

Exclusive Outlook

WEST COAST ASSET MANAGEMENT, INC.

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After The Peak: Apocalypse or Opportunity?

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Last month's article prompted some readers to look up "Peak Oil" on the Internet, where they found predictions of Middle East resource wars and all-out nuclear conflict with China, Russia, India, etc. They found charges that the entire Peak Oil discussion is prompted by oil interests to increase prices and profits, and they saw life-after-the-peak scenarios that evoke Treasure Island's Long John Silver, who declared, "Them that dies will be the lucky ones."

Like most Internet-based debates, arguments on both sides are light on verifiable sources and void of practical solutions. To its credit, a website at www.oilscenarios.info at least presents a range of five oil-depletion timeline possibilities, from "Pollyanna" to "Optimistic" to "Plateau" to "Pessimistic" to "Head for the Hills."

We cannot predict which - if any - of these scenarios may play out, but we believe big changes to our oil-based way of life are coming, and we need to adapt the way we live and invest. We also believe the changes could be improvements, particularly if we choose to make them so.

Spend an hour people-watching at a shopping mall and you may experience a sobering revelation. Be honest with yourself, and admit that you see vast numbers of overweight people, shopping for things they don't need and demanding continuous entertainment. Blessed with liberty hard-won by our nation's founders and veterans, and enriched by 150 years of cheap oil, we've somehow reduced our highest aspirations to a new sweat suit and a corndog on a stick. But what if oil cost \$300 a barrel? How might our priorities change?

Consider the bottle of water you drank while conducting your mall observations. That water often costs more per quart than gasoline. Doesn't that seem wrong? As the world's oil production struggles to keep up with demand, America must learn what the rest of the world has known for decades: oil is extremely valuable. How will life in America change? Is there any way to prosper in

the age of expensive oil?

THE DEATH & REBIRTH OF SUBURBIA

James Howard Kunstler approaches the topic of Post-Peak America with more journalistic integrity than most, and his book The Long Emergency is probably the best overview of issues we must face in the coming years. According to Kunstler, America made poor choices after WWII: "Perhaps the worst was to let our towns and cities rot away and to replace them with suburbia, which had the additional side effect of trashing a lot of the best farmland in America. Suburbia will come to be regarded as the greatest misallocation of resources in the history of the world."

Well, maybe, but humans have a funny way of surprising pessimists. We may yet invent or discover new energy sources to maintain our current way of life. Even so, there are powerful advantages to developing more compact, walk-able communities supported by nearby farms. Such arrangements are far more energy-efficient and people-friendly, especially with our increasing ability to work from home.

Kunstler sees the suburbs as the future slums and ghost towns, but they could also evolve from their failed vision of "country living for everyman" into a province of the rich. Or, with houses large enough for extended families and yards big enough for French Intensive

Farming, the suburbs could evolve into reasonably self-sufficient towns.

The community of the future, based on the small towns of the past, is already attractive to Americans. Research shows that homebuyers are willing to pay a premium to live in pedestrian-friendly communities with convenient mixes of residential, retail and office space, large sidewalks and tree-shaded streets. The developers who are creating and/or re-creating such places may represent investment opportunities.



ENERGY ALTERNATIVES

No known combination of alternative energy resources can replace the efficiency of oil today. Oil possesses virtually magical properties of energy compaction. A mere gallon of gasoline carries your whole family 20-40 miles from home for a day at the beach or the lake. Your great-great-grandparents rarely traveled that far, and only with considerable effort. Cheap oil allows us to travel far and wide without a second thought.

Wind, biodiesel, nuclear, ethanol, solar and other alternatives all have serious limitations, including the amount of oil they require, but some have achieved unexpected improvements in cost effectiveness and, perhaps more importantly, acceptance by corporations and the public.

Brazil, for example, today sees the fruits of their decades-long planning for energy independence. As Marc Sumerlin wrote in the 10 January Wall Street Journal, "Over the last three years in Brazil, the share of new car sales that can run on high-content ethanol fuel has risen from 4% to 67%. Its sugarcane-based ethanol is priced competitively with gasoline."

On the same day, an Associated Press story opened this way: "Natural-food grocer Whole Foods Market Inc. said Tuesday it will rely on wind energy for all of its electricity needs, making it the largest corporate user of renewable energy in the United States."

As the price of oil rises, investment and innovation in alternative energy sources will increase, as we have seen in recent months. Companies devoting resources to research and development of such innovation should be studied as prospective investments.

AGRICULTURE

At the dawn of the oil age, the world population was about 1.5 billion. Early in the 20th century, Fritz Haber figured out how to make fertilizer from petrochemicals, dramatically boosting food production worldwide. As a result, today there are well over 6 billion people; a three-fold increase during the time of cheap oil. While the Peak-Oil doomsday fanatics might recommend an investment in crematoriums for the massive die-off they predict in 2070, we will instead look for promising alternatives to petrochemical agriculture. When rising oil prices encourage agribusiness to seek alternatives to oil-based fertilizers and pesticides, entrepreneurs will race to provide them.

TRANSPORTATION & THE RETURN OF RAIL

Alternative fuels and electricity may suffice for personal transportation, but electricity and pedal power do not stand a chance at moving mass quantities of goods.

America's distribution system relies on diesel-guzzling trucks and an incredibly expensive highway system. Railroads are the most fuel-efficient transportation, and the rail system is more

economical to maintain than the interstate highway system. Unfortunately, our railway system is in ruin. We don't expect this very soon, because it demands great political will and cooperation, but the railroads will be back. We see few alternatives.

