

Weather and Inventories

Summary and Recommendation

A favorable long-term outlook for U.S. natural gas royalty trusts keeps us from becoming overly concerned with unpredictable weather. High inventories of natural gas point to downward price pressure if the weather is warm while low inventories of heating oil point to upward price pressure if weather is cold. Substitutability keeps the price of one fuel from getting too far out of line with the other. Meanwhile, latest distributions declared in the past week were higher than the previous month for 4 of 6 trusts. Sharp increases in distributions next month appear predetermined because of the time lag between real-time production and payment of distributions.

U.S. Natural Gas and Oil Royalty Trusts

The Account

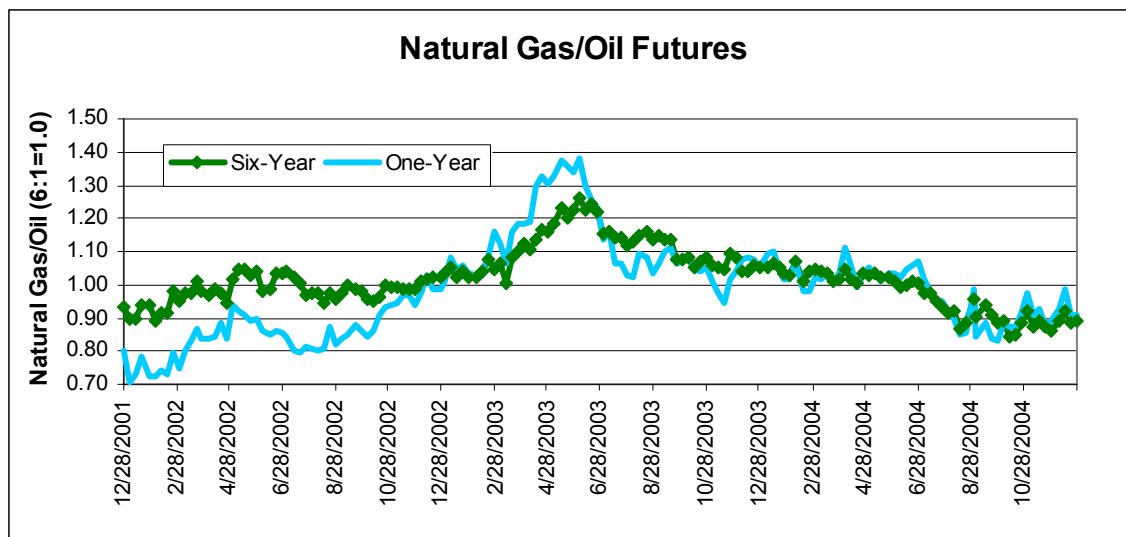
	<i>Symbol</i>	<i>Price (\$/un) 23-Dec 2004</i>	<i>Units</i>	<i>Market Value (\$)</i>	<i>Next Twelve Months Distrib. (\$/un)</i>	<i>NTM Distrib. Yield (%/yr)</i>
Cross Timbers Royalty Trust	CRT	39.76	400	15,904	2.99	7.5
Dorchester Minerals, L.P.	DMLP	23.40	700	16,380	1.97	8.4
Hugoton Royalty Trust	HGT	26.83	500	13,415	2.54	9.5
Mesa RoyaltyTrust	MTR	67.60	200	13,520	5.45	8.1
Permian Basin Royalty Trust	PBT	13.89	1,200	16,668	1.11	8.0
Sabine Royalty Trust	SBR	35.45	400	14,180	3.34	9.4
San Juan Basin Royalty Trust	SJT	29.86	500	14,930	2.99	10.0
	<i>Total</i>			<i>104,997</i>		<i>8.7</i>
Futures Strip						
12 Month - Oil (\$/bbl)		43.24				
12 Month - Natural Gas (\$/mmbtu)		6.57				
72 Month - Oil (\$/bbl)		39.46				
72 Month - Natural Gas (\$/mmbtu)		5.87				

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Q: Are you worried that spot gas price could fall apart without sustained cold weather?

A: Always worried. Logically, the spot price should not matter much to investors because the value of a stock should reflect future prices over the life of reserves. Spot price starts to matter when it affects perceptions of long-term price.

Natural gas futures prices have been trending down relative to oil for more than a year since mid 2003 (see chart [Natural Gas/Oil Futures](#)). As a result there is some discounting of gas relative to oil already with one-year average and six-year average at 0.9 assuming 6:1 is par. (Six-year gas at \$5.87 has the approximate heating value of oil at \$35.22 on the 6:1 basis. The ratio of that equivalent price to six-year oil at \$39.46 is 0.89.) It looks like the decline has been arrested and the next move could be up.

