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Clean And Green ETFs

Will McClatchy, ETFZone 12.28.06, 12:00 PM ET

Socially responsible funds for many years were no more than large-cap funds with alcohol and tobacco cut out. Offerings have evolved considerably in recent years, and there are now two main approaches to social investing in the form of exchange-traded funds.

One approach extends the traditional method. Not only are basic "sin" sectors cut out, but further filtering is made so that firms with the strongest commitment to social or environmental goals remain. IShares' two ETFs epitomize this strategy.

IShares KLD Select Social Index Fund (nyse: KLD - news - people) largely follows the Russell 1000 but is composed of only 218 of its component companies. The recently launched **iShares KLD 400 Social Index Fund** (amex: DSI - news - people) largely tracks the Standard & Poor's 500, but it takes some other firms as well.

Another approach is to ignore the big-cap indexes and instead to seek out firms whose main business is environmental innovation. PowerShares' two ETFs follow this path. **Powershares Wilderhill Clean Energy** (amex: PBW - news - people) invests in innovative energy firms, while the newly introduced **PowerShares Cleantech Portfolio** (amex: PZD - news - people) targets any technology firm that is making a positive environmental impact.

The following table shows the notable differences in price-to-earnings ratios and average size.

ETF	Ticker	P/E	Avg. Size	Holdings	Fees
iShares KLD Select Social Index	KLD	17.73	$24B	218	0.50%
iShares KLD 400 Social Index	DSI	N/A	$68B	401	0.50%
PowerShares Wilderhill Clean Energy	PBW	29.12	$3.6B	42	0.60%
PowerShares Cleantech Portfolio	PZD	68.96	$1.2B	75	0.60%

The iShares ETFs are dominated by multibillion-dollar companies with fairly cheap earnings. The PowerShares funds hold relatively small companies with growth characteristics. (A price-to-earnings ratio for DSI is not yet reported, but it surely is below 20.)

A few examples of holdings illustrate the difference. KLD holdings are headed by **American Express** (nyse: AXP - news - people), **IBM** (nyse: IBM - news - people) and **Johnson & Johnson** (nyse: JNJ - news - people), while DSI starts with **Microsoft** (nasdaq: MSFT - news - people) and **Procter & Gamble** (nyse: PG - news - people). PBW's top holdings are **SunPower** (nasdaq: SPWR - news - people), **Ballard Power Systems** (nasdaq: BLDP - news - people) and **OM Group** (nyse: OMG - news - people). Every single company in the iShares ETFs is a household word, while the PowerShares companies are relative unknowns.

Further analysis shows that PZD is 54% composed of small-cap growth companies, while PBW is 59% small-cap growth. Being so new, the funds have little track record, but the past behavior of their underlying indexes (with no expenses counted) suggest they are not for the faint of heart:**….**

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KLD and DSI appear to be far less volatile. Beta calculations, a measure of how much a security moves when the market moves, confirm the discrepancy. The iShares funds show betas close to 1 (moving in tandem with the overall market and not so risky) while the PowerShares funds show betas significantly higher (reacting to news more than the overall market and more risky).

Clearly, these two groups of funds should be used for different purposes. The iShares duo are suited for a core large-cap buy-and-hold position in a fairly conservative long-term portfolio. The fees are a reasonable .50%, which buys the investor peace of mind that they are avoiding involvement with activities they deplore. While KLD and DSI cut out tobacco and defense, other firms whose social mores are widely questioned remain, including alcohol, fast food, oil and big-box stores. Each has its proponents and detractors, and full debate on each could be lengthy. Suffice it to say that investors should scan the holdings of these funds to make sure they conform to their own beliefs.

The PowerShares duo is much more of a trader's tool, but it might be seen as a buy-and-hold position for the person seeking emphatic commitment to progress in the environment. Neither strategy is conservative nor suited to a large portion of a retirement portfolio. Fees at 0.60% are reasonable for specialized small-cap investing. Investors should be aware that an enormous amount of money has been piling into private-equity deals for small firms in this area. On the one hand, that means that the quality of companies entering the index in coming years should be very high, but competition will increase as well, so expectations and valuations seem high at present. This need not be an impediment to the trader who can prosper in any kind of market, but the buy-and-hold investor should probably wait.

All the funds' fees exceed those of plain, vanilla large- or small-cap funds by about .40%. Investors should consider that they could obtain similar returns from these plain vanilla funds and still give away .40% in direct donation to a social or environmental cause.

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