



January 2008

Snake Oil

One of the most striking differences between a cat and a lie is that a cat only has nine lives – Mark Twain

I get an annoying amount of junk mail. New Economy junk mail doesn't take its form as paper, but as electrons. Last week my junk email folder received over 500 items. Two predominant themes emerged from this rabble: sure fire solutions for enlarging a certain part of my anatomy, and can't miss investment opportunities. I'll stick to commenting on the latter.

A growing number of these electronic solicitations are focused on alternative energy stocks. In my January 2005 Newsletter titled "Why I Love \$3.00 Gas", I chronicled the cycle of events inevitable as energy prices rise. This cycle invites entrepreneurs to take some risks as the rewards are elevated along with rising prices. What I didn't discuss in the newsletter is another inevitability; that along with honest, hard working entrepreneurial types, the raised stakes also attract some rather seedy characters.

The January issue of Equities magazine contains an article written by Fred Scaglione entitled, *No Sector is Perfect*. In it, Fred follows the life cycle of a company, Southbridge Ethanol, a subsidiary of Southbridge Enterprises (symbol, SORD.OB). The stock began trading on October 5th, 2006 at \$1.57 per share. Over the course of the next two weeks the stock traded about 78,000 shares daily and closed on October 19th at \$1.55. Enter the hucksters. On October 20th, e-mail promotions began and for the next seven days urging investors to get on board a "train that was about to leave the station". The stock's average daily volume jumped from 78,000 to approximately 300,000 shares over the next week. The stock closed at \$1.84 on October 27th, or a profit of over 17% in seven days. Once the spamapalooza was over, however, the stock drifted to a new low in the mid twenty cent range. The stock is trading at 5.5 cents as I write this.

A new form of bacteria has been discovered in the form of "analysts" that write about these stocks. In the case of Southbridge, three "investment research" firms were paid cash and company stock by Southbridge to write and disseminate information about Southbridge. According to a May 31, 2007 SEC filing, not only did Southbridge not produce one drop of ethanol, it had a negative book value of \$738,000.

What concerns me about this is not only the amount of fraud that is perpetuated by these charlatans, but the allure that is created along the way. Yes, there is money to be made in alternative energy, and yes there are legitimate companies doing good work that will succeed. The problem is sifting through all of them to figure out which alternative sources of energy and which technologies will be the winners (remember Betamax?).

What is happening in alternative energy has already been played out in other industries. The biotech field is a great teacher. Small biotech companies sprung up in the 80's and 90's, all trying to discover the next big cure. The problem was that many of these companies were one trick ponies, betting the pharm (sorry) on a single drug or process. For every company that succeeded, dozens went the way of the 8-track. There are two ways to play the alternative energy game. The first is to load up on enough alternative energy stocks figuring that somewhere in the portfolio is a piece of coal that just needs enough time and pressure to become a diamond. The second way is to wait for the model that developed in biotech to repeat itself in the alternative energy sector. As small companies developed drugs and processes that were accepted by the markets, these technologies were snapped up by the big players in the drug industry. You can bet that "big oil" is keeping its collective eye on this horizon, and we'll hang around for the ride.

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