JPS Global Investments—The Quarter in Review

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Market Summary

The stock market lost its confidence during the second quarter of the year and experienced its first down quarter since March of 2009. The S&P 500 Index ended the quarter 13% below where it started. May and June were the culprits, accounting for a 15% drop in the index. The chorus of economists, politicians, business leaders, and journalists, who were expressing pessimism in the pace of the recovery, grew ever louder. In that environment, investors didn't need much of a catalyst to step on the brakes, but they were given plenty: a European sovereign debt crisis, the "flash crash" (electronic trading systems caused the Dow to fall 700 points in 8 minutes), a terror plot, and the BP disaster.

The European fiscal crisis continued to escalate, with not only Greece, but also Portugal, Ireland, and Spain (unflatteringly referred to as the PIGS), continuing to unnerve creditors. Moody's downgraded the sovereign debt of Greece and Portugal, and put Spain on review for a possible downgrade. Granted, Moody's didn't surprise anyone with these moves, nor does it have complete credibility following its massive failure to accurately rate mortgage backed securities. However, on balance it is still a negative for the European economic outlook.

If Europe wasn't enough to push markets over the edge, we had to absorb the news of a foiled Times Square bomb plot and a gushing oil well 5,000 feet below sea level in the Gulf of Mexico. The latter exposed how incredibly unprepared both BP (and likely any other oil company) and the government were, to deal with a major disaster of this kind.

If investors aren't ready to feel comfortable with "the basics" and energy/commodity price pressure is low, green investing is not going to shoot out the lights. Selling the bad news, however, doesn't make for a sound investment strategy, in my view. Once the bad news has occurred it is usually too late. Besides, a knee jerk reaction to market news can hurt a portfolio significantly, because volatility implies big moves in both directions.

I think the right attitude to have in this market, is to have low expectations for performance in the short-term and be on the look-out to pick up stocks that have become really cheap. Over time, those bargains will pay off in a diversified portfolio.

Sustainable Investing Update

Mid-Year Solar Update

The first quarter was terrible for solar stocks. The second quarter continued the sector's slide, until early June, when solar stocks began an ascent. As measured by the Claymore/MAC Global Solar Index, the sector is approximately 25% off its June 7th low, through July 21st. One should keep in mind, however, that the sector is still 25% below where it ended 2009. A recent catalyst has been strong demand from Germany, where projects are rushing to get funded prior to the end of 2010, as feed-in tariffs there will be less attractive in 2011 and beyond.

The Tier 1 solar companies are finding that their production for 2010 is sold out, which is certainly providing support to their stock prices. However, 2011 does not look as pretty. Greentech Media Research, projects a capacity of 16.1 GW by the end of 2010. Capacity will continue to outpace demand in 2011, leading to a possible overcapacity of as much as 10GW for 2011 (GTM Research). This will put pressure on module prices, which might need to reach $1.4/watt for supply and demand to clear (GTM Research). At that price, some of the weaker players will fold and consolidation will take place. Though a medium-term challenge to solar, it will push solar PV to parity with other sources of electricity generation, which in turn will unleash demand.

So who are the winners in the 2011 environment? We think those companies with low manufacturing costs, market leader positions, vertical integration to the project level, and scale in attractive markets such as Italy (high insolation, high feed-in tarrifs, high electricity costs), will gain at the expense of the weaker players. We also think there will be some significant price volatility as the industry goes through this challenging phase, which could lead to attractive buying opportunities for our solar stocks. As far as existing holdings, that means SunTech and First Solar. We also have our eyes on Trina Solar, Wall Street's favorite, but it needs to fall from grace a bit first.

BP

What are the lessons to be learned from the BP oil spill in the Gulf of Mexico? Asking that question implies that there is something good that can come out if it; some lessons to be learned. However, if that is the only way we can learn, I am not very optimistic about the future. The BP story has been well published and there is not much for me to add in terms of the magnitude of the tragedy and the sequence of events. I will therefore restrict my comments to the perspective from which we look at stocks: risk and return.

There is no better example of what environmental risk means and why investors need to consider it. Going into the quarter, BP was worth $180 billion, coming out of it, the value had been halved to $90 billion. To put that into perspective, that loss in value is on the order of magnitude of the total market cap of countries such as Greece, Portugal, and Austria.

According to the Occupational Safety and Health Administration (OSHA) BP committed 760 "egregious, willful" safety violations, while Sunoco and Conoco-Phillips each had eight, Citgo had two and Exxon had one comparable citation (ABC News, May 27, 2010). If you look back at the stock valuation prior to the spill, you would conclude that BP's elevated environmental risk was not reflected in the stock valuation, and investors paid for that.

Though this might be an "aha" moment for savvy investors, I am not convinced it will boost the green economy per se. I agree with New York Times reporter Robert Friedman's assessment that "so far, [the administration's] policy is [to] think small and carry a big stick," failing to parlay the momentum of public anger into a bold strategy to end our country's oil addiction.

Tesla

JPS is not an investor in Tesla, but the IPO has generated quite the buzz on the green investing circuit, so I almost feel obliged to talk about it. Looking at the stock chart for Tesla, one could conclude that investors drive the stock like the owners drive the car: rapid acceleration and deceleration, combined with lots of tight turns. Perhaps they are the same people.

Benjamin Graham (famed value investor), stated that the market in the short-term is "like a voting machine–tallying up which firms are popular and unpopular. But in the long run, the market is like a weighing machine–assessing the substance of a company." Certainly, Tesla has a shot at winning the beauty contest, or popularity contest here in the short-term. What I am less sure about is if this luxury car maker will be successful long-term at transforming into a maker of mass-produced cars, which is where it tells investors the bacon is.

