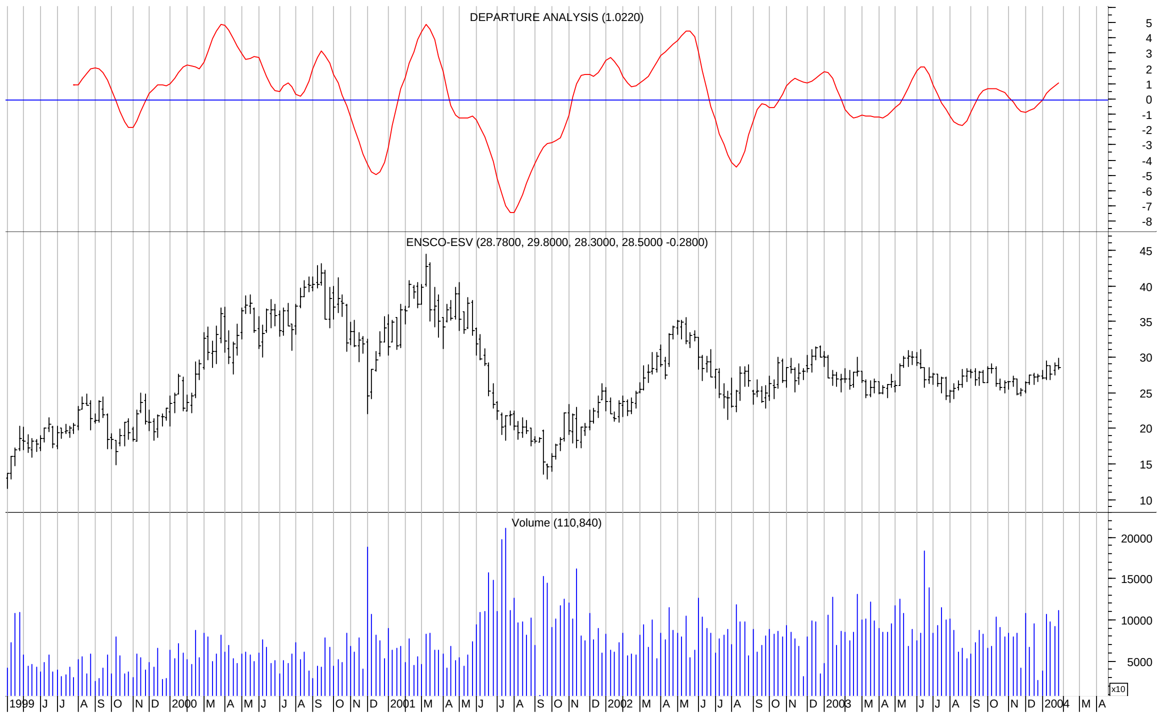
This sector has a strong seasonality. Here are the percentages of months in which the sector has outperformed the S&P. For example, energy stocks have outperformed the S&P 21% of the time in the month of January.

October- 46%
November- 23%
December- 43%
January- 21%
February- 62%
March- 77%
April- 77%

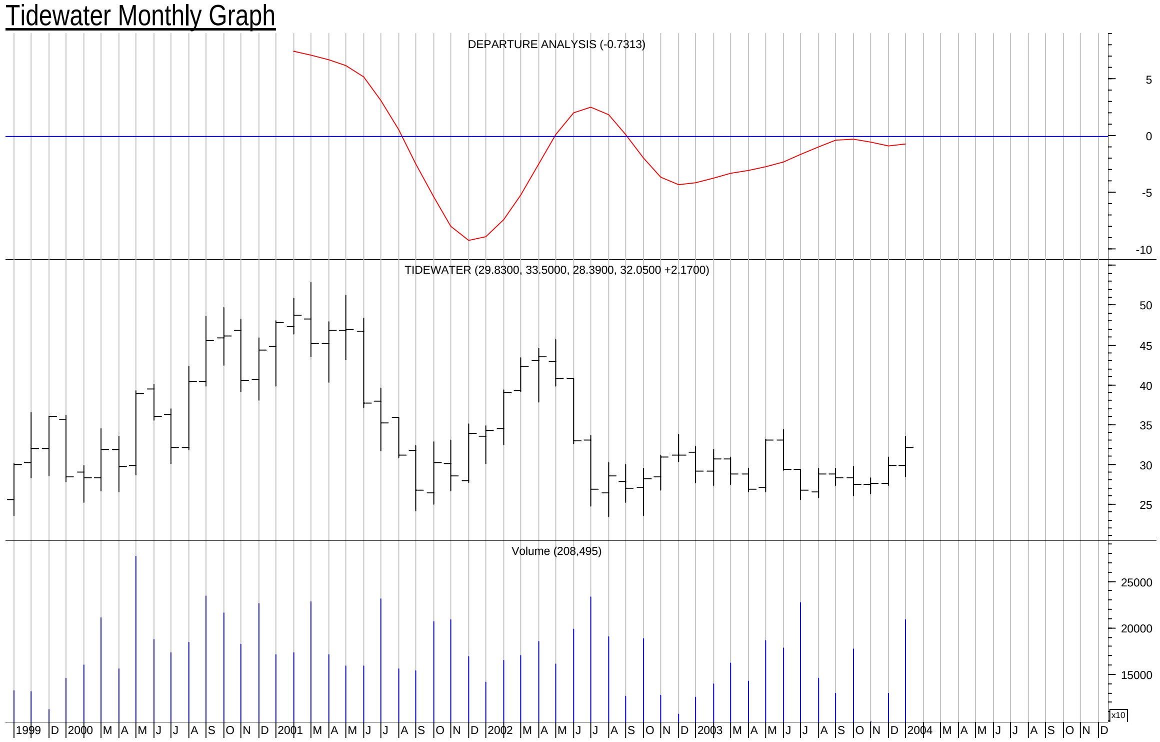
As you can see, the current surge in this sector began in what has traditionally been a weak time for these stocks. Clearly, there is some stronger and longer-term cycle pushing the stocks up, overriding the weak seasonal. Now that we are entering the seasonally stronger time of the year, the sector will accelerate. The strongest groups within the sector will likely continue to be exploration, drilling, oilfield services, and refining.

I continue to hold Transocean (RIG), Atwood Oceanics (ATW), and Drilquip (DRQ) in managed accounts. Ensco (ESV) and Tidewater (TDW) have not moved much yet, but show good bases to move higher in 2004. Schlumberger (SLB) will also continue to be a leader.

