NEWGATE
CAPITAL MANAGEMENT LLC

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FLASH REPORT

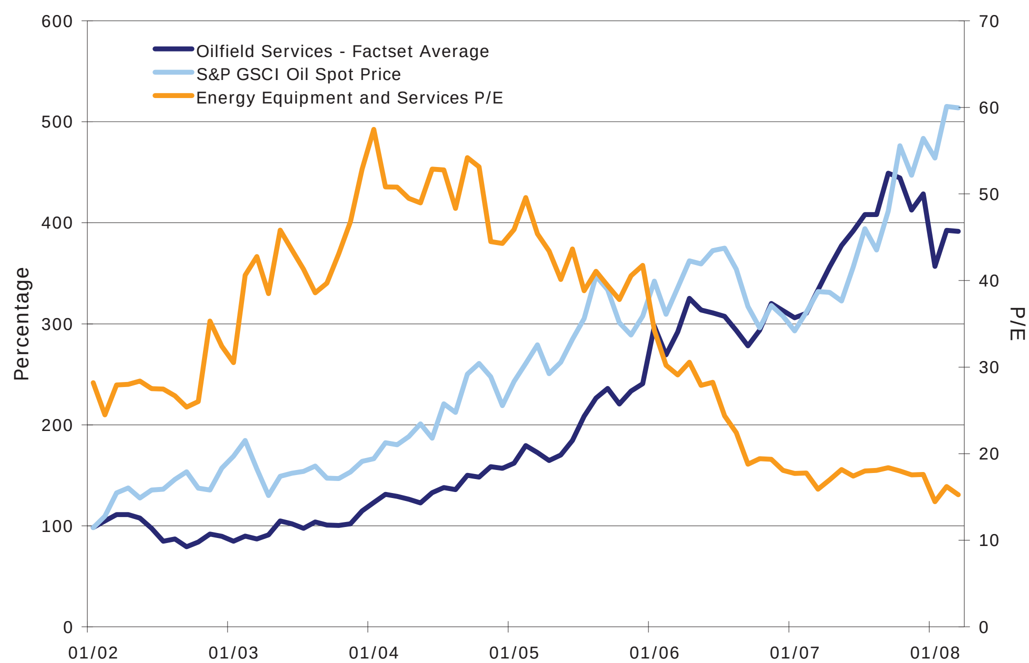
Industry Update – Energy Servicing and Drilling

The first quarter of 2008 showed evidence of a shift in the market for commodities and commodity-related equities. One industry that has come into focus is Energy Servicing and Drilling. There are several aspects of the relationship between commodity prices and the returns on commodity equities that should be clarified, if not corrected.

Oil servicing and drilling companies have increased in price, along with the price of oil (see Chart 1). There is an obvious and legitimate concern that should oil prices decline, prices of oil servicing companies will decline as well.

There is an important maxim to remember: correlation does not prove causation. Returns on oil servicing companies are not necessarily being driven by high oil prices themselves, but by expenditures required in the search for increased oil production. The catalyst for that search was the increase in energy prices. However, the search will not necessarily cease if prices decline; a fire does not go out after the match is extinguished. We believe that demand will be sufficient to warrant additional production at any reasonable forecast price for oil.

Chart 1: Cummulative Return/Energy Equipment and Services P/E



Source: Factset

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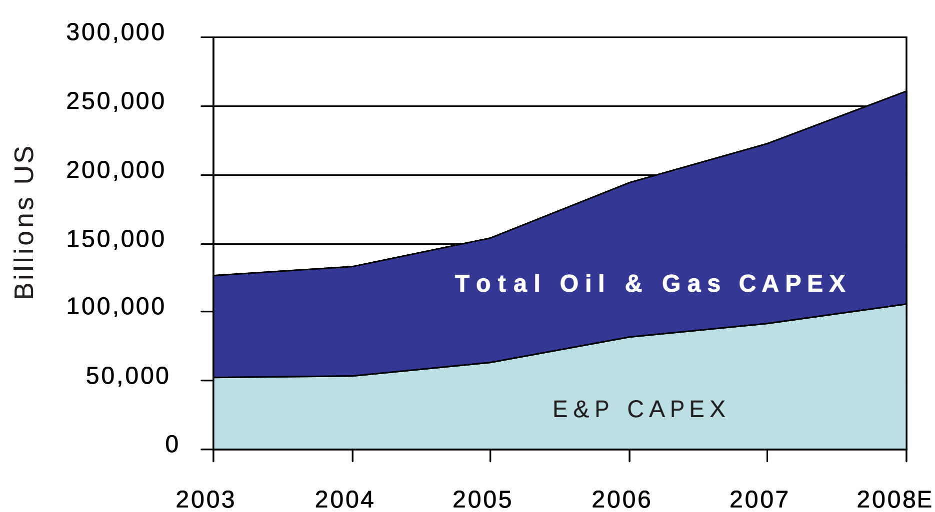
Expenditures by the major companies in the industry are shown in Chart 2. They have trended up sharply after some 20 years of flat or declining investment. It is this investment that is causing the surge in earnings in servicing companies (also seen in Chart 2). Earnings are the true source of the industry's excess returns, and these earnings are not connected to the actual price of oil. ExxonMobil recently announced an increase in their capital expenditure budget to $25 billion, and projects totaling $30 billion annually through 2112. The other major oil companies either have or are expected to make similar announcements. The companies in the energy servicing sector are the direct beneficiaries of this additional spending.

If oil declines to the $20/bbl last seen in 2003, it would cause the cancellation of many of the new projects that the major oil companies have put in place over the past few years. But more realistic long term forecasts for oil are in the $60-70 range and should produce little if any alterations in the future search for increased production and efficiencies.

It is clear that the price of oil has a great impact on the short term performance of the stocks in the energy servicing industry. We believe that this exaggerates the volatility of these investments and clouds the long term earnings potential of companies in this industry. While costs for these companies have increased, this industry has displayed the ability to pass higher costs along to their clients. Despite the recent price appreciation, P/Es for most of these companies are in the mid-teens for current earnings, and even lower for forward earnings (see Chart 1). Even if earnings do not increase as expected, valuations do not appear excessive at this time. At Newgate, we view this sector as the preferred way to invest in energy, without taking the risk of specific projects. At this time, energy servicing and drilling continues to be a significant portion of the Newgate Global Resources Portfolio.

Chart 2: Energy Sector Capital Expenditure



Source: Howard Weil Incorporated; 2008 Capital & Exploratory Expenditure Survey