



## JPS Global Investments—The Quarter in Review

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### **Market Summary**

Though the passing of 2009 was good riddance for most people in the developed world, it actually was not such a bad year for investors. It is not atypical for markets to do well on the waning side of a recession. The Dow Jones Industrial Average finished the year up 18.8% and has risen almost 60% from its March low. In a similar fashion, the S&P 500 Index rose 23.5% for the year and 64% off its low.

The question for many was, “is the past still any guide for the future?” Those that answered that question with a “yes” had better returns in 2009, than those that were on the sidelines waiting for more proof. Of course, hindsight is 20/20. The unfortunate truth is that what drives most investors to cash is significant losses, so they need the big gains to recover.

The unprecedented government support certainly benefited the markets and may have averted a depression. The Federal Reserve pumped a massive amount of cash into the banks, doubling its balance sheet from \$900 billion to over \$2 trillion, and has kept rates near zero. The Treasury hasn’t been shy about spending either. Though eventually we will have to pay for this spending spree, for now we have stepped away from the precipice of economic collapse. Eventually, we will go through our period of atonement when both households and the government will have to pay down debt. Households have clearly started, though it is unlikely their example will be followed anytime soon.

What does this mean in terms of our investment outlook? 2009 returns are unlikely to be repeated in the developed world. The winding down of economic stimulus and the Federal Reserve’s printing press will take some of the wind out of the stock market. Bright spots are emerging markets and the green economy.

To the extent that developed market companies can provide products and services to a growing China, India, et al, they have the potential to do well. In 2002 the car market in the US was still 5 times the size of the Chinese car market; in 2009 more cars were sold in China than in the US. In June of 2009 there were 220 million internet users in the US and 338 million in China. The world is changing and so must our portfolios.

### **Sustainable Investing Update**

#### **Copenhagen**

A delegation of 192 countries returned from Denmark with unimpressive results. Some had hoped that the December 2009 United Nations Climate Change Conference in Copenhagen would result in Kyoto 2.0, but the world had to settle for some vague political statement without firm binding emission targets. It was not all in vain. Rich countries agreed to fund a 3-year \$10 billion per year program to help poorer nations mitigate and adapt to climate change, with the goal of ramping that program up to \$100 billion per year by 2020. Furthermore, developing nations will provide audited reports every two years on their

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voluntary actions to reduce emissions. Perhaps equally important is the realization that more might be achievable when smaller groups of countries create frameworks that roll-up into a broader UN framework, rather than trying to get 192 countries on one page.

According to Yvo de Boer – the United Nations climate chief – an international agreement should ultimately address the following key questions:

- By how much industrialized countries are willing to reduce their greenhouse gas emissions.
- How much major developing countries such as China and India are willing to do to limit the growth of their emissions.
- How climate change mitigation and adaption efforts in developing countries are going to be financed.
- How the money raised for the developing countries-focused climate change & adaptation programs is going to be managed.

We are not there yet, but there is reason to hope that more concrete plans and agreements will be hashed out in subsequent months and years. An important first milestone would be something positive from lawmakers in the United States.

### Green Economy Outlook 2010

I approach an outlook for 2010 with great caution, as admittedly uncertainty reigns when it comes to market forecasts. The path of prognostications is littered with bold statements from seemingly intelligent people that failed to materialize. Harry Dent's prediction of Dow 20,000 by 2009 did not quite pan out, though he did see a bubble bursting. Oil never reached \$200/barrel a la Goldman's prediction (they could still be right, as they were talking about the 2010-2012 time period).

Here's a prediction from Wharton's Jeremy Siegel in 2007: "I think the stock market will have another winning year in 2008. For every percentage point that stock returns fall below 8% (my prediction) this year, they should exceed 8% next year (meaning, for example, if stocks gain 6%

this year, they should finish 2008 up 10%). And I believe that financial stocks, which have plummeted 18% so far this year, will outperform the S&P 500 Index next year as the credit crisis fades."

Having peppered you with caveats, and though we try to expect the unexpected, we do spend some time thinking about how to position our investment assets to succeed in the coming one to two years. Here are some broad trends that we are trying to position our portfolios for:

1. In October 2009, we concluded that although the existing environment was tough for solar, the outlook was getting better and that solar stocks had a chance of turning the corner in 2010. Since then, the sector was up in the 10-20% range into the first week of January, but has since given most of that back.

In Germany there is talk of reducing the feed-in tariff for 2010 by 16-17% in April, which could have a significant effect on demand. One of the challenges of Solar is that it can't stand alone quite yet; government support is a life-line. The question is whether cost can come down fast enough to make up for decreasing subsidy support. We still believe in Solar, but are not adding to the sector at the moment, until there is more clarity.

2. Wind energy is more cost competitive than solar. The issue in the wind industry is over-capacity in the short-term, and the risk of credit conditions deteriorating once more. The long-term picture for wind looks solid and the key players should be able to survive and do well. There is a smaller risk of disruptive technologies unsettling the established players as compared to the solar industry. The short-term headwinds might provide a good entry point into wind stocks during 2010.