Ensco Weekly Graph



Tidewater Monthly Graph

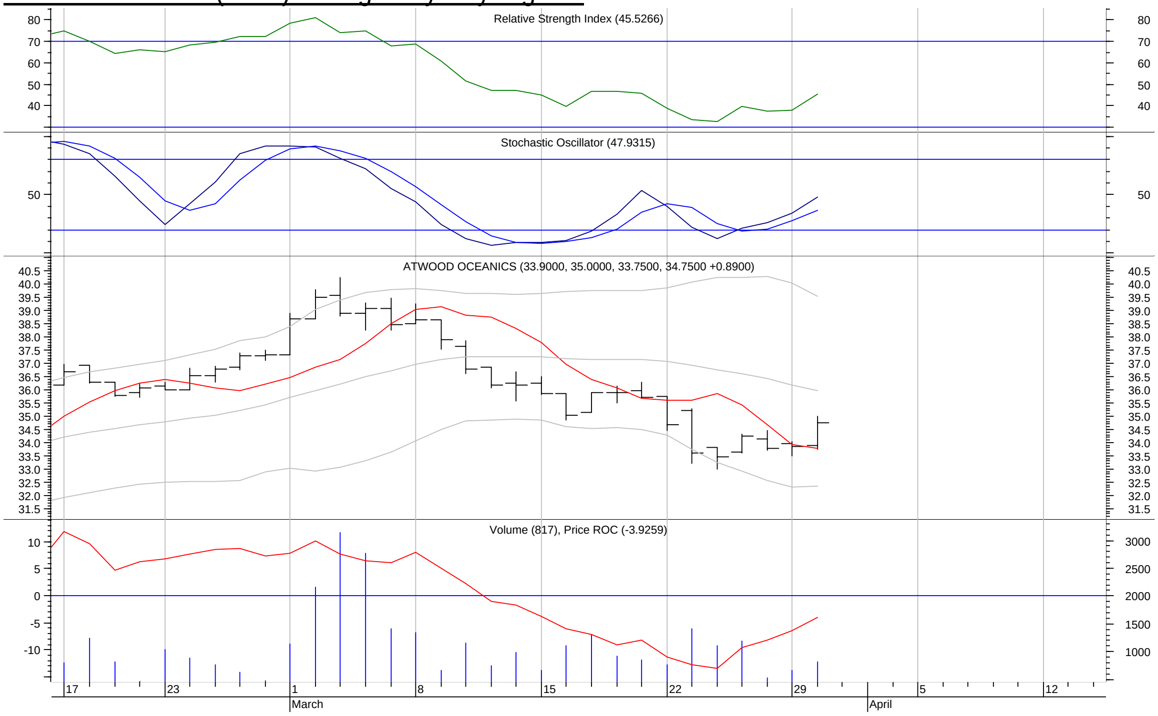


April 2004 Cycles Research

I would still hold the oil drilling and service stocks, which I turned bullish on late last year. They have had normal corrections and are now giving buy signals as depicted in the ATW chart below. The same applies to Transocean (RIG-5/28/93) and National Oil (NOI-10/29/96).

The oil price remains in an uptrend with $42 as the next objective. Crude just gave a buy signal on the 30th.

Atwood Oceanics (ATW) Giving Daily Buy Signals



May 2004 Cycles Research

The Fundamentals of the Energy Sector Remain Intact

Due to the low price of oil from 1980 to 1999, there was little exploration and drilling. As a result, new sources of oil were not discovered quickly enough. Then older and cheaper sources of oil have been exploited. In order to develop new sources, there must be investment in exploration and drilling. This activity was not conducted when oil prices were lower, but the new and higher prices make the higher-priced oil supplies feasible.

OPEC has targeted prices in the $22-$28 range. Wall Street professionals think that oil will revert back to the low $20s. Oil companies have boosted their target price to $22 from $18. I know that Abu Dhabi is using $25 as a base price. “The crowd” is looking for a low oil price. Using contrary opinion, these projections call for higher oil prices. I think that $25 is probably the support level.

In 1980, energy companies were 28% of the S&P. Energy stocks and inflation hedges collapsed. In 2000, technology stocks were 30% of the S&P, and the stocks collapsed. Energy stocks are currently 6% of the S&P, a level usually seen by a sector that is near its lows as tech was in 1990. Is there enough capital in this sector to supply rising energy needs? The answer is no. The major oil companies have been investing 30 to 40 cents of every dollar from their cash flow in the mature markets of North America. Efforts by independent firms in exploration and production have been insufficient to make up for the shortfall. The oil rig count has been flat at 1100 for the last six months despite high energy prices. For the last five years, oil production has been two percent. The companies have been concentrating on higher-growth areas in Asia such as Russia. This has led to supply-demand imbalance.

The stocks of most of the stocks of oil producers trade at PE multiples that are low because analysts still think that oil prices will go lower. Actually, energy prices are not that high; they simply have not risen in 20 years. If one inflation-adjusts the numbers, energy is very cheap. Inventories are so low that even a minor disruption such as a refinery fire sends prices up sharply. Demand is more than exceeding any gains from fuel efficiency.

I shall conclude with this quote from Barrons:
"Before the end of the decade, we will have $60 oil."
-Felix Zulauf

June 2004 Cycles Research

Oil to $60 Per Barrel

I studied an interesting graph of annual oil prices back into the late 1800s. It depicts the wellhead price of oil, the cash price paid at the well. The figures are only available on an annual basis. This graph, courtesy of Yelton Fiscal in Ridgefield, Ct., also features a smoothed moving average of price momentum. The price momentum has based and then turned up three times. The subsequent moves are in the table below:

YEAR	PRICE CHANGE	PERCENTAGE
1910	0.60 to 4.00	570%
1930	0.70 to 4.00	471%
1970	4.00 to 30.00	650%
2000	10 to ?	?

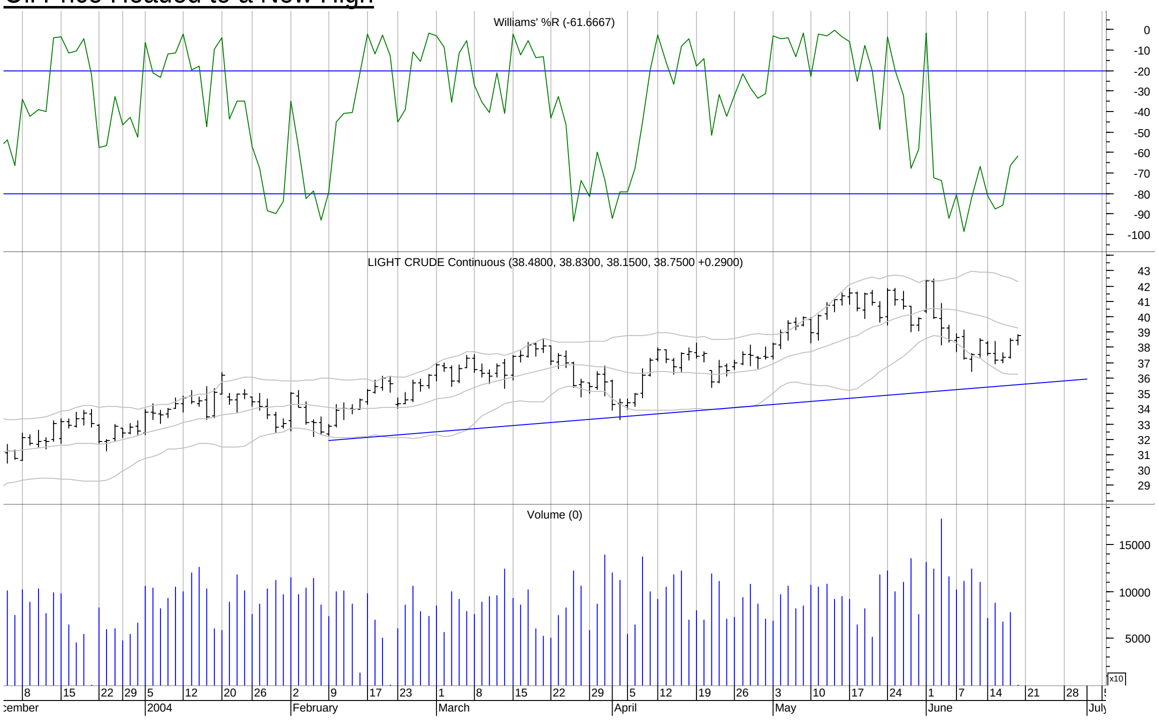
We are currently on the fourth basing period. If the past is a guide, then we can expect oil to rise to the $55 to $60 per barrel range.
I remain bullish on the energy stocks that have been recommended in past issues: Transocean (RIG), Anadarko (APC), Atwood Oceanics (ATW), and National Oil (NOI).

