



THE GURU'S CORNER

Waiting out the next energy boom

Commentary: Green gold from high yield resource trusts

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NEW YORK (S&F) -- The rise in energy prices during the past two years is well recognized by anyone who has had to pay a utility bill or fill up a car. Stocks in companies that produce and distribute energy have benefited during this period.

In the near term, it's not clear whether energy stocks will continue to perform. The price of oil appears to have found an upper limit in the range of \$56 a barrel. The Amex Oil Index ([XOI: news, chart, profile](#)), which represents primarily the performance of stocks in large, integrated oil companies, is down 5% in the past three months.

However, the long term prospects for the energy sector are undoubtedly positive. World oil production is expected to peak around 2030, while demand for oil is projected to grow strongly as living standards in India and China rise.

There are energy investments that have the potential to produce income even during periods when the price of oil is stable -- energy trusts. These trusts (many of which are Canadian) sell shares and use the proceeds to buy or lease oil land. They make money by extracting and selling oil or natural gas from their land (rather than from exploration). The amount of profit from such activity depends on the terms on which the oil land was acquired, on the extent to which the company has hedged against price fluctuations, and on the current market price.

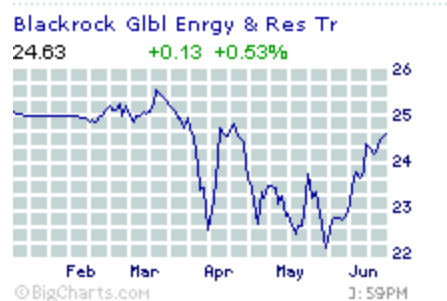
Energy trusts are arcane investments -- small, often illiquid companies you most likely never heard of, whose financial statements are full of subjective data such as the amount of proven vs. probable reserves. The reason why such investments are attractive is that they pay very large dividends, in some cases more than 10% a year. However, some of this dividend represents a return of principal. Our own firm has estimated that the actual investment return potential from certain Canadian energy trusts under current market conditions lies in the area of 7% a year.

For those of you who are not energy analysts, but would like to participate in a potential long term energy boom, the Black Rock Global Energy and Resources Fund ([BGR: news, chart, profile](#)) is a closed-end fund available that can perform due diligence for you. Even better, at current prices you can purchase \$1.00 worth of energy assets for only 95 cents. The current dividend is 6.2%, which is a fair return to earn while you wait for oil prices to climb.

In addition to energy trusts, this fund holds interests in master limited partnerships (which own pipelines, for example) and other energy-related stocks and bonds. Many of the underlying securities in the fund are illiquid, which makes this a very logical way for individuals to gain exposure. During the past three months the performance of BGR has been similar to that of the oil index.

However, this fund does have the potential for significantly greater price risk than a collection of large oil company stocks, both because of the riskier nature of the underlying investments and because closed-end funds can trade far away from their net asset value. Therefore, BGR is appropriate as part of a diversified portfolio for long term holding.

As of Wednesday's close, BGR traded at 24.50, representing a discount to net asset value of 4.2%, according to the Closed-End Fund Association. BGR is recommended at a



discount of 5% or more.

Marvin Appel holds an academic doctorate in statistics. He applies his background in computer research and mathematical modeling to create asset allocation strategies for the Systems and Forecasts newsletter. Appel has client accounts invested in BGR at the time of this writing. (systemsandforecasts.com)

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