



MARKET OVERVIEW

The TSX energy market followed the path of oil prices for most of the month. As oil prices bounced off \$140 per barrel the S&P/TSX Capped Energy Index reached new highs. However, the market skeptics felt the oil price was due for a correction at some point and chose to sell the energy markets late in the month. Consequently, the index went south while the price of oil continued its upward move beyond \$140 per barrel. Speculators beware!

S&P/TSX CAPPED ENERGY INDEX



THE JUNE QUESTION: HOW MUCH OF THE PRICE IS SPECULATION?

From all angles and all stakeholders, the question for June focused on price speculation versus fundamentals. By the end of the month, the answer was clear: no one knows.

Consider:

- Juxtaposing two crude oil exchange-traded funds shows the bearish fund is more than 7 times the size of the bullish fund, indicating a lack of confidence in prices holding at June levels
- Six Asian governments have reduced domestic fuel subsidies which will allow those countries prices to the consumer to rise and likely reduce demand
- Producer hedge positions are surprisingly low; if producers thought prices were soon to drop, they'd be locking in more of their future production at today's prices. Producers who were sitting with sizeable hedge positions from last year have given up much of the 2008 price increase. The low level of hedged volumes overall indicates the strong balance sheet positions and little need to lock in a price.

"IF YOU TAKE A CAT AND THROW IT OFF THE TOP OF A BUILDING, IT'LL BOUNCE OFF THE STREET BUT THAT DOESN'T MEAN IT'S ALIVE," SAID MARC CHANDLER, WHO OVERSEES CURRENCY STRATEGY AT BROWN BROTHERS HARRIMAN. "THIS IS PARTLY A DEAD CAT BOUNCE, AND IT'S PARTLY BECAUSE INVESTORS ARE THINKING FRIDAY WENT TOO FAR TOO FAST."
— MONDAY MARKET IMPROVEMENT FOLLOWING FRIDAY, JUNE 6 OIL PRICE SURGE AND MARKET DROP.

"WHAT ABOUT THOSE WHO ARGUE THAT SPECULATIVE EXCESS IS THE ONLY WAY TO EXPLAIN THE SPEED WITH WHICH OIL PRICES HAVE RISEN? WELL, I HAVE TWO WORDS FOR THEM: IRON ORE. YOU SEE, IRON ORE ISN'T TRADED ON A GLOBAL EXCHANGE; ITS PRICE IS SET IN DIRECT DEALS BETWEEN PRODUCERS AND CONSUMERS. SO THERE'S NO EASY WAY TO SPECULATE ON ORE PRICES. YET THE PRICE OF IRON ORE, LIKE THAT OF OIL, HAS SURGED OVER THE PAST YEAR. IN PARTICULAR, THE PRICE CHINESE STEEL MAKERS PAY TO AUSTRALIAN MINES HAS JUST JUMPED 96 PERCENT. THIS SUGGESTS THAT GROWING DEMAND FROM EMERGING ECONOMIES, NOT SPECULATION, IS THE REAL STORY BEHIND RISING PRICES OF RAW MATERIALS, OIL INCLUDED."

**PAUL KRUGMAN, NY TIMES
JUNE 27, 2008**

THE PUSH-PULL BETWEEN HIGH ENERGY COSTS AND CONSERVATION
“THE ENERGY INFORMATION ADMINISTRATION SAYS THAT EVEN IF BOTH COASTS WERE OPENED [TO OFFSHORE DRILLING], PRICES WOULD NOT BEGIN TO DROP UNTIL 2030.”



SPRING THEMES – CAPP CONFERENCE

Bubbling up at the CAPP conference were recurring topics such as:

Resource plays -- The Montney, Horn River and Bakken and coalbed methane (CBM) stories are big. Companies from junior to seniors are citing these plays as sources of immense reserves opportunity;