June 20,2004 Special Report

Oil has followed the long-term forecast. Early in the year, I wrote that higher energy prices would be one of the big stories for 2004. In addition, energy stocks, such as Atwood Oceanics were recommended last winter. This is a brief update.

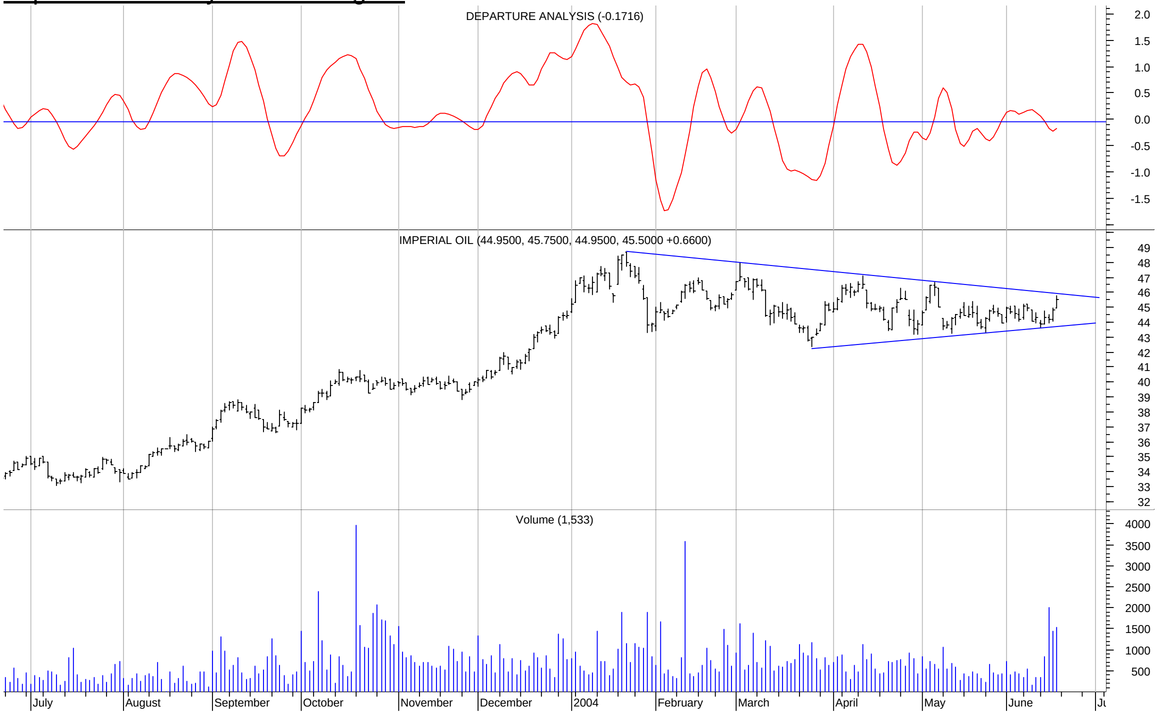
Oil, depicted below, appears to have completed a wave down and is ready to make a new high in the 43-45 area. Note the oversold condition and the higher lows in the oscillator. In addition, we are nearing the seasonally strong time of the year for oil prices.

Oil Price Headed to a New High

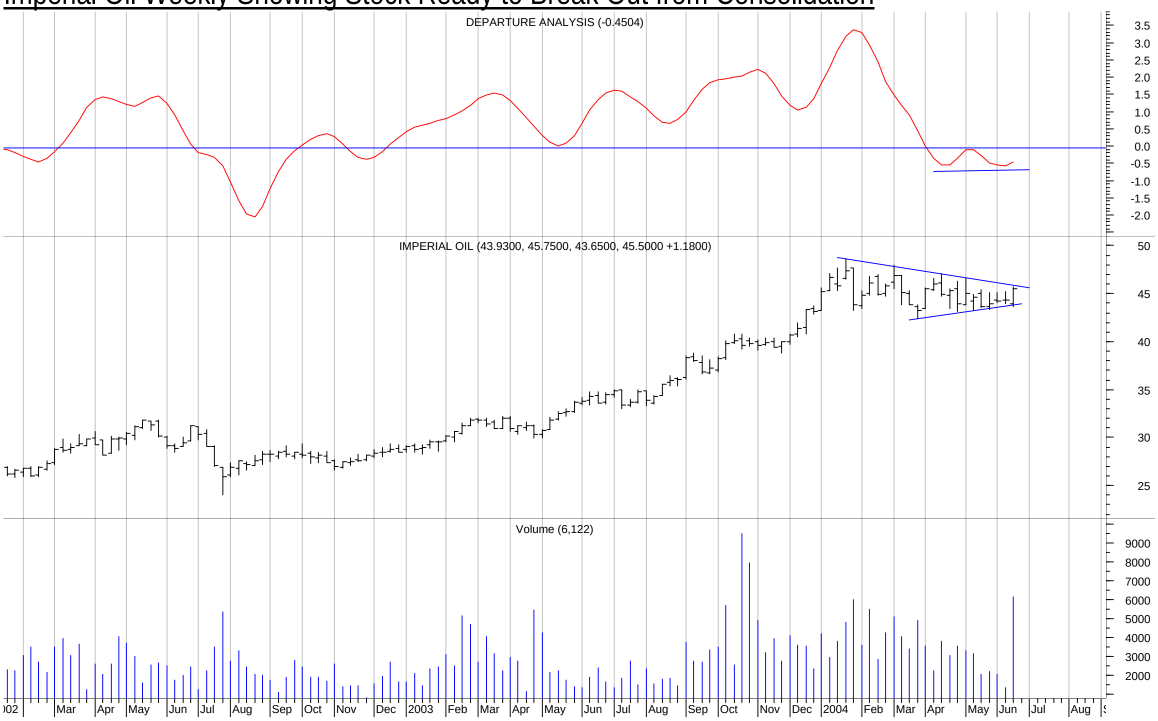


Imperial Oil (IMO) trades on the Amex. The daily chart below depicts IMO ready to break out of a tight consolidation range, supported by a series of higher lows in momentum both daily and weekly.

