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Sustainable Oil Sands Sector Index™ (SOSSI) October 2008 Commentary

Canadian energy stocks are continuing to outperform the underlying energy prices on the way down. For the fifth time in the last six months, energy stocks have failed to gain as much or have lost significantly more than the crude oil or natural gas prices (see table below).

Index	Symbol	Region	Aug 2008 Return
NYMEX Natural Gas	NGAS	US	-6.4%**
NYMEX Crude Oil	OIL	US	-12.8%**
Oil Sands Sector Index™	SOSSI	Canada	-26.1%*
S&P/TSX Capped Energy	TTEN	Canada	-21.4%*

* Return in Canadian dollar terms.

**Return in US dollar terms.

As I write this comment on Oct 2, 2008 the Canadian energy benchmark is down another 11% this month. I reiterate my belief that this is a historical overreaction that will quickly be reversed. Despite all the concerns about the US and global economy and the lack of credit for business and consumers, I still expect oil demand to exceed 87 million barrels per day on average for 2008. Meanwhile, supply is stuck in the 85 million boe/day level where it has been for the last 4 years. The credit crisis will only slow down the development of both fossil fuel resources and alternative energy resources going forward. Also, the likely injection of trillions of new money in the global financial system will result in renewed commodity inflation in the near future. Despite these positive trends, energy stocks are trading at 4 year lows even though the companies themselves are significantly more profitable than they were in 2004 with a \$40 per barrel average price on crude oil.

Top Performing Stocks Sep 2008

Husky Energy	-8.4%
Imperial Oil	-13.2%
Enerplus Resources	-16.6%
Baytex Energy Trust	-19.2%
Penn West Energy Trust	-20.8%

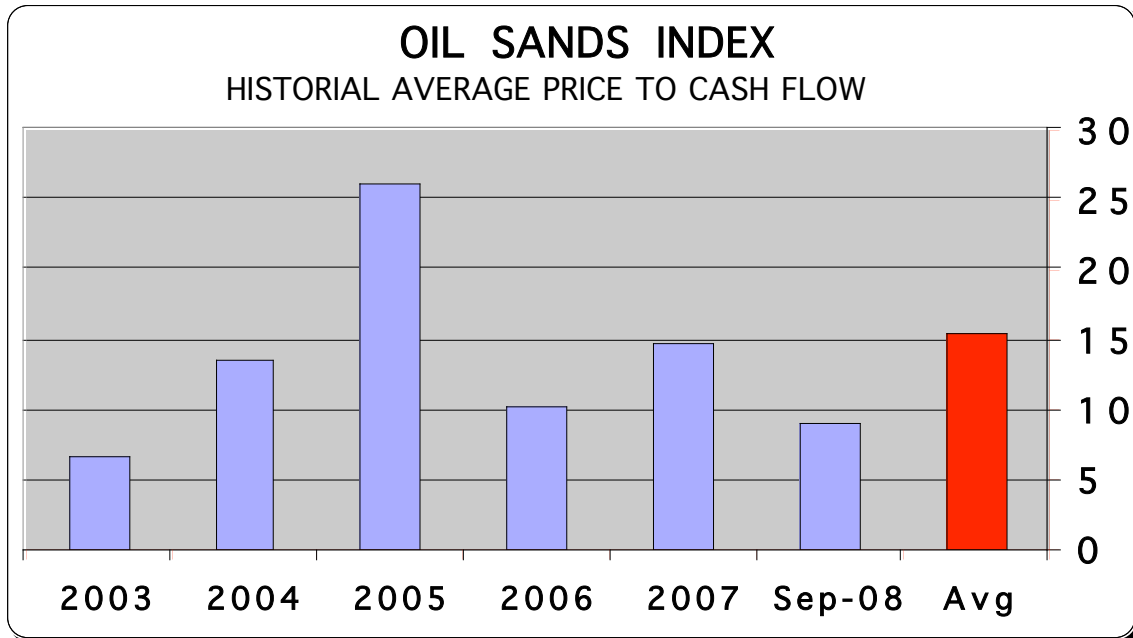
Worst Performing Stocks Sep 2008

UTS Energy	-71.4%
OPTI Canada	-47.1%
Ivanhoe Energy	-40.7%
Suncor	-34.4%
Connacher Oil & Gas	-34.3%