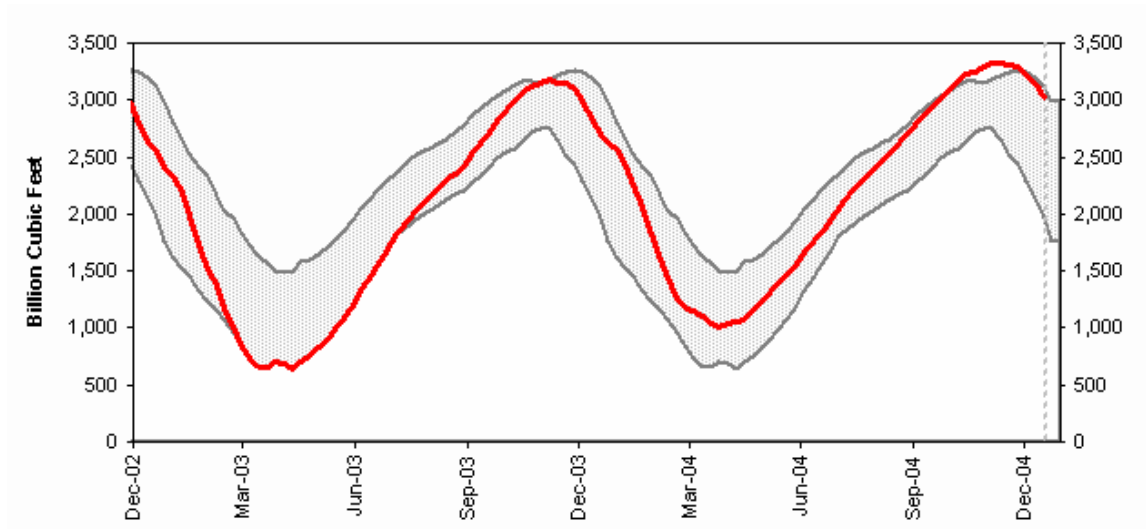


Presumably the potential concern is that storage operators would dump gas in the spring if inventories don't get burned up during the winter. Yet the alternative of leaving extra gas in storage until the next winter seems unlikely to cost more than, say, \$1.00 a million BTU. At the current futures price for natural gas delivered in January 2006 of about \$7, natural gas might have a spot price of \$6 in a warm winter for the next few months. That could be 10% downside to current January 2005 futures.

Meanwhile current natural gas inventories are perhaps 500 billion cubic feet above the midpoint of the historical range for the beginning of winter (see chart [Working Gas in Underground Storage Compared with 5-Year Range](#)). Compared to annual natural gas consumption of about 20 trillion cubic feet, that is only 2.5%, or little more than a weeks demand. Logically that is not enough to have an impact on long-term perceptions in our opinion.

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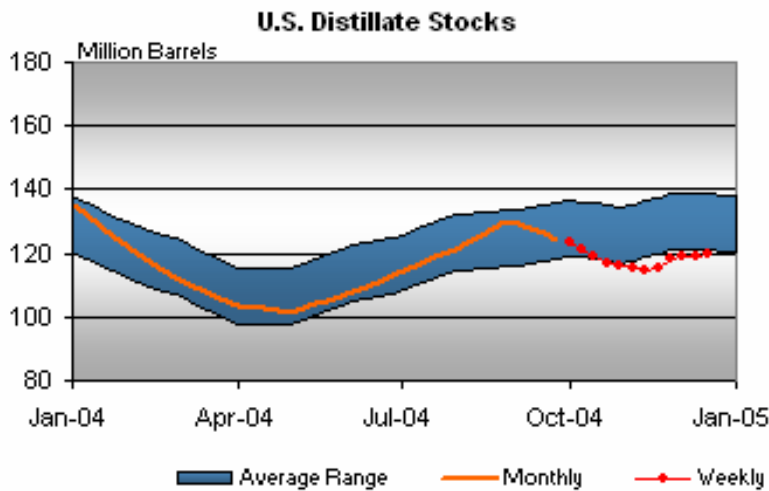
Working Gas in Underground Storage Compared with 5-Year Range