Imperial Oil Ready to Move Higher

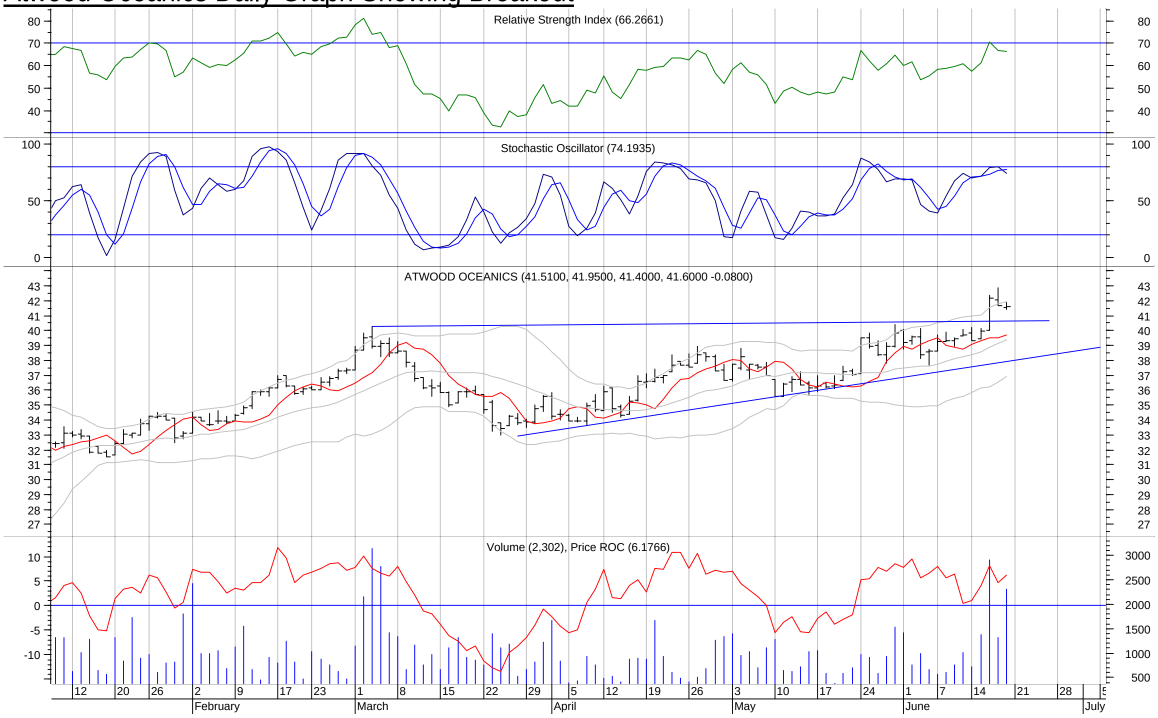


Imperial Oil Weekly Showing Stock Ready to Break Out from Consolidation

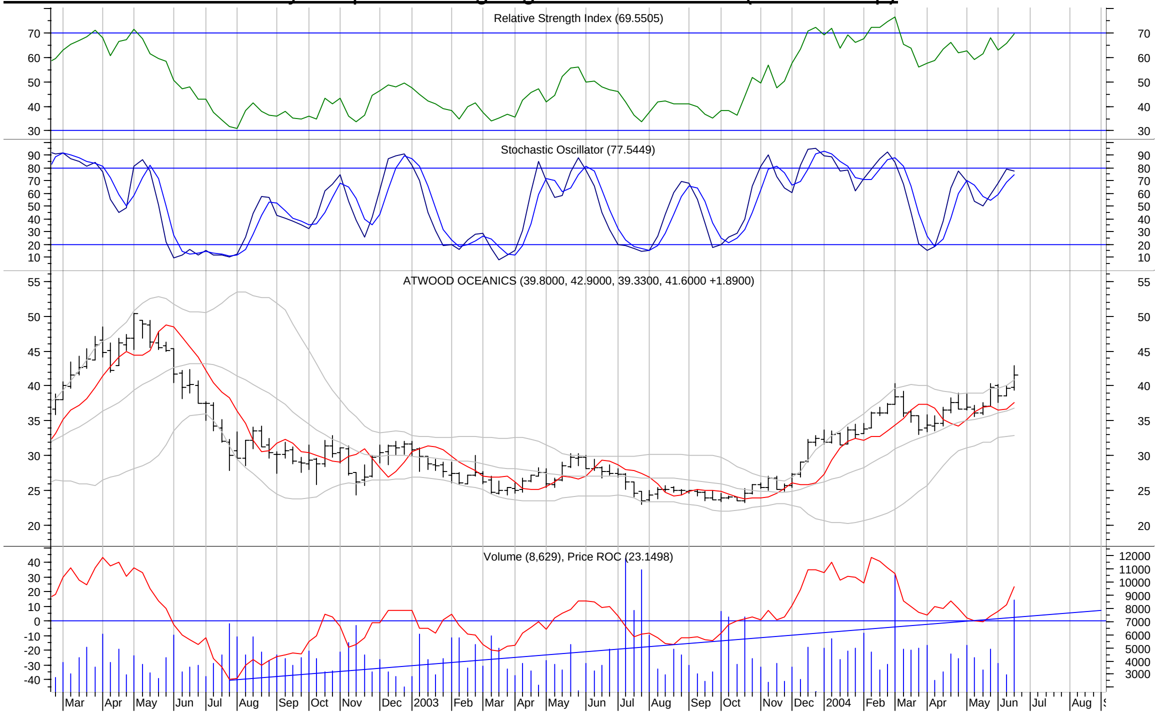


Atwood Oceanics is depicted below daily, weekly and monthly. The breakout on the daily/weekly charts suggests 46.5 to 47 on this move. The stock was originally recommended in the high 20s last winter. The monthly graph shows the snapping of a major downtrend line. If you have a portfolio that must be fully invested and are measured against a benchmark, ATW will continue to outperform.

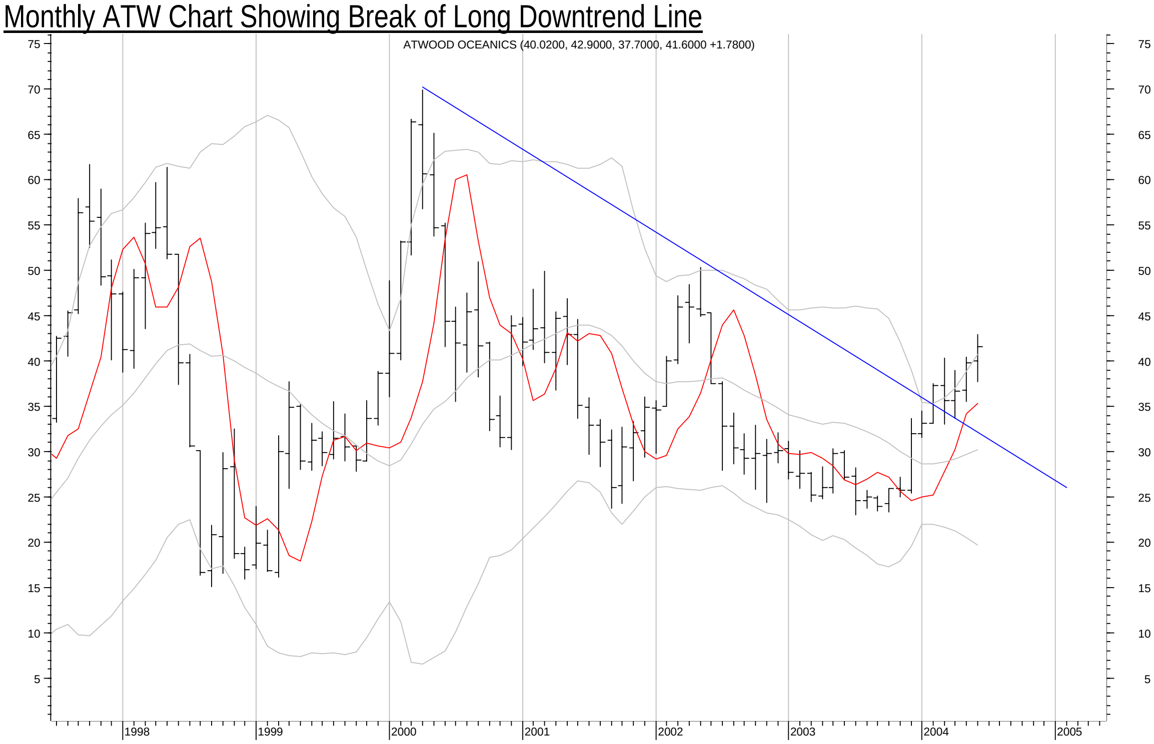
Atwood Oceanics Daily Graph Showing Breakout



