



Peak Oil Mini-Me



William Smead
Chief Executive Officer
Chief Investment Officer

Dear Clients and Prospective Clients:

Mike Myers is a very talented writer and comedian. His *Austin Powers* movies really hit my funny bone. In the second *Austin Powers* movie, Austin's arch nemesis Dr. Evil clones himself. His clone looks just like him, but is less than half as tall and attempts to be just as evil on a pound for pound basis. Mini-Me, as his clone is called in the movie, creates strife between Dr. Evil and his son, Scott. Scott was the product of Dr. Evil's dalliance with Frau Farbissina, a loyal employee who he "got weird" with.

Bespoke Investment Research reported yesterday that Oil has now gone up 108% in price per barrel in 118 calendar days. It is the sixth best bull run in the commodity since 1986. Four of those bull runs occurred in the huge secular move from \$11 per barrel in late 1998 to the peak at \$147 one year ago. This one and the 164% increase when Saddam Hussein invaded Kuwait in the summer of 1990 are the most violent in the shortest amount of time. The four other 100% plus gains in price lasted a minimum of 453 days to a maximum of 542. The huge run from \$11 to \$147 per barrel culminated in a Malthusian orgy and sought to validate a theory called "Peak Oil". This theory held that the un-interrupted growth in emerging economies around the world was coinciding with the peak of worldwide oil production. In effect, Dr. Evil (those countries producing Oil and companies involved in producing it) would hold the rest of the world hostage and demand "Millions" of dollars (he meant billions and trillions) in ransom.

In the minds of Smead Capital Management there were at least four big problems with all the excitement about "Peak Oil". First, it was predicated on uninterrupted growth in emerging markets and that has already been debunked. Second, high prices and fat profit margins caused over-production as every country or company which could find and produce oil did. Third, and most importantly, it assumes that the largest oil consumption country (U.S.A) will not permanently modify its behavior. We believe that we will move away from gasoline powered transportation producing air pollution, just as we moved away from horse transportation activated by oats and hay (resulting in manure) between 1910 and 1925. Everything moves faster nowadays and the huge economic reset of the last year and the will of the Obama Administration seem to have jumpstarted the process. Lastly, the move from \$11 to \$147 per barrel culminated in a "bubble". And "bubble" markets can have bounces, but they don't get put back together for a minimum of 5 to 7 years from what we read and know of history.

This year's run from \$32 to \$72 per barrel looks and acts like last year's activity, but we think it is a Mini-Me among oil rallies. It is predicated on the idea that emerging economies will lead us out of the worldwide recession. Under that assumption, the use of oil and other commodities would be at the forefront of the economic recovery. Today's oil bulls think oil is the best place to be because the building of infrastructure, in their minds, will dominate

the economic recovery. This compares to U.S. consumers who have permanently reset their spending at lower levels. We think they are wrong. Even though China or India have one billion people their consumers still control a pittance or Mini-Me level of buying power in comparison to the average American. An old and true business adage says, "If nothing is sold, nothing is produced." Most production is held hostage by retail sales. Just ask any automobile company today and they will reinforce us. If the U.S. economy doesn't come back, don't hold your breath waiting for everyone else to get back their "Mojo" back.

We believe we are in the midst of what we think is a Mini-Me rally in Oil which is attracting the same kind of hot money that it attracted in the first half of 2008. It would like to hold our economic recovery hostage and hog up investment capital. Don't believe this rally in Oil. We think it is "catnip for clones".

Best Wishes,



William Smead

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