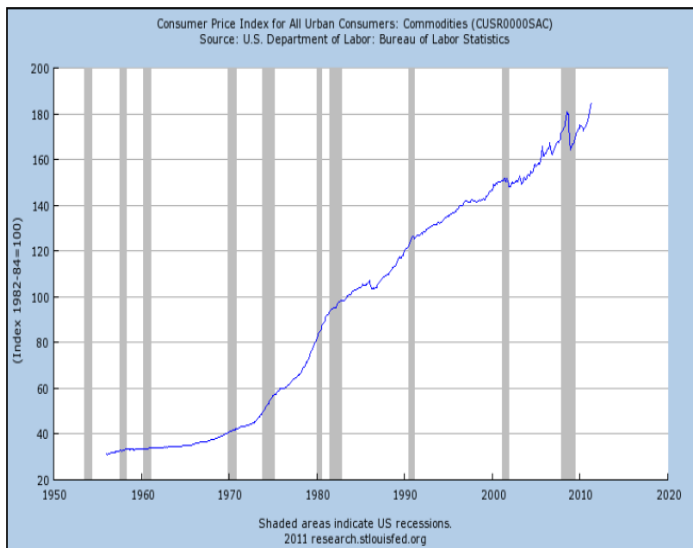




FOCUS POINTS

There seems to be a collective sigh of relief as the price of a barrel of WTI crude oil has dropped to the low \$90's from close to \$115 and the price at the pump for regular gasoline has backed away from the \$4.00 level in many areas of this country. It could also be that with the release of oil from the strategic stockpile, we now feel like the government is paying attention to our concerns. But this is probably a temporary phenomenon; due to many factors, **the price of oil is likely to remain at levels higher than we would wish, and will probably continue to work its way up even further over the coming 3 – 5 years.**



The U.S. is the number one consumer of petroleum, and our willingness to change our consumption pattern is not promising. The discovery of new oil reserves worldwide has been less than annual production since 1980. And the population worldwide has grown faster than oil production; oil production per capita peaked in 1979. In 2010, global oil consumption was 87.4 million barrels per day (mbd), a level surpassing the prior record in 2007, while global oil production fell short in 2010 by 900,000bd. **The U.S. Joint Forces Command in England advised our allies in 2010 that, by 2012, surplus oil capacity could entirely disappear, and, by 2015, there could be serious shortages.** This think tank was also, however, quick to advise that this shortage prediction was not to be taken as a statement of U.S. governmental policy. Regardless, this think tank's predictions seem to have hit the mark.

The consumption of oil in the U.S. declined over the course of the 2007-2009 recession by 10% or 2mbd. Viewed in isolation, this is a significant figure.

But our 2mbd reduction has been exceeded by the growth in demand for oil in emerging markets, leading to global consumption reaching a new high in 2010.

We are not suggesting that we are on the verge of running out of oil. **As the price of oil rises, as it inevitably will, oil and oil substitutes will be developed.**

This article is more about resources in general, and the expected future demand for those resources, than it is about oil in and of itself. It is important to recognize that oil impacts the price of all commodities. Oil is an important part of the production of fertilizers, detergents, solvents, adhesives, and most plastics. And it is obviously a significant factor in all modes of transportation.

Populations demand resources, and at higher levels of per capita income, individuals consume more resources. Per capita GDP in the U.S. is around \$33,070 with a population of 309 million people. China has a population of 1.4 trillion people with a per capita GDP of \$3,029, while India's population of 1.2 trillion people generates \$1,061. **These two countries combined have more than eight people to every one American.** That being said, the U.S. economy is mature. India's and China's economies are at their incipient stages. The latter fact, combined with India's and China's enormous populations, intimates room for rapid economic development, and an accompanying accelerated demand for resources. Indeed, **these countries are considered by many to have replaced the U.S. as the growth engine for the world economy.** While the growth in the world's economy will generate more prosperity, with that will come an advanced demand for all resources, including oil, copper, iron ore, cotton, corn, beef, pork, and chicken. And so, **we can expect to see increased pricing pressure for all resources in the long term.**

Looking at the world today with developed economies awash in liquidity trying to stimulate growth and employment, **it is easy to draw the conclusion that we are at the risk of generating an inflationary spiral driving prices up and forcing central bankers to raise rates.** Unfortunately, however, the Fed has limited capabilities to address inflationary demand exogenous to the U.S.

Thus, **the risks are such that TSBJ remains very cautious in the fixed income market; we choose bonds with short maturities and high quality credit ratings. We prefer the opportunities in the equity markets over the next 12 – 18 months.**