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STREET SAVVY

Traders Buy Rumor, Sell Fact On Ethanol Push

By **SPENCER JAKAB** A DOW JONES NEWSWIRES COLUMN

NEW YORK -- Mark Twain's contention that history may not repeat itself but that it often rhymes is nowhere more evident than in the stock market, with the recent performance of ethanol stocks being the most recent example.

In what should have been a tremendous boost for the biofuel industry, President George W. Bush pledged Tuesday night to boost ethanol output to an astounding 35 billion gallons, more than four and a half times the current federal mandate, coupled with a big push to commercialize cellulosic ethanol. What was the response to a 360% increase in the size of their potential market? Industry-leaders like Pacific Ethanol Inc. (PEIX) and Verasun Energy Corp. (VSE) were down sharply, both dropping about 6% in early trading. Cellulosic bellwether Xethanol Corp. (XNL) was more than 13% lower at one point.

"A year ago we had a big run-up -- an even more robust run-up -- and a major sell-off," said Rob Wilder, chief executive of WilderShares LLC, the company behind the first exchange-traded fund to track alternative energy.

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"The buying in ethanol is still speculating on the actual future profits," said Wilder. "We're hearing a lot about restrictions on feedstock, which is not bullish, and the second thing is the price of oil, which has come down. If you get oil below \$50 (a barrel) and \$4 corn (per bushel), it's much more of a squeeze."

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The development of cellulosic technology is also by no means assured. Wilder is hopeful for cost breakthroughs but cautioned that investors are "putting on somewhat rose-colored glasses" by assuming it's a sure thing.

The moral of the story from the sharp gains and subsequent selling in ethanol stocks these past several days is that investors were initially overexuberant. Those savvy enough to sell ahead of Bush's speech were able to lock in profits by studying just the recent past. The same instinct of selling a hot sector during a surge in its popularity rather than when the cold, hard reality of the marketplace set in would have served investors well in other areas too like tech stocks in 1999 or energy shares in early 2006.

(Spencer Jakab, a columnist who provides insightful and unique takes on the stock market, previously wrote about the energy market.)

**---By Spencer Jakab, Dow Jones Newswires; 201-938-2429;
spencer.jakab@dowjones.com**