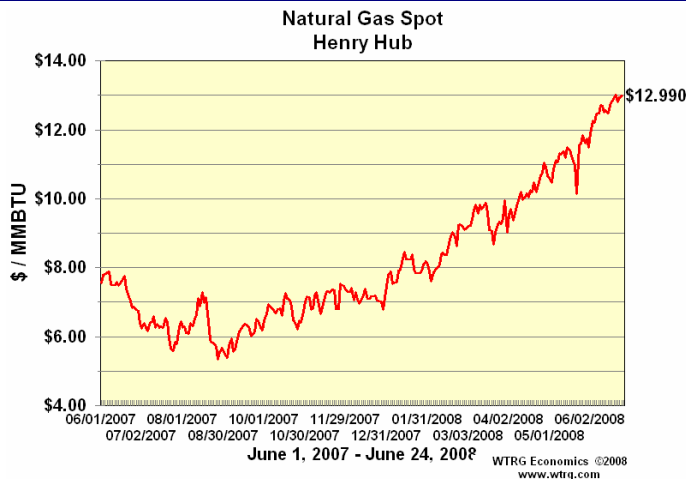
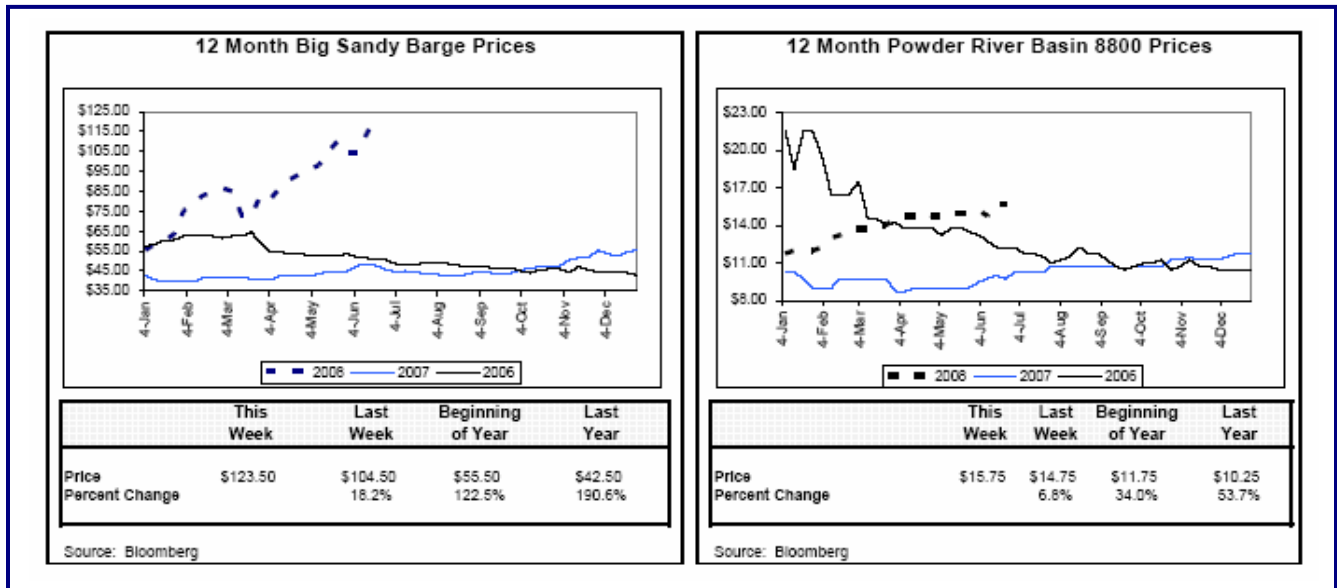
Technology opportunities –horizontal drilling and multi-stage fracing continue to be the keys to accessing the more interesting resource plays. Further, with experience using these technologies, they’ll be more increasingly applied to conventional plays, improving their economics.

Commodity Prices – Cash is still king and prevailing prices are creating the opportunity of cash flow well above levels forecast last fall.

Cost Management – The high prices and increased activity in the field will once again pressure costs upward. The ones to watch will be the producers who are most skilled at containing these pressures to maximize their value-adds.

BOTTOM-UP – NATURAL GAS PRICES FROM THE COAL POINT-OF-VIEW

Another look at natural gas prices, this time from the bottom up. Coal prices offer insight into natural gas prices as an effective floor price natural gas. Surprisingly strong coal prices are one of the strongest indications that natural gas prices will strengthen.



“THE REALITY IS THAT CANADIAN GAS SUPPLY IS DECLINING AND CANADIAN CONSUMPTION IS GROWING. GAS DEMAND FOR THE OIL SANDS WILL RISE TO ALMOST 3 BCF A DAY A DECADE FROM NOW. CANADIAN GAS DEMAND GROWTH WILL BE CONSIDERABLE. THIS IMPLIES A “DOUBLE DIP DOWNWARD” OUTLOOK FOR U.S. GAS IMPORTS.”

ZIFF ENERGY GROUP

■ B.C. LAND RIGHTS SALE HITS A RECORD

Hot! Hot! Hot! B.C. land sales in the first half of the year totaled \$972 million, almost meeting the 2007, full-year record of \$1 billion. Horn River and Montney gas plays are the story. EnCana is anticipating a billion cubic feet per day of natural gas at Horn River. The \$1 billion mark was approached following a June haul of \$213 million, almost exclusively from natural gas producers targeting the two hot play areas.