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For the last few months I have been talking with investors on how attractively priced Canadian energy stocks are at this time. The chart below reviews the historical price to cash flow ratio of the current oil sands sector index stocks.



As you can see we are approaching valuation levels last reached during the lows of the sector just prior to the beginning of the war in Iraq. As of October 2, 2008 the basket of oil sands stocks I track are trading at only 9 times price to cash flow (PCF) which is substantially below the 5 year historical average of 15.5 times PCF. The table below shows the trend for each individual company. Please note I excluded Oilsands Quest (BQI-AMEX), OPTI Canada (OPC-TSX), and UTS Energy (UTS-TSX) due to their lack of cash flow over the last 5 years.



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	Year End Price to Cash Flow Ratios						Avg
	2003	2004	2005	2006	2007	Oct-08	
Baytex Energy Trust	4.4	5.9	5.2	5.9	5.3	5.4	5.3
Canadian Natural Resources	2.8	3.6	6.2	6.8	6.3	5.5	5.1
Canadian Oil Sands	14.3	10.6	11.5	13.6	12.0	8.6	12.4
Connacher Oil & Gas	16.0	11.0	96.0	15.9	18.0	12.6	31.4
EnCana Corp	5.8	7.0	6.6	6.2	6.0	5.0	6.3
Enerplus Resources	8.2	8.0	7.7	7.0	6.1	4.9	7.4
Husky Energy	4.0	6.6	6.6	7.4	7.0	5.5	6.3
Imperial Oil	9.1	9.0	12.5	10.4	13.3	10.5	10.8
Ivanhoe Energy		101.3	167.0	22.4	77.5	45.1	92.1
Nexen	3.3	3.2	2.7	5.7	4.9	3.0	3.9
Penn West Energy Trust	3.2	5.1	5.6	6.2	4.8	3.7	5.0
Petrobank Energy	4.6	5.4	17.8	19.3	25.0	6.9	14.4
Petro-Canada	5.0	4.2	6.3	6.5	6.9	3.2	5.8
Suncor Energy	7.0	9.5	13.5	9.3	13.4	7.6	10.5
INDEX AVERAGE	6.7	13.6	26.1	10.2	14.8	9.1	15.5

What I find interesting about this table is that most of the companies are now trading well below their 5 year average PCF and in some cases they are at their lowest levels during the whole period under review.

This argument is even more compelling when you review how the growth of company cash flow per share seems to translate to similar investment returns. Companies such as Petrobank Energy, Canadian Oil Sands Trust, Canadian Natural Resources, Suncor and Encana have been best performers in terms of cash flow growth and investment performance since 2003.



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	5 Yr CF/sh Growth	5 Yr Total Return
Baytex Energy Trust	108%	317%
Canadian Natural Resources	209%	386%
Canadian Oil Sands	586%	449%
Connacher Oil & Gas	130%	98%
EnCana Corp	200%	181%
Enerplus Resources	68%	56%
Husky Energy	176%	304%
Imperial Oil	108%	152%
Ivanhoe Energy	0%	-71%
Nexen	117%	122%
Penn West Energy Trust	36%	143%
Petrobank Energy	857%	1223%
Petro-Canada	77%	31%
Suncor Energy	135%	191%
INDEX AVERAGE	200.5%	255.9%

The current short-term concerns over economic growth and financial instability will eventually pass and I believe the former stars will again reward investors when the sector turns around.

Derek Gates, CFA

Founder of the Oil Sands Sector Index™

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