ENERGY SECURITY

The term "Energy Security" is discussed in nearly every periodical these days. Despite the tens of thousands of nuclear warheads in the world, a fuel spigot now represents the weapon of choice for resource-rich nations. When Russia's President Putin turned off the natural gas pipeline to Ukraine (and by extension to parts of eastern Europe), the reaction was immediate and dramatic.

Putin compromised on the price increase for Ukraine, but made his point clearly. As supplies dwindle, resource-rich nations will become enormously powerful, or targets, or both. Energy disruptions make powerful weapons; hence Osama Bin Laden's expressed desire to drive the price of oil to \$200. The effect on the value of the dollar could be disastrous by itself; many investors hold foreign bonds as a hedge.

THINK AND ASK QUESTIONS

At the end of the 1975 film "Three Days of The Condor," Joseph Turner uncovers a CIA plot to secure oil by invading the Middle East. When Turner tells the deputy director that he should ask the American people before making such ruthless decisions, the deputy replies, "Don't ask 'em now. Ask 'em then. Ask 'em when they're running out. Ask 'em when there's no heat in their homes and they're cold. Ask 'em when their engines stop. Ask 'em when people who have never known hunger start going hungry. You wanna know something? They won't want us to ask 'em. They'll just want us to get it for 'em!"

That's one choice; go take what we need. Some believe it's happening right now. This might delay oil shortages for a decade or two, but at what cost? Fear can empower politicians and drive the economy, but destroy everything we value at the same time. Rather than fear the coming changes, investors must think and ask questions.

Should we invest in defense companies like Northrop Grumman? What about electricity providers like Edison International? Will tight supplies of natural gas make nuclear and/or coal a better investment? How long will oil and gas companies profit from excess demand? Should you be investing in urban real estate, or betting on the re-development of the suburbs? Is there a play in agriculture?

On the other hand, what happens if Peak Oil is a myth and the price of oil drops? We try to maintain a portfolio that can benefit from a range of different scenarios; for example we believe companies like Wrigley and Johnson & Johnson are less vulnerable to fluctuating energy prices. Dramatic changes face us as oil prices become more volatile. As the world around you changes, where will you find opportunity? ▲

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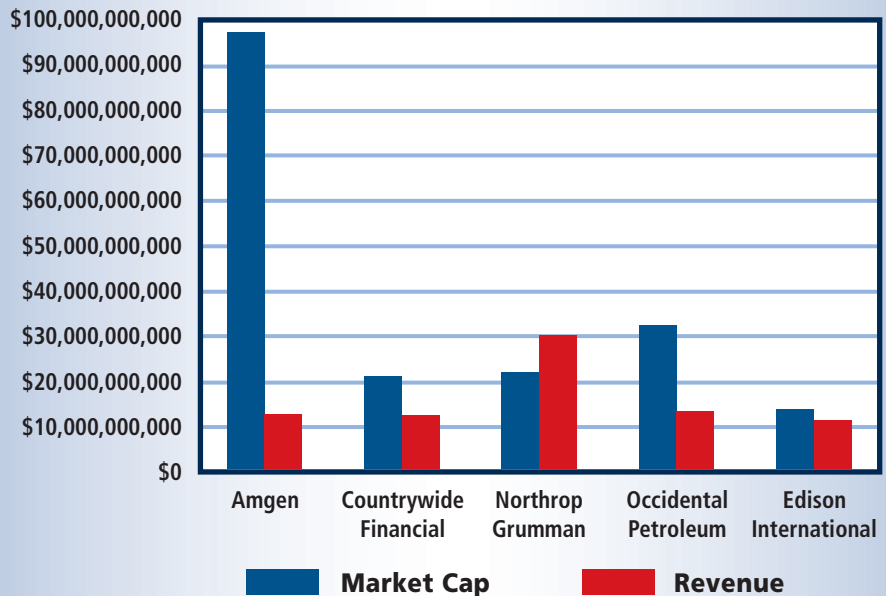
SEEING IS BELIEVING

Amgen and the SoCal Four

Amgen (AMGN) is highly regarded here in Southern California for all the right reasons: they do innovative work of value to humanity, they provide an excellent culture for their co-workers, and the stock has performed well over time. Maybe too well.

In any list of L.A.'s largest companies, Amgen holds the top spot with a market capitalization over \$99 billion. Yet, their revenues are just over \$12 billion. Compare these numbers with four other Southland giants:

Five Southern California Companies



Company	Market Cap.	Revenue
Countrywide Financial	\$20,470,000,000	\$11,860,000,000
Northrop Grumman	\$21,160,000,000	\$30,710,000,000
Occidental Petroleum	\$32,130,000,000	\$13,960,000,000
Edison International	\$13,950,000,000	\$11,210,000,000
Total	\$87,710,000,000	\$67,740,000,000

Amgen's market value is \$11 billion greater than the combined capitalization of the southland's largest mortgage company, defense contractor, oil company, and electric company.

Granted, Amgen could discover a new product that would spike revenues in future years, but we wonder which you would rather own: the 8/1 market cap-to-revenues of Amgen, or the combined 1.3/1 market cap-to-revenues of these other four solid performers (with \$11 billion left over!)? Please submit your thoughts by email to info@wcam.com

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