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INTERVIEW

What \$300-a-Barrel Oil Will Mean for You

Charles Maxwell, Senior Energy Analyst, Weeden & Co.

By LAWRENCE C. STRAUSS

AN INTERVIEW WITH CHARLES MAXWELL: He correctly predicted the recent price spike -- and he sees an eventual move to around \$300 a barrel.

CHARLES MAXWELL, WHO BEGAN HIS CAREER in the energy business in 1957 working for Mobil Oil, is no stranger to *Barron's* readers. In an article he penned nearly four years ago, Maxwell predicted that oil prices would move sharply higher by 2010, and then higher still. Maxwell, 76, got the timing and trend right, though his top price of \$60 a barrel by 2010 proved far too low. "Oil is unique in that when it begins to disappear, there really aren't any good substitutes, which there are for so many other commodities," Maxwell says. "It's that lack of substitutes that forces the pricing mechanism to balance supply and demand."



Brad Trent

"Only price will slow the use of oil; the rising price tells us we don't have enough. So, we are now beginning a bitter, bitter competition for fuels that will see the price rise to ridiculous levels." — *Charles Maxwell*

Maxwell has worked since 1999 as senior energy analyst at Weeden & Co., an institutional brokerage firm in Greenwich, Conn., having started as an energy securities analyst in 1968. Oil prices came down last week, trading at around \$108 a barrel, but he predicts an eventual sharp move upward -- to around \$300 a barrel -- owing to a lack of available supply. *Barron's* caught up with Maxwell recently for his latest assessment.

Barron's: *What's your prediction for the price of oil over the long term?*

Maxwell: I see it heading on an upward slope. Around that long-term line, there will be a lot of ups and downs. I thought the peak on this cycle might be somewhere around \$100 a barrel, but it turned out to be a lot higher, more than \$145 in early July. But like a child's blocks piled one upon another, you finally reach a point where at \$145 they were beginning to sway. It had gone far beyond the fundamentals. So the

questions are: 'What are the fundamentals and what should the price be?' The answers depend on where you are sitting and what you own.

What's your view?

I would put the price of oil today at somewhere between \$75 and \$115. That implies quite a fast rise, given that we were averaging about \$32 a barrel for West Texas Intermediate in 2003. However, it is perception that really is changing, not the true value of oil throughout the system. The perception change involves whether we are going to move into an era where oil supplies will be generous and easy to find and, therefore, relatively cheap -- or whether those supplies are going to be closed off for both political and geological reasons.

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Which scenario do you see?

We are not going to have enough oil, and we are going to have to start a huge switch in which we make do with a number of other fuels that are not so easy to convert to our immediate energy needs, mainly for transportation.

It sounds like this comes down to not having enough supply to meet demand.

We will have enough coal supply to meet demand, but the real question there is, 'Can we afford to substitute a great deal of coal given the emission problems?' The carbon footprint of coal is very high. We will be forced to use some more coal, but until we develop clean-burning coal technologies and underground gas fields to store carbon dioxide, we are going to be under very tight restrictions on its incremental use. That doesn't seem to be such a bad thing until you look at, say, nuclear power, which would be another big alternative, and you realize that it's being used effectively by the French, the Japanese and the Germans. But for various reasons, nuclear power has become a political football in the United States. If we committed to nuclear power today, we wouldn't have it up and running for another 10 years or longer.

Does the tight oil supply, coupled with a lack of enough viable alternatives, make the U.S. vulnerable in terms of having enough energy supply?

It does, probably between about 2010 and 2025, thanks to a lack of sufficient power to drive our economy on an upward course. We haven't yet seen declining energy supply at a time of growing GDP. So for the moment, we will need more power to drive the world economy higher.

What's been constraining the supply of global energy, oil in particular?

There are several factors, one being resource nationalism. The Russians are the classic example. They are not against us, but they simply want to develop their own supplies in their own way, on their own timetable, with their own money and with their own methods. Another example is Iraq. I said once to a junior minister of that country that Iraq would be producing 9 million barrels a day with the full development of reserves that most of us think are here, as against the 2½ million barrels a day they were producing at the time. And he said to me, 'Could we do that? Yes. Would we do that? No.' He said, 'I predict you will never see more than 6 million barrels a day coming from Iraq, ever' [to preserve the supply].

Another constraint is political instability in various places, including Nigeria. There's also refining, which is probably one of the easier constraints to solve. The world is using a great deal more lighter crudes, and we are actually producing more of the heavier crudes. We have to continue to change the refining system to handle the heavier crudes in order to give us the lighter products.

What other constraints exist?

Many countries, for political reasons, don't want to allow oil companies to come in and do business. They don't like us, the U.S. in particular. Venezuela is an example where they do allow you to come in, but under terms that are so harsh that companies don't. The remaining constraint relates to geology, although it's not the primary issue today. It is the geopolitical and the instability issues that are stopping the biggest part of the development.

How would you sum up the geological issue?

The easy places to find the oil have been, in most cases, tested, proven and produced. This occurred in the continental U.S. in the 1920s and 1930s and, on a worldwide basis, in the 1960s and 1970s. Now we are looking for oil in places like the Arctic of Russia or the Arctic of Alaska, where costs are much higher. It is not only more difficult to operate in those places, but it is a long way to transport the oil. There may be a great deal of oil under Antarctica, but, because it is a land mass, unlike the North Pole, which is water, we can't see through the ice sheets that cover Antarctica. So we don't know where to drill there.