Atwood Oceanics Weekly Graph Showing Higher Lows in ROC (bottom strip)

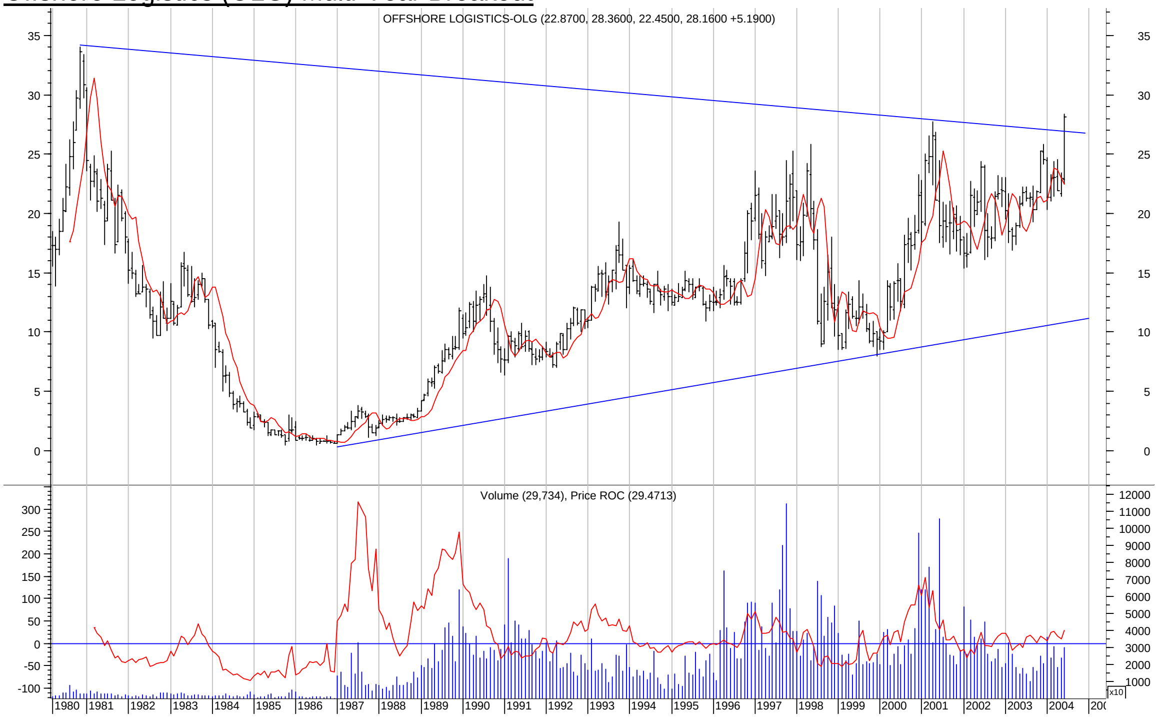


Monthly ATW Chart Showing Break of Long Downtrend Line

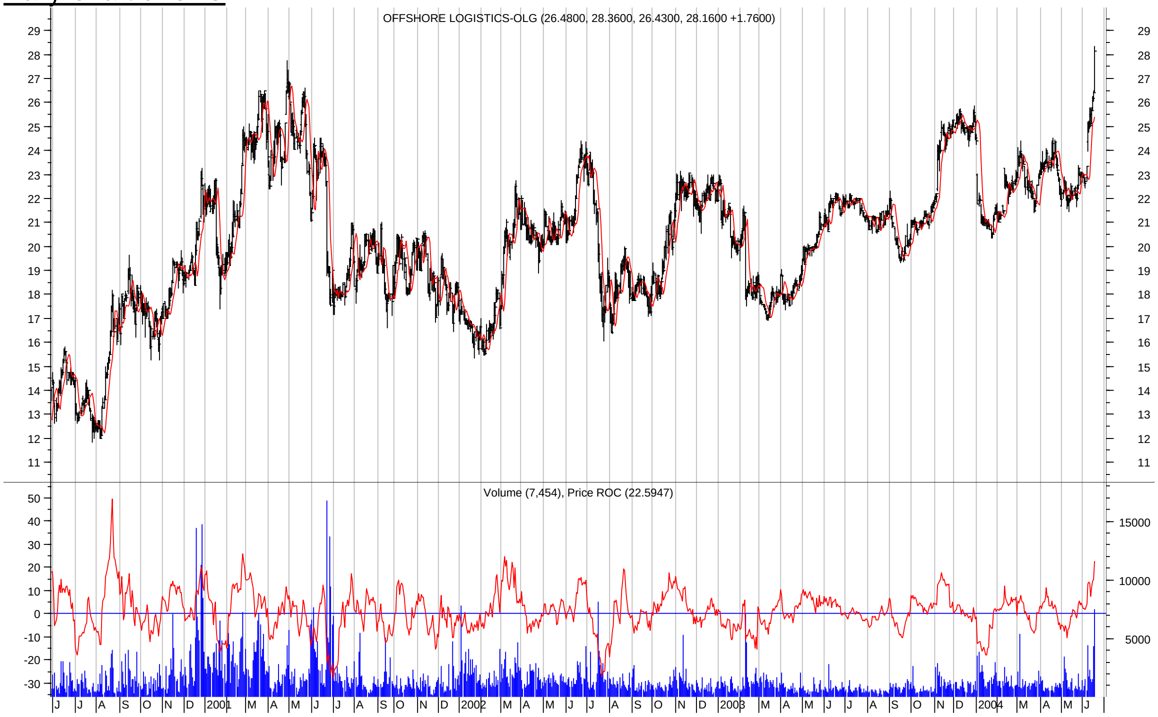


Offshore Logistics (OLG) has just broken out of a 24-year trading range. The last time that I saw anything like this, it was the breakout of the food group in 1980, which preceded a 13-year outperformance. This is a high risk buy at this point, but it is a buy if you are a long-term investor. I wanted to give you some longer-term perspective on the potential of this rally.
The daily chart follows the monthly, showing the strength of this recent move.

