DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Our panel has been asked to talk to you about commodities – resources and metals. We haven't seen commodity markets like this since the days of disco. I am even hearing words that I haven't heard for 30 years – tungsten, . . . molybdenum. Commodity stocks have supplanted the technology stocks of the late 1990's as the engine of stock market profits and as the subject of breathless daily reporting by the financial press. In our opinion, much of what gets reported is (as with the tech era) sensationalized, short term focused, and ill-informed. Each new record high price is reported breathlessly. Weekly U.S. oil and gas inventory numbers are analyzed ad nauseum as if they actually mean something. An endless stream of pundits is trotted out to debate whether this bull market is just another tech-like bubble, or an elongated super commodity cycle.

Firstly, let's have a look at what is creating all the fuss. Below is a table that shows the appreciation in various commodity prices from previous cyclical lows:

	Cyclical Low US$	Cyclical Low Date	Recent Price US$	% Appreciation
WTI Oil	$10.83 per barrel	Dec. 11, 1998	$69.94 per barrel	545.80%
N.A. Natural Gas	$1.72 per mmbtu	Nov. 16, 2001	$6.56 per mmbtu	281.40%
Nickel	$1.75 per lb	Dec. 11, 1998	$8.68 per lb	396.00%
Copper	$0.61 per lb	Nov. 07, 2001	$3.23 per lb	429.51%
Zinc	$0.34 per lb	Nov. 07, 2001	$1.46 per lb	329.41%
Gold	$255.55 per oz	Apr. 02, 2001	$667.00 per oz	161.00%

NICKEL

OIL

GOLD

NATURAL GAS

ZINC

COPPER

As a consequence of these moves, the market values of the producing companies have appreciated, in many cases, to an even greater extent than the underlying commodities.

I want to emphasize three points here today:

1. Regarding commodities . . . we are in a "bull" market not a "bubble" market.
2. The real easy money is already in the can.
3. One commodity . . . uranium . . . may be the key determinant of the future of the commodity bull market.

Bull Not Bubble

To suggest that the rally in commodity prices is akin to the tech bubble of the late 1990's is ludicrous. In the tech bubble, companies with little or no revenues at all were accorded valuations of hundreds of millions and in many cases billions of dollars. For example in March 2000 the combined market value for the tech darlings, Research in Motion and Ballard Power, was $28.4 billion. The companies had combined revenues at that time of $96 million, and no profits. By comparison, the 4 largest Canadian conglomerates: CP, Power Corp., Onex, and Edper Brascan (now Brookfield) had a market cap of only $22 billion. However they had revenues of $20 billion and profits of $1.7 billion. Even more dramatic, Nortel had a market cap at that time of $245 billion. For this amount you could have purchased the 4 Canadian conglomerates, plus the big 5 Canadian banks, and put $150 billion in the til. It would have been a good trade. Nortel's current market cap is $13.3 billion and the combined market cap of these same conglomerates and the banks is $301.96 billion. End game 2006 . . . Nortel $13.5 billion or 4 conglomerates, 5 banks, plus $150 billion in cash, equals $450 billion. Now that was a bubble.

I would argue that the strength that we are seeing in all commodity markets today is the direct result of an economic imbalance caused by years of underinvestment in new productive capacity. Specifically using oil and gas as an example, I don't know if $70 is the correct price right now. Maybe it should be $50 or $100. But we do know why the price is higher than the $10.83 low in December 11, 1998 . . . and it is not because of wild speculation. It is a simple matter. Demand has grown faster than productive capacity. In the early 1980's we estimate that excess capacity represented as much as 30% of daily demand. Surprise . . . oil prices fell for 20 years. Now, for the first time in the past 35 years we have reached a point where there is very little excess capacity in the system today. Some in fact would argue there is none. Because supply is now constrained, the price must rise to a level where demand is then rationed. Although it is too early to say definitively, there is no evidence yet that demand is being destroyed by current pricing.

