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Pursuing the Green in Clean Energy

Monday November 20, 9:42 am ET By Brett Steenbarger

Investors can use ETFs to accomplish a number of trading goals. My recent blog post illustrated how ETFs can be used to diversify holdings by spreading capital across non-correlated assets. In this post, we'll look at an example of how ETFs allow us to participate in sector themes.

With ETFs, individual investors can make the transition from thinking of themselves as traders to regarding themselves as portfolio managers. Increasingly, every well-capitalized investor can become his or her own hedge fund.

The sector theme that I'd like to pursue is clean energy. Several forces have come together recently to support the pursuit of energy alternatives:

- 1) On the heels of the Iraq experience, U.S. citizens will look to energy independence as a response to national security that will supplant the recent paradigm of unilateral interventionism.
- 2) Clean energy is a natural response to concerns over global warming that will help us re-establish ties with ecologically concerned allies abroad.
- 3) Clean energy is no longer a pipe dream, as the average consumer is now familiar with ethanol and hybrid engines--not to mention higher fuel prices.
- 4) Energy independence is increasingly seen as a way of taking us out of thorny competitions for resources with Russia, China, India, and developing nations.
- 5) Most important of all, clean energy has become as American as apple pie. Republicans are looking to launch a large initiative and Democrats are ready to make global warming a national priority.

Bottom line? We're going to see an increasing share of resources devoted to clean energy, which could bring some green to investors in that sector. The problem, however, is that the sector is highly fragmented. Where do you place your bets: Renewable energy, such as solar? Power conservation? Clean fuels? Power storage? Fuel cell technology?

The best play I can find in the field is the diversified one: the PowerShares WilderHill Clean Energy Fund (AMEX:[PBW](#) - [News](#)). The fund holds 42 stocks across the green spectrum and allots no more than 4% of the

portfolio to any single stock. Most of the issues are small cap, pure plays in clean energy.

Participation in the Fund has been growing. When it was first introduced in March, 2005, the average volume was under 100,000 shares per day. By June, 2006, the 50-day moving average of volume peaked at over 700,000 shares per day and, at present, is over 300,000. As investors seek a way to participate in the green theme without having to crystal ball individual stock winners, the volume should continue to expand.

As the chart below indicates, PBW nearly doubled in value between May, 2005 and May, 2006. Volume exploded by over a factor of 10 during that time. Since then PBW has pulled back from May highs on reduced volume and failed to participate meaningfully in the recent large-cap/value stock led rally. Note also that the Fund is quite volatile relative to the S&P 500 Index. In 2006 thus far, the average daily change has been 1.42% and the average daily high-low range has been 2.25%.

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The correlation between PBW and the S&P 500 Index (AMEX:[SPY](#) - [News](#)) during 2006 has been .62. That means that general market movement accounts for over 36% of the variance in PBW price. The correlation between PBW and the Russell 2000 Index (AMEX:[IWM](#) - [News](#)) in 2006 has been .71, accounting for nearly half the variance in PBW price change.

What to do? I'm waiting for a general market pullback and will assess PBW at that time. It may be a while before these stocks generate meaningful profits, and it will take Congress and the President a while to hammer out any clean energy initiatives. It is difficult to imagine, however, that the two parties, struggling for a popular response to problems with terrorism and global warming, won't try to outdo each other by wrapping themselves in the mantle of clean.

And that could mean green for investors with a longer-term horizon.