I would like to see them reach a few more milestones, before making a commitment. Will I miss some of the upside? In the end, if they are successful "yes." But at the same time, I will miss the downside too, if things don't work out as planned and investors get disappointed.

People love fast cars. Add some glitzy Silicon Valley eco-inspiration to it and you have something many can get excited about. Then park a few Tesla Roadsters in downtown Manhattan for the company's NASDAQ debut and you have a formula for success.

When Krispy Kreme Donuts went public in April of 2000, many on the floor of the NYSE were excited and gorging on free donuts that were delivered for the occasion. In August 2003, the stock reached a high of $44 up almost 350% from where it started. Today, it trades at $3.37, 92% off its high. Is that a fair comparison? Probably not. What it does show however, is that temptation can be a dangerous thing.

Carbon Politics

It is undeniable that the green sectors are influenced to a large extent by what happens in Washington. As the old energy economy is heavily influenced by government policy and vice versa, so is the new energy economy. Not having a national energy policy that is reliably supportive of alternative energy and energy efficiency, is the largest headwind the green economy faces. Consequently, many green investors are deeply concerned with what the November elections might bring.

In California, Proposition 23, sponsored by Valero Energy and Tesoro, two large Texas refining companies, would essentially suspend AB 32, the State's Global Warming Law, on grounds of the alleged correlation between unemployment and environmental legislation. This seems odd, considering that some of the developed countries that currently have the lowest unemployment rates also have the most stringent environmental laws (Germany, Sweden, Holland, for example).

Nonetheless, Prop 23 is a dark and ominous cloud as it is cleverly written to suggest it promotes jobs, which is the number one issue for voters (and rightfully so).

On the Federal front, the Kerry, Lieberman, Graham climate change bill, is now just the Kerry-Lieberman bill and few in Washington give it much of a chance of passing. Senator Reid announced on July 21st that cap and trade legislation, even a limited version that would only apply to the electric utilities sector, is shelved indefinitely, and will not be part of pending national energy legislation.

I hold out a sliver of hope that the increasing lobbying clout of alternative energy companies and the prospect of green jobs, will create some bi-partisan appetite for the carrot (supporting alternative energy and cleantech), if not for the stick (punishing traditional fossil fuel energy generation and imposing carbon caps).

Though legislation would provide a big boost, regulation is farther along. The U.S. Environmental Protection Agency (EPA) recently announced it will expand permitting requirements starting July 2011 under the Clean Air Act to cover all new facilities with greenhouse gas (GHG) emissions of at least 100,000 ton per year and modifications that increase GHG emissions by at least 75,000 ton per year. The EPA estimates that approximately 900 additional permits covering new generating capacity and 550 permits covering existing capacity will need to be obtained as a result of the ruling.

As the EPA and the States become more proactive on the regulatory front, the business community will become more supportive on the legislative front, as they will see the writing on the wall and conclude it is in their best interest to have a seat at the table. Assuming that the era of externalizing environmental costs is drawing to a close, businesses will likely be better off with a clear national policy, as it will assist them in making informed capital investment decisions that might otherwise be shrouded in uncertainty.

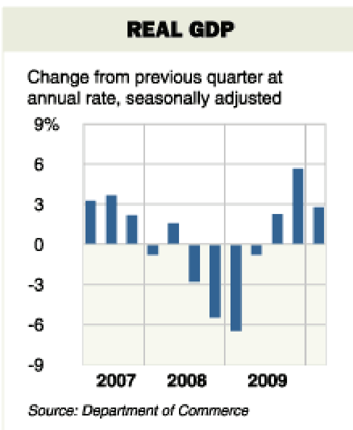
Financial Markets Data

Performance as of 6/30/10

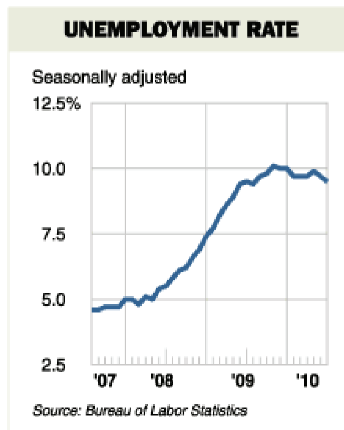
	quarter	yr-to-date	1-yr	3-yr avg.
S&P 500 Index	-11.43%	-6.65%	14.43%	-9.81%
MSCI World Index	-12.74%	-10.42%	9.53%	-12.45%
KLD Global Climate 100 Ind.	-12.20%	-12.14%	5.44%	-9.23%
WilderHill Clean Energy Ind. (PBW)	-17.07%	-24.91%	-18.06%	-26.52%

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

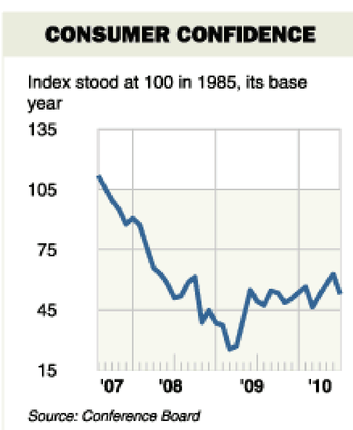
Economic Indicators



Q1: 2.7%



June: 9.5%



June: 52.9

May: $42.3 billion