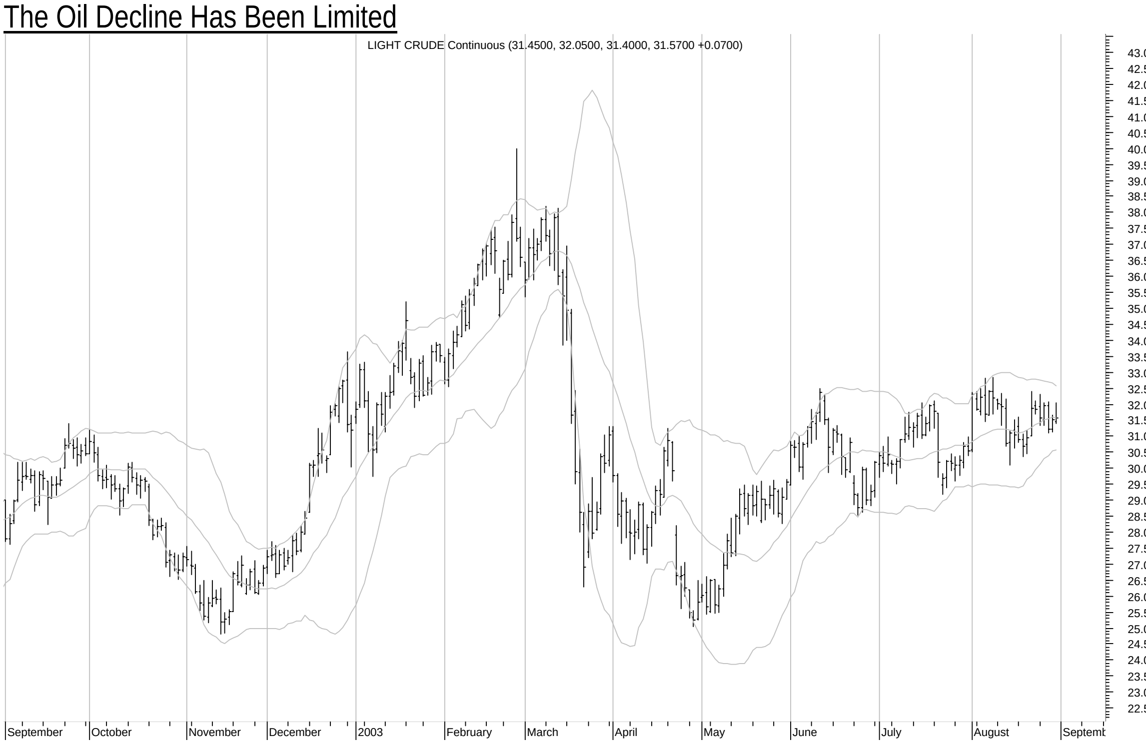
Offshore Logistics (OLG) Multi-Year Breakout



Daily Chart of OLG



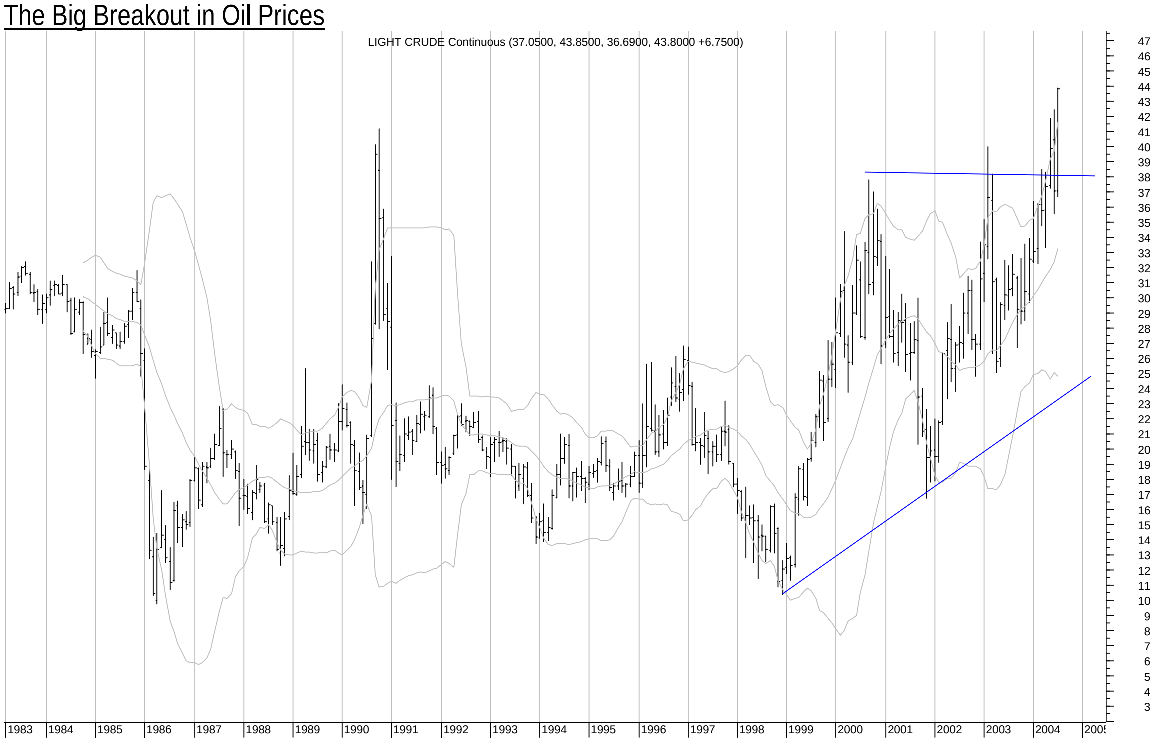
The Oil Decline Has Been Limited



<u>August 1,2004 Cycles Research:</u>

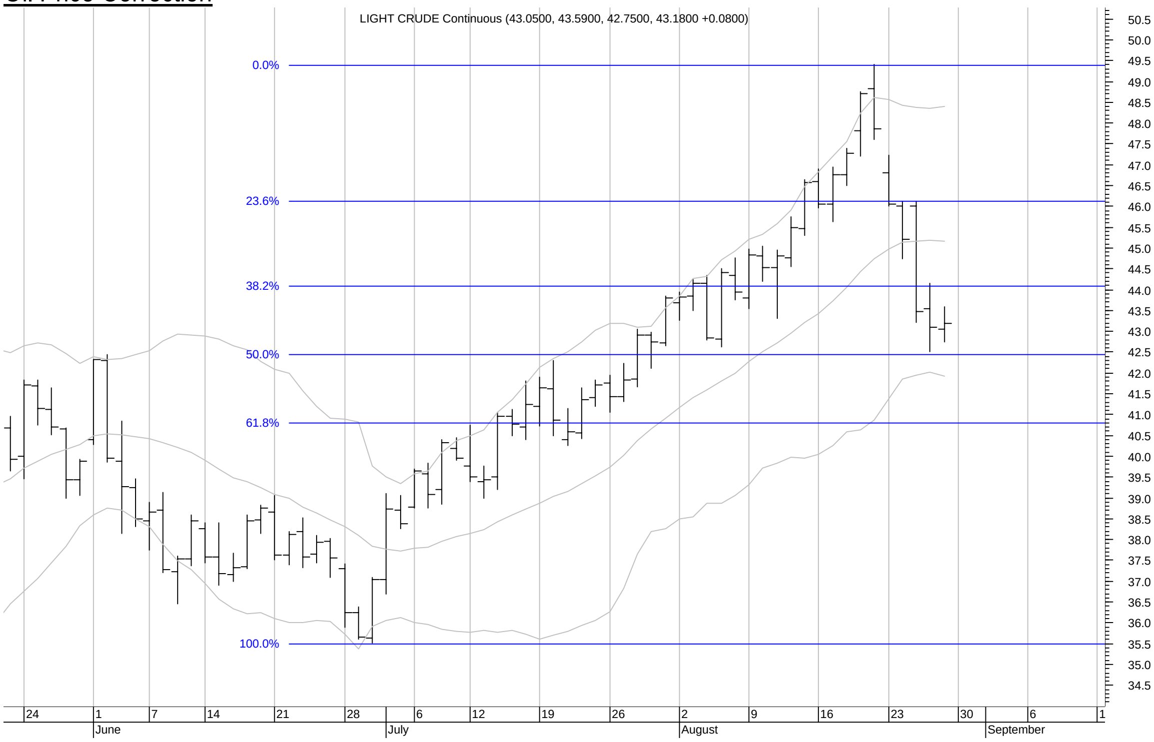
Below is the price of crude oil monthly going back to 1983. Note the breakout, Actually, this is a breakout above the 1980 high, so we have a break from a 24-year consolidation. This is a sign of a much bigger move to come. It is interesting to note that just prior to this break to the upside, some had been calling the daily action of oil an impending double top. Obviously, this was not correct. This is what bull markets do-they climb a wall of worry. The Arabs keep telling me that oil cannot stay above $30 for political reasons.
How far can crude go? The last time that I saw a breakout from such a long trading range, it was when the food group broke out in 1980. The group then outperformed for 13 years. A good rule of thumb is to multiply the trading range by .618. Thus the foods were in a 25-year range, so 25 times .6 is about 15 years. Oil has been in a 20-year range, so we can expect about 12 years of higher oil quotes. Note that the 0.6 rule of thumb was developed for stocks, so it might be a bit shorter for commodities.