3. Investors are looking beyond wind and solar to battery storage, smart grid applications, transportation, and infrastructure and we think this trend will continue. In 2009, smart grid and energy storage outperformed wind and solar and unlike previous years, there was a true divergence among sub-sectors of the clean energy sector. Particularly

energy efficiency plays are interesting, as these companies are selling cost savings. The economics are there, if the upfront costs can be financed, unlike most alternative energy plays, where cost-parity has not been achieved yet (unless of course one accounts for the true cost of fossil fuels; but that is unfortunately just an academic exercise). We have seen this play out in our portfolio, with stocks like EnerNOC (smart grid) and BYD (energy storage, hybrid cars) among our top performers for 2009 and solar stocks lower down the list.

### **The Biggest Bang for Your Green Buck**

Although subsidies can provide crucial support for nascent industries to develop, the level of subsidies can pose a risk. This risk becomes evident when support wanes and sales crater (e.g. US wind industry during the last decade and Spanish solar industry in '09). Also, if the subsidies are too high, governments are in effect setting prices for energy, which is likely not efficient (e.g. corn ethanol in the US). Having said that, it is only fair to level the playing field, as fossil fuels also receive substantial subsidies. From a policy perspective, the best solution is the middle road, whereby there are some subsidies, but the government is not picking the winners among different clean energy sources.

My opinion on policy and the direction of policy are not exactly in alignment, nor do I have anything to add in terms of knowing what the future holds in that regard. However, as investors we *can* look at the unsubsidized cost of energy sources, to see which one might be more attractive in the absence of policy. According to Bloomberg New Energy Finance, if we use the cost of coal as the benchmark, the cheapest forms of renewable energy are (in ascending order starting with the cheapest): natural gas (not clean but cleaner than coal), geothermal, landfill gas, onshore wind, biomass, offshore wind, thin film solar, crystalline solar, and wave power.

McKinsey came out with a similar report, but went one step further, including energy efficiency in the

line-up. From a cost standpoint, money should first be spent on energy efficiency if it can reduce demand for energy at a lower cost than alternative energy can supply it. The somewhat intuitive conclusion was that energy efficiency gets a bigger bang for the buck, in terms of greenhouse gas emission reductions and may explain some of the recent investor enthusiasm for this sub-sector.

### **Retrofitting Your Portfolio's Utilities Exposure**

All major investor-owned California utilities (SDG&E, PG&E, Southern California Edison) will miss the 2010 Renewable Portfolio Standard (RPS) that calls for 20% of electricity to come from renewables, according to a recent report by Black & Veatch. The report states that generally utilities are making the effort, but it takes a long time to build the new infrastructure, especially the transmission lines.

In some other parts of the country, utilities might not be doing as well on the carbon reduction front. A recent study conducted by Carbon Point, marked The Southern Company, American Electric Power, and Duke Energy as having the greatest carbon risk. Assuming a future cost of carbon credits of \$15/ton and factoring in the free allowances the companies are expected to get under current proposed legislation (which is looking less likely to pass in the short-term), Southern would have to pay about \$393 million a year, to offset its carbon emissions.

On the other end of the spectrum, PG&E would likely see gains from carbon cap and trade legislation. Other beneficiaries would be Exelon and FPL (I should note that we are not likely to invest in Exelon, as we are not big fans of nuclear power expansion).

Utilities are valuable portfolio holdings as they tend to be less volatile than the market and pay consistent dividends. As green investors, we are interested in the cleaner utilities, which we think have lower risk than their industry peers and will play a key role in a greener economy.

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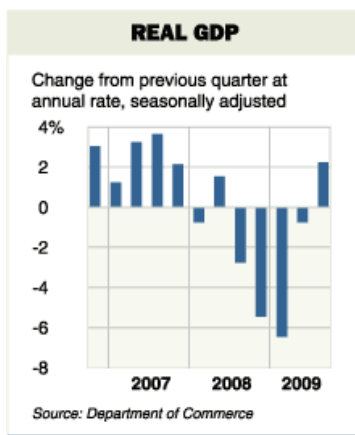
## Financial Markets Data

### Performance as of 12/31/09

	quarter	yr-to-date	1-yr	3-yr avg.
S&P 500 Index	6.04%	26.46%	26.46%	-5.63%
MSCI World Index	6.35%	31.49%	31.49%	-6.62%
KLD Global Climate 100 Ind.	2.60%	31.06%	31.06%	-1.14%
WilderHill Clean Energy Ind. (PBW)	1.29%	27.61%	27.61%	-14.04%

All returns are Total Return, with the exception of MSCI World Index and PBW returns, which are Price Return.

## Economic Indicators



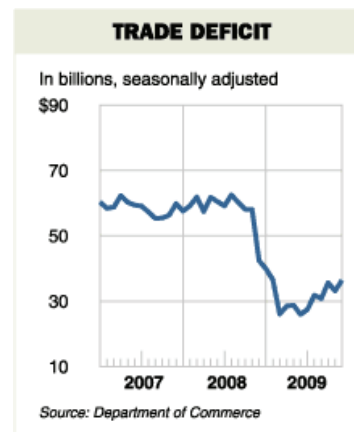
Q3: 2.2%



December: 10.0%



December: 52.9



November: \$36.4 billion

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