The surging price of oil in the past 7 years has rekindled the great debate regarding "peak oil". The concept was first brought to prominence by the late American geophysicist, Marion King Hubbert, in a paper that was presented to the American Petroleum Institute in 1956. In that paper, Hubbert predicted that oil production in the continental U.S. would peak between 1965 and 1970, and worldwide by 2000. United States production peaked in 1971 and has been declining ever since. The fact that Hubbert's prediction of a peak in global production by 2000 has come and gone has led to much criticism of the theory. Proponents of the theory take the position that the OPEC oil embargos of 1973 and 1979 drove up prices and reduced demand, thereby delaying the inevitable production peak.

I am not a geophysicist. Any qualified geophysicist could likely put me away in a debate about the peak oil hypothesis. I am simply an investor trying to take best advantage of the cards that are dealt. Debating whether the peak is at hand is not a particularly efficient use of time. Even though Hubbert's theory does make a lot of sense to a layman like me, it is easier to make investment decisions with facts not theories. Fact – when oil production began in the mid 19th Century, the large oil fields recovered 50 barrels for every barrel used in the extraction, transportation, and refining processes. This ratio has become less efficient over time. It is estimated that between 1 and 5 barrels of oil are recovered for each barrel used in the recovery process. To me this implies simply that oil becomes harder to extract (more costly) as an oil field is depleted . . . the price therefore must be higher.

The Easy Money is in the Can

The commodity story . . . oil, gold, base metals . . . is not a bubble and it is not yet history. The chronic lack of investment in productive capacity over the last 20 years has collided head-on with continued demand growth – particularly from developing nations.

Zinc is a classic example. With years of low prices, the result has been a lack of investment in new mines. We are now at a point where a number of major mines are nearing the end of their useful lives and will gradually shut down over the next five years. Teck Cominco estimates that we will lose 1.4 million tonnes of existing production because of closures by 2011 (roughly 20% of current production). This cannot be made up with new production from known deposits. If demand grows by 1.5% per annum over the next five years, it will result in a supply gap of 3 million tonnes per annum. With some variations, the picture is similar for nickel and copper as well.

That said, I have been in the investment business long enough to know one thing . . . the big profit is made investing in areas that are clearly out of favour. We have made really big money from investments we made in oil and gas exploration and production companies, copper, zinc, and nickel producers in the late 1990's and early this decade. This was a time where tech stocks were in fashion and "old economy" stuff like oil and metals were bland, boring, and nearly worthless. It was a time when oil, according to the Economist Magazine, was headed to $5 per barrel and we could purchase the best junior oil and gas companies for 2 ½ to 3 times cash flow and $20,000 per flowing barrel. These same companies today are trading at 8 times cash flow and $100,000 per flowing barrel. Not bubble values, but not bargain basement either.

Bull markets also bring out the greed factor in the investment banking business. The demand for resource investments increases and the banks help create a slew of new vehicles to sop up demand. Unremarkable management teams with unremarkable projects, get capital too cheaply, or get capital they should not get at all.