<u>The Big Breakout in Oil Prices</u>



September 2004 Cycles Research:

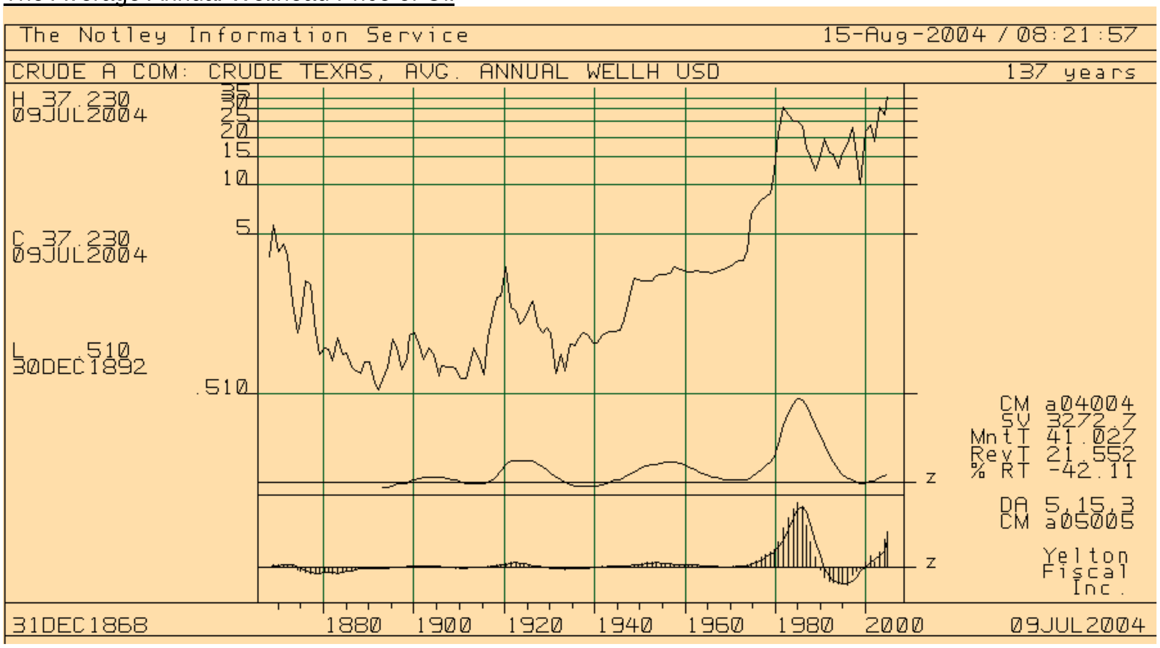
Oil Price Correction



The longer-term picture has kept me bullish. Below is a screen capture of the wellhead price of oil, a graph that I have referred to in the past. This is the cash price paid at the wellhead, a figure that has been recorded on an annual basis for the last 137 years, chart courtesy of Yelton Fiscal of Ridgefield, Ct. The price appears to tracing out a 5-wave movement, with the 1925-1980 rise as being a wave 3. The 1980-1990 decline is wave 4, and oil is currently in a wave 5 to new all-time highs. In a past issue, I pointed to the moving average smooth that you see in the middle strip. There have been 3 higher lows that have preceded each rally. Applying the past percentage gains, this rally points to the \$60-\$65 level. It is this long-term picture that has made me bullish. As we can see, oil is not even overbought from this long-term perspective.

How do rising crude prices affect the stock market? Ned Davis Research calculates that when the 26-week rate of change of oil prices are above 0, the market increases by an annual rate of 5.7%. When this rate of change is below 0, stocks rally at an 14.4% annual rate.

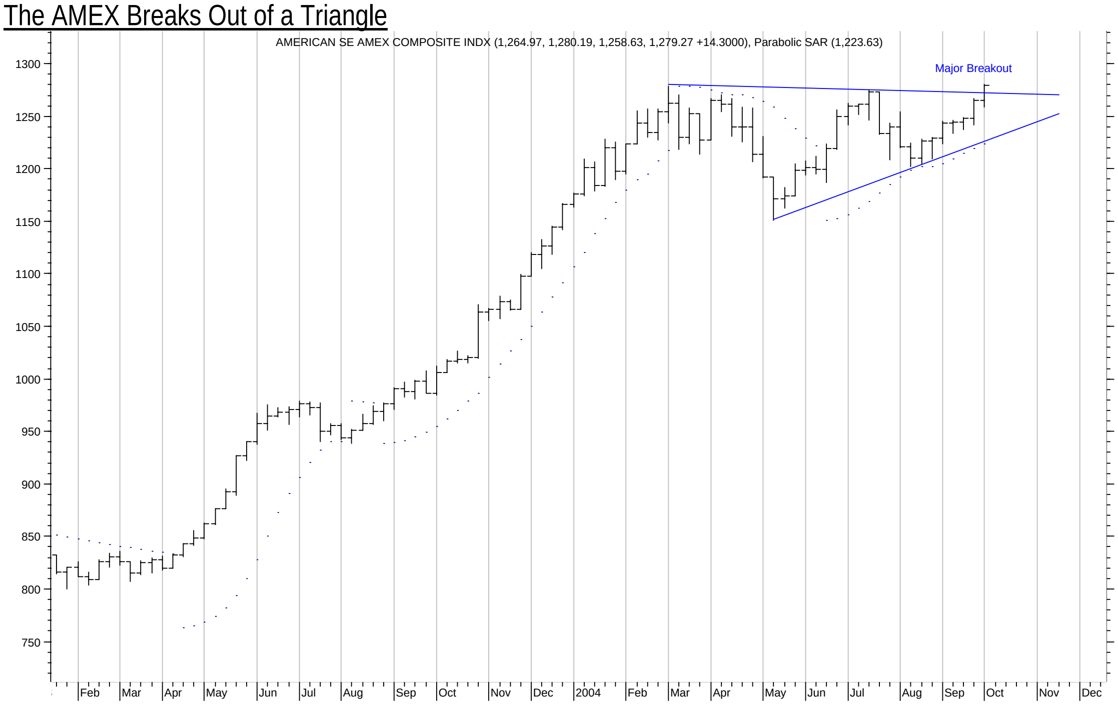
The Average Annual Wellhead Price of Oil



October 2004 Cycles Research

The AMEX consists mostly of energy stocks. The graph below shows a breakout from a triangle. The rule is to measure from the bottom of the triangle to the top, and then to project this distance form the top. This suggests a run of at least another 10% over the near term.