Source: <http://tonto.eia.doe.gov/oog/info/ngs/ngs.html>

Heating Oil Inventories Tell the Opposite Story

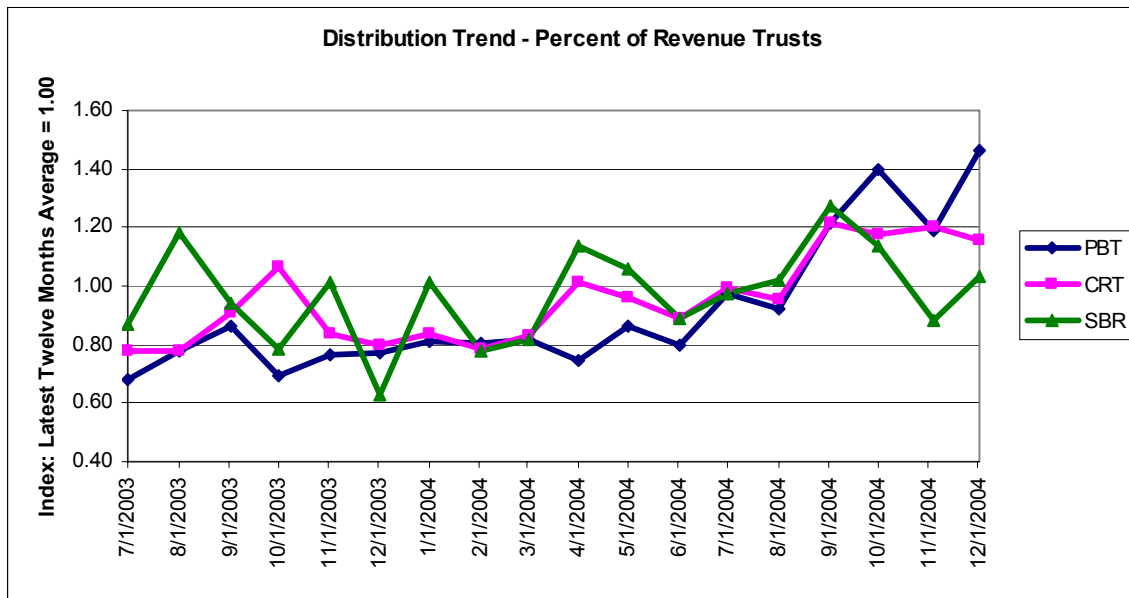
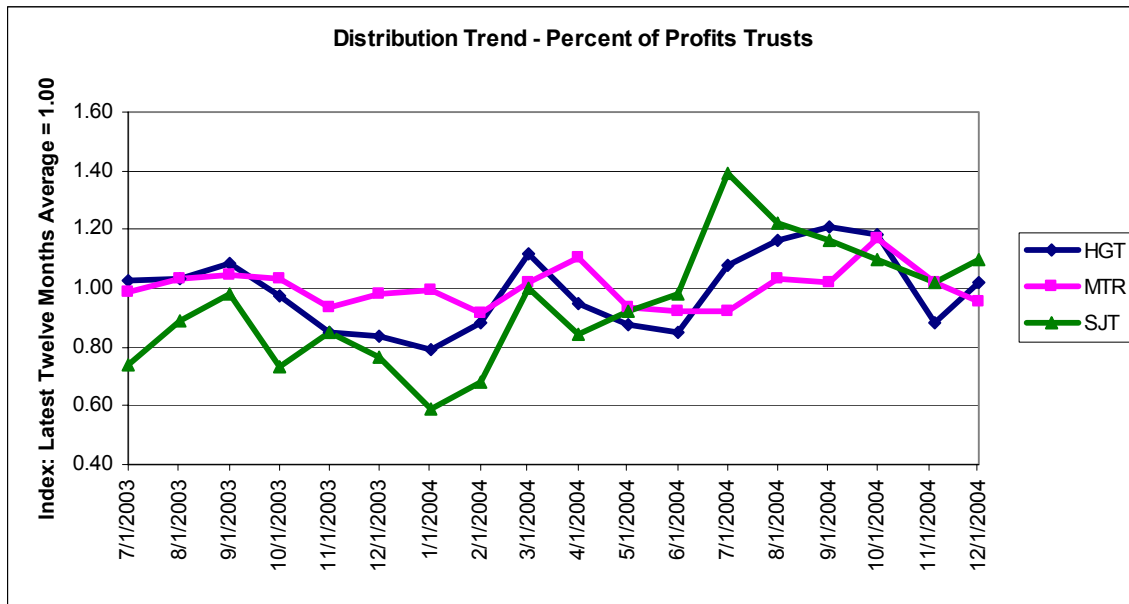
Natural gas price can almost not be weak absolutely if oil price is strong. Heating oil inventories, not particularly ample globally, are below the normal range in the U.S. Just as one might be worried about the combination of warm weather and high inventories for natural gas one might also contemplate the combination of cold weather and low inventories for heating oil.



Source: http://tonto.eia.doe.gov/oog/info/twip/twip_distillate.html

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December Distributions Declared



Kurt H. Wulff, CFA

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