There's also the issue of existing fields that are diminishing. The classic example is that in 1985, the North Sea produced 2½ million barrels a day from nine fields, compared with about 1.7 million barrels today from nearly 100 fields. We are running desperately on a treadmill on which it is very difficult to stay up, because they are not finding as many new fields as old fields are being depleted.

At some point, doesn't it come down to lowering consumption or tapping alternative sources of energy?

Right, and we will probably do both. Ten years ago, 40% of the world's energy was in oil, versus 39% in 2006. It should reach 38% in the next five years -- and 37% three years after that. So oil is slowing, and I expect it will stop its growth around 2015, at which point the supply begins a slow retreat.

Then what?

We will either have to reduce our economic growth around the world, which has all kinds of political and social repercussions attached to it, or we will have to find a substitute for oil. But it turns out that oil is a remarkable type of energy, as it doesn't spoil when you keep it overnight in a warm dish. It transports easily. It stores easily. It is very fluid. You can pump it across long distances. Oil has been the basis on which we have made a remarkable economic expansion, and now we may be tested by something a lot more serious, which is a coming shortage of oil and a need to start using other forms of fuels, which are not naturally the ones that we have developed.

Where does natural gas fit in?

Its supply should last another 40 or 50 years before it runs into the same problems of peaking that we have in oil. Natural gas has a very low carbon footprint, meaning it's a cleaner type of energy, and it has wonderful petrochemical adaptability. But it doesn't help at the moment to solve our principal problem, namely oil supply, particularly for transportation uses.

The dependence of the U.S. on foreign oil has grown significantly. Where do you see that going?

Dr. M. King Hubbert, the great geophysicist for Shell who gave his name to the Hubbert's Peak, said that we would reach the limit of domestic production of oil in the continental United States in the early 1970s. That, he said, would touch off a major change in the way we lived, the way we drove, where we lived, and so forth. But when we actually got there -- and he was correct that it was the peak of American oil in November 1970 -- the transformation to the use of foreign imported oil was almost seamless. There was no great change in people's habits. He thought the American public would never be stupid enough to fall for the concept of foreigners continuing to give us all the oil that we wanted.

Could you elaborate on why you see the price of oil going much higher?

The price is eventually the only thing that will slow down the use of oil; the rising price tells us that we don't have enough of it. So, we are now beginning a bitter, bitter competition for fuels that will see the price continue to rise to these ridiculous levels.

How high do you think the price of oil will go from here?

We will see \$300 a barrel -- or roughly \$250 in today's dollars -- because oil supply will be so short. If you want that oil, that's what you will have to pay for it. That will be in 2015, after the peak of oil [supply]. But even earlier, around 2010, more than 50% of the non-OPEC world will have peaked in its production of oil so the dependence on OPEC will become extreme. That will give OPEC a chance, I'm afraid, to lift prices rather more quickly on us than they are doing today.

What concerns you the most about such high oil prices, assuming that turns out to be the case?

One thing is that people are going to be asked to change much faster than they are willing to.

What's on the horizon over the next two years?

Supply and demand will be equal temporarily. There are three or four Saudi oil fields coming on stream, but there won't be any more low-sulfur crude fields coming on after the end of 2010. There's also the recession, which takes away some demand, but oil prices will remain high.

Where do you see energy investment opportunities right now?

The tar sands, particularly those in western Canada, will be one area where the oil industry will continue. That includes companies like [Suncor Energy](#) (ticker: SU) and [EnCana](#) (ECA), both of which are on my buy list. They are integrated energy companies with big exposure to natural gas. EnCana has a deep asset base, huge North American land holdings and a disciplined management team. My target price, which is for the next 18 months to two years, is \$112, compared with around \$67 recently. My price target for Suncor is \$90 (versus about \$50 last week) but it might take three or four years to get to that level.

Any other investment themes?

I see other types of opportunities developing in energy, although not in the traditional areas. It is going to be a lot easier in the next 10 years to reduce demand than it is going to be finding new supplies to substitute for oil. That's a very big principle. It will require increasing amounts of energy, particularly electricity, to run the new world.

Can you be more specific on companies?

There are going to be so many new companies and so many new technologies that it boggles my mind at the thought of identifying all of them. There are going to be a lot of new industries coming in and wonderful opportunities in the stock market. But the old names in energy that I've covered for years won't be what they were. Most of the oil companies will be swallowed up by the larger ones. Then the larger ones will be broken up into trusts or new corporations. I don't think the oil industry can go on as it is now.

What kind of world can we expect to live in with all of these changes?

It will be a little simpler. Your friends are going to be a little closer to you than they were before. Your vacations are going to be a little closer to home. You are going to have lower temperatures in the house. We will drive smaller cars with less horsepower, but they will get 60 to 80 miles to the gallon, enabling us to stretch gasoline supplies a lot further. There are going to be thousands of new adjustments leading to new investment opportunities. But the adjustment to that rising oil price, which could take as long as 20 years, will be a very harsh social experience -- not only for our society, but for every society.

Thanks very much, Charley.

E-mail comments to mail@barrons.com

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