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Alternative-Energy Funds Could Offer High-Powered Returns

By Rob Wherry | Rob Wherry Archive | Published: June 21, 2007

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Wind power and other forms of alternative energy — solar, hydro, geothermal, biomass — are quickly coming into vogue across the globe thanks to record high oil prices, shrinking reserves and world-wide demand that is expected to increase 50% by 2030, according to the International Energy Agency. What has also given them some attention is that these sources are now at the heart of profitable businesses. That hasn't always been the case. Clean Edge, an industry research firm, anticipates biofuels, wind, solar and fuel cells will generate $217 billion in industrywide revenues by 2016, up from $56 billion in 2006. Even the typical American has changed his perception: A survey by Calvert, a socially-responsible investment firm, found that 85% of the 1,094 people that they polled thought putting money into alternative energy was a good way to protect the environment and make money, too.

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Add all that up and you have a decent investing opportunity. You could spend your time reading over analyst reports on alternative-energy companies — what little there are on these thinly-traded firms — looking for a diamond in the rough. But a smarter option is to scoop up the shares of one of the growing number of mutual and exchange-traded funds that specialize in this field. As always, though, be prepared for sector funds like these to experience dramatic ups and downs. And we would suggest only building a 5% or smaller position in this niche.

The concerns here are numerous. Many alternative-energy companies are small firms that are barely profitable. Lose a few customers or fail to make a piece of technology work and it could be lights out. Alternative-energy investors not only need to be aware of the price of a commodity like oil — the higher it goes the more attractive managing solar and wind farms becomes — but also others like corn, a chief ingredient in ethanol. There are political concerns, too. "Both Republicans and Democrats agree we need to be energy independent," says Todd Rustman, president of GR Capital Asset Management in Newport Beach, Calif. But that doesn't mean there aren't gripes. Locals, especially, complain that wind farms are eyesores and hurt property values. Those protests can lead to costly delays or even derail some potential money-making projects.

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GR Capital's Rustman gives some of his clients get exposure to this niche by using the **PowerShares WilderHill Clean Energy ETF** (PBW: **20.36**, **+0.01**, **+0.1%**). This exchange-traded fund tracks an index of 40 or so stocks that generate a substantial portion of their revenues from alternative-energy sources. It also includes companies whose technology supports the industry. Top holdings include **Evergreen Solar** (ESLR: **8.90**, **-0.25**, **-2.7%**), electronic meter manufacturer **Itron** (ITRI: **74.18**, **+0.55**, **+0.8%**) and **Cypress Semiconductor** (CY: **23.63**, **+0.43**, **+1.9%**), which, in addition to chips, makes solar cells. The fund, which was launched in March 2005, has had its share of roller coaster rides, posting returns as high as 20% in some quarters, according to Morningstar. Over the last year it's trailing the broad market. But so far 2007 has been good: Its 15.2% return is well ahead of the S&P 500. That's not exactly an apples-to-apples comparison. But remember: When you make a sector bet you have to think of the return your money would have made if you had put it in a safer investment.

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