



Will new energy discoveries change the game?

Less than a decade ago, the world was very concerned about future availability of energy sources. There was the spectre of 'Peak Oil', soaring prices for crude, the threat of carbon dioxide-induced global warming and even conflict in the Middle East over control of energy sources.

However in the past few years, the discovery of vast resources of shale oil and gas is turning these energy paradigms on their heads.

Many large global energy companies have acquired new technology to move their shale-based reserves into natural gas production. Others are positioning themselves to do the same in the knowledge that this unconventional source of oil and gas will solve many energy issues around the world.

Once considered too costly to extract, shale oil and gas can today be accessed through horizontal drilling and hydraulic fracturing of deep geological formations. Commonly known as 'fracking', this process involves injecting fluids at high pressure into shale deposits to free trapped gas.

By comparison, crude oil is recovered from accessible pockets below the earth's surface. While oil is expected to remain the number one global fuel until at least 2040, these new extraction techniques mean natural gas will ultimately overtake coal for the number two spot.

As natural gas emits less carbon dioxide than coal when combusted, using it to produce energy is generally thought to be less harmful to the environment. With more nations adopting emissions laws and carbon pricing, in time it will be financially beneficial for companies to opt for low-pollution energy sources.

Oil reserves declining

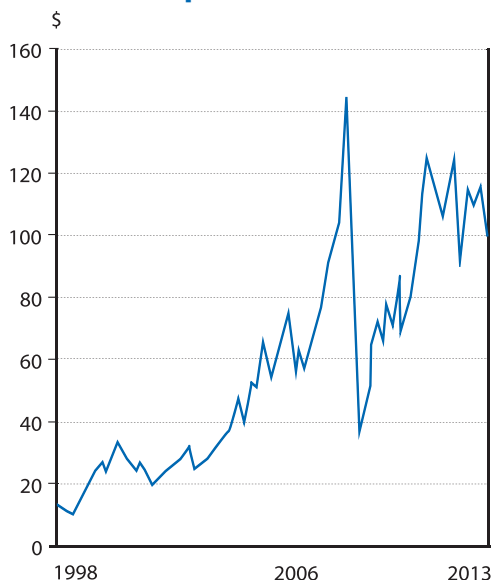
Concerns about the earth's dwindling oil reserves are not new. In 1956, Shell oil geologist King Hubbert estimated US oil production was likely to peak around 1970. It peaked in 1971. He also predicted a global peak would occur around 2016.

Production of oil from conventional sources plateaued in the past decade, sending prices soaring. As the chart shows, the price climbed from US\$40 a barrel in 2004 to US\$140 in 2008, before easing to the 'new normal' of around US\$100 a barrel.

Snapshots



Global oil prices



Source: tradingeconomics.com/commodity/brent-crude-oil

Oil and coal have fuelled economic development and improved living standards for the past 200 years.

However, a ballooning world population, coupled with unprecedented economic development in China and other emerging economies has hugely increased demand for energy in recent years.

Projections from the International Energy Agency indicate that between now and 2035, demand for energy will soar a further 36 per cent.

There is no doubt this appetite for energy is driving exploration of new fuel sources.

Where fracking fits in

While environmental safeguards are crucial, there is no disputing the economic benefits of producing natural gas from fracking shale deposits to meet future energy demands.

Investment guru Jeremy Grantham, of Boston-based fund manager GMO,

estimates shale gas will boost US economic growth by 0.5 per cent a year over the next five years.

While that may sound small, it is already a game changer. In January, The Economist noted the trend among US manufacturers such as Dow Chemical and General Electric to bring operations home, due to rising wages in China and falling energy costs in the US. Over time, natural gas has the potential to reduce America's crippling dependence on foreign oil.

Opportunities for growth

Australia's gas industry started more than 30 years ago after the 1970's Middle East oil shocks; we now have multi-billion dollar liquefied natural gas developments on the north-west coast. More recently, explorers rushed to exploit Queensland's coal seam gas deposits and are now eyeing resources in other states too.

While China and the US have the world's largest shale gas reserves, Australia is no slouch. We have the sixth largest reserves and this has attracted the attention of at least a dozen ASX listed explorers.

While there's no doubt the oil and gas sector is extremely complex, as consumers of energy and investors through exposure in our super funds, it is important to recognise the far-reaching economic impact of these developments.

Prices for oil and gas may fluctuate, but natural gas has a major part to play for decades to come. If you would like to discuss any aspect of your investment portfolio, please call us.



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