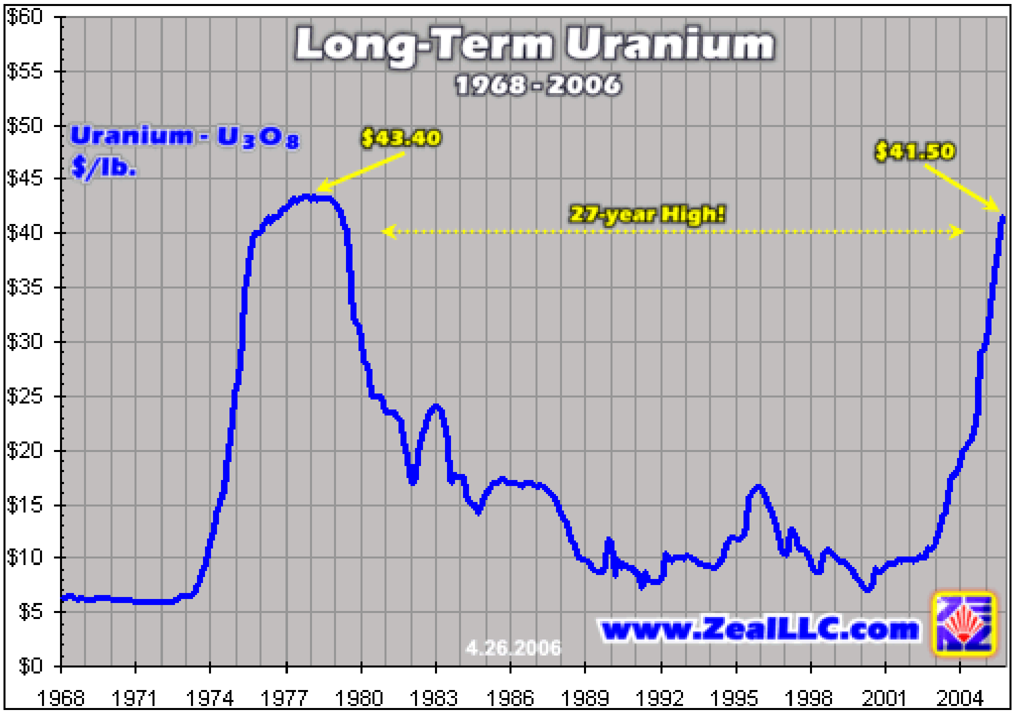
It is not time to pile in. It is time to exercise discipline. Look for the temporarily out of favour resource companies. They are out there.

Uranium – the Key?

If global growth is to continue, particularly among the emerging countries, the commodity most needed to enable this is energy. If you can't turn the lights on in the new plant, or fire up the equipment, there will be no growth. Shortages of energy, and the rising cost of energy, could become the achilles heel of global expansion. In today's world, 80% of all global energy is derived from fossil fuels. It does not make much sense in a supply constrained environment to keep burning fossil fuels to generate electricity. Alternative sources of energy must be deployed.

Nuclear ultimately is the path the world must take in order to procure the energy needs of the future. Nuclear energy is quickly becoming the acceptable alternative to fossil fuels that power the world today. Uranium is the commodity that makes it happen.

If you look at the historical price chart for uranium over the past 35 years, it looks just like oil . . . a big ramp up in the 1970's, peaking at the end of the decade, and then a steady decline for 20 years, and back up over the past 3 years.



Like many other commodities, uranium is in a major economic imbalance as mine production has fallen behind soaring demand. It hasn't been a big problem until now. Few new reactors have been built in the past 25 years and the demand deficit has been satisfied by eroding the huge global stockpiles that were built up during the cold war.

Today there are 441 nuclear power reactors in the world, providing roughly 16% of the world's electricity. There are currently 27 plants under construction and another 151 in the planning stages.

Observing press reports in recent years, it is becoming increasingly clear that the world is beginning to forget the Chernobyls and Three Mile Islands of the past and embrace nuclear fuel as the future. Nuclear plants have become safer, cheaper, and easier to construct.

I would like to draw your attention to an article that was published in the Washington Post April 16, 2006. This may be the tipping point of public opinion. It was written by Patrick Moore, who helped found Greenpeace in the early 1970's. He opens with the statement that at that time he believed that nuclear energy was synonymous with nuclear holocaust. Thirty years later his views have changed . . . "*nuclear energy is the only large-scale, cost effective energy source that can reduce emissions while continuing to satisfy a growing demand for power. And these days do it safely.*"

It is clear that the potential bottleneck to future global prosperity is the cost and shortage of energy. It is also clear that although wind and solar power have their niches they cannot replace big baseload plants. Hydro has been pretty much built to capacity and the price and future supply of fossil fuels is too uncertain.

What does this mean for uranium? Higher pricing will be necessary to encourage the development of future supplies. It requires enormous amount of capital to explore for uranium and the lead times for the development of projects is lengthening because of government red tape. We suspect that today's price of $40 per pound may look cheap a few years down the road.