The AMEX Breaks Out of a Triangle



Turning to individual stocks, we first review past recommendations in the table below. Remember, in a bull market the way to make money is to buy and hold quality stocks in strong companies.

Stock	Current Price	Objectives
Atwood Oceanics (ATW)	49.44	52, 60
Transocean (RIG)	36.51	42, 47
National Oil (NOI)	33.82	45
Imperial (IMO)	52.27	58-59
Noble (NE)	46.07	60
National Oil (NOI)	33.82	44

March 2005 Cycles Research

In 1980, energy companies comprised 28 percent of the S&P 500 market capitalization. This proved to be a high as energy stocks and inflation hedges collapsed. These stocks represented about 6% of the S&P at the low a decade earlier. In 1990, tech stocks were about 7% of the S&P, and in 2000, technology stocks were 30 percent of the S&P, as the sector topped. Energy stocks are currently about 8 percent of the S&P, a level usually seen by a sector that is near its lows as tech was in 1990. From this viewpoint, energy is closer to a low than a high.

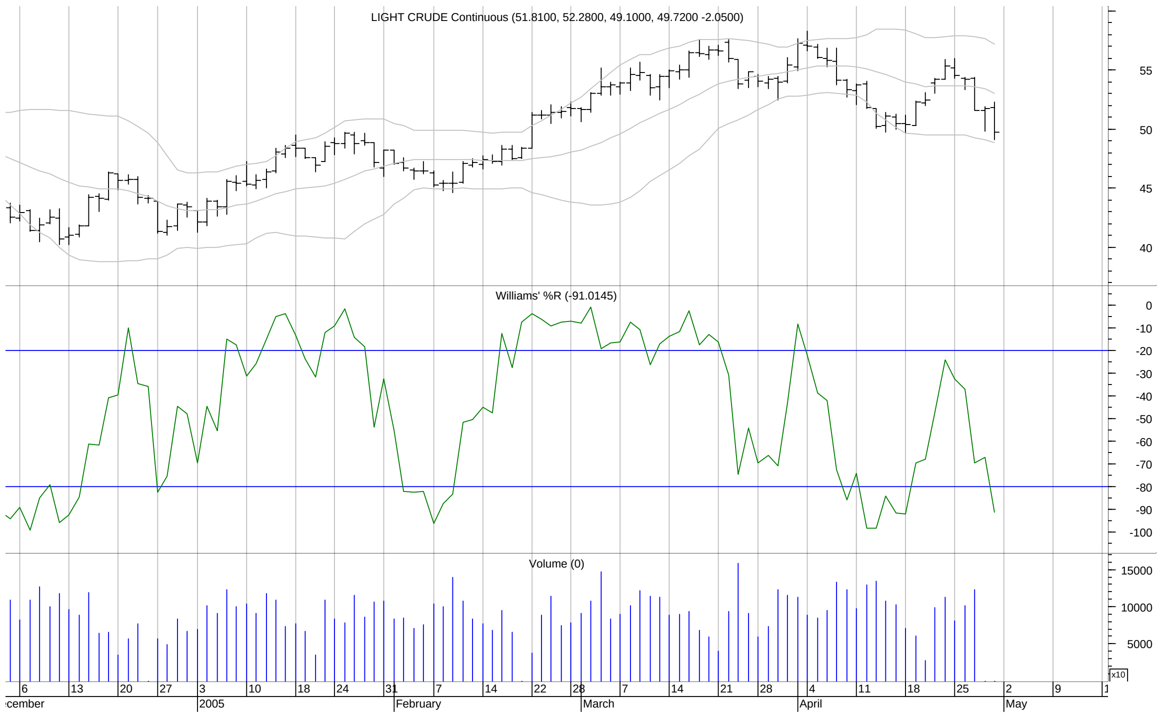
Here is another barometer of sentiment. I maintain a ratio of the open interest of puts divided by the open interest in calls on a weekly basis on the OSX oil index. High readings are bearish (too many puts being written) and low levels are bullish. The ratio hit 2.8 in the first week of February, the highest level since 2002. In only 4 weeks, it has fallen to 1.2, a tremendous shift to bearishness, the mood fuel that accelerated the oil stock rally.

May 2005 Cycles Research

Energy

Oil will likely continue to fall through the month. The cycles bottom out at the end of May. Downside objectives are 47 and 38.

Crude's Downtrend



July 2005 Cycles Research

Energy

My colleagues called me the original energy bull in 2003, and we have seen a long advance in oil prices. I termed the April-May pullback as a correction and called for an end to the decline on May 22-23 at $47. Subsequently, in the last issue and on Bloomberg and CNBC, I called for new highs which were achieved last week. When the networks asked for my new target, $55-$60 having been achieved, I set $80 as the next stop.

Back in the 1970s, we reckoned that higher oil and commodity prices were a fundamental negative for 80% of the companies that have stock on the NYSE. Only 20% of the companies benefit from higher commodity prices. During that decade, the oil, mining, and gold stocks rallied while most other stocks declined. We are in a similar environment. When oil exceeded $60 last week, stocks broke down. The realization that oil is not going fall and that higher oil prices are a fundamental negative finally sunk in.

How high does a commodity move after it exceeds a prior high? In the June issue of Past*Present*Futures (National Institute for Investment Research, 1158 26 St. #523, Santa Monica, Ca. 90403), James Flanagan answered the interesting question of how highs does a commodity go after it exceeds its prior all-time high. For 23 commodities, the answer was an average of almost 130% over 9 months. There were a few extreme moves such as 652% for silver in the 1970s that skewed the results to the high side. Oil exceeded it prior high on July 14, 2004. The 50% move by oil since that time is less than that achieved by 18 of the 23 commodities, suggesting that oil has further to go. If we take 129% of $40.98, we get about $98. This actually exceeds, but does confirm, $80 as a reasonable target.

I watched a Bloomberg interview with Jim Rogers a few days ago that was very instructive regarding sentiment. He was promoting his commodity fund. He said that, when he began it in 1998, no one believed his venture was worthwhile. When the commentator pointed out the recent pullbacks in commodity prices, Rogers said that any pullback in a bull market is a buying opportunity. When the commentator protested, Rogers said that when the top is in, the commentator will be telling him that he is crazy to sell. Rogers was right; that is the sentiment in any bull market. This service has been adamant about holding energy stocks through thick and thin. The shares prices are correlated to the price of oil and not to the overall market.