JPS Global Investments—The Quarter in Review

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Market Summary

"Beware for the Ides of March," advice Julius Caesar did not take to heart, resulting in his untimely death. Mid-March, stock market bears might have dismissed any chance of a strong first quarter for the markets in 2011; time was running out. From the beginning of the year through mid-February, the major indices were up in the 6-8% range, but those gains were subsequently erased. However, the second half of March saw a sharp reversal of fortunes, and as a result the S&P 500 index and the Dow Jones Industrial Average finished the quarter up 5.42% and 6.40%, respectively. It was the Dow's best first quarter in 12 years.

International markets lagged, delivering a 3.36% return, as measured by the MSCI EAFE Index (Europe, Australasia, and Far East). This return can be mostly attributed to the weakening dollar as in local currency terms the index was essentially flat. Considering what the world had to go through, this is an entirely respectable showing.

As the conflict in the Middle East escalated beyond the largely peaceful transition in Egypt to other parts of the region and turned more deadly and uncertain, specifically in Libya, oil prices started to rise. Though Libya controls less than 2% of daily production, it was a stark reminder of the limited extra production capacity available to the global economy and the outsized importance of the Middle East with respect to oil supply. A reminder that we need to double down on our efforts to develop renewable fuels, I believe.

When the earthquake struck Japan on March 11, oil prices had risen almost 25% in just 3 weeks. Understandingly so, the world's attention quickly shifted East. Japan suffered its worst crisis since the end of World War II. The suffering and destruction caused by the combination of a massive earthquake, tsunami, and nuclear disaster in the same category as Chernobyl, has yet to be fully comprehended. One cannot but admire and empathize with the Japanese people for their courage and their collective ability to absorb such immense suffering yet not lose their capacity to put society before self.

On a financial level, Japan stabilized remarkably quickly from the initial shock. The Nikkei Index lost 16% in a matter of days, but rebounded 13% from its low, to close out the quarter 5% below where it was before the earthquake struck. The G-7 (the seven richest economies) intervened in the currency market on behalf of Japan to dampen the excessive demand for the yen. Such currency intervention had not happened in over a decade.

Worries that Japan's critical role in certain high-tech industries would result in global supply chain disruptions did not rise to the level of posing a threat to the global economic recovery. Japanese companies, trading partners, and governments rose to the occasion, this in stark contrast to the bungling of Tokyo Electric Power (TEPCO) at the managerial level. Granted, the real question that (green) investors will be asking is not just whether other nuclear power plants are better situated, managed, and maintained, but whether nuclear

power should play an expanded role in the future energy mix at all. The appetite for nuclear power suffered a major blow and, in my view, spending capital on making nuclear power "safe" might be better spent on making more benign sources of renewable energy viable.

Sustainable Investing Update

California's Solar Ambitions

On April 12th, Governor Jerry Brown signed California's 33 percent Renewable Portfolio Standard into law. This sets the stage for investor owned utilities to ramp up their renewables portfolios from the current 18% to 33% of electricity generation.

What might seem surprising, is that approximately 50% of California's current renewable energy generation (excluding nuclear and large hydro) comes from geothermal, 36% from wind, 7.5% from biomass, and less than 1% from solar. This does not factor in solar that may reside outside of the utilities' generation assets, such as modules installed on rooftops by property owners. Regardless 1% is a very small number, considering all the media coverage solar energy receives. However, this might be an enormous opportunity for solar; in other words, rather than the glass being half full, it is only 1% full and there is lots of room for growth. In fact, according to data from the California Public Utilities Commission, 57% of approved but not yet built utility renewable projects are for solar. Similarly, 55% of proposed, yet to be approved projects are for solar.

The utility-scale solar pipeline breaks down approximately 50/50 between photovoltaic solar and solar thermal. In addition to the State of California, the Department of Energy (DOE) has not been afraid to commit either. On April 18th, the DOE gave a $2.1 billion loan guarantee to Solar Trust/Solar Millenium, for the world's largest proposed solar plant. The loan will help fund the first 484 Megawatts of a 1 Gigawatt solar project near Blythe, in Riverside County. In the same vein, BrightSource Energy, received a $1.6 billion loan guarantee for a 370 Megawatt solar thermal tower system near Ivanpah and SunPower received a loan guarantee for its 250 Megawatt California Ranch project near San Luis Obispo. Though these loan guarantees are conditional, they are a big step in getting the projects off the ground and attracting additional capital. Contrasting these positive developments against the headwinds faced by solar companies due to uncertainties in Europe surrounding subsidies, increased competition and pricing pressure from China, and a possible supply/demand imbalance, makes it a challenging sector to invest in. However, we believe that this uncertainty also creates attractive buying opportunities, with the potential for long-term gains accruing to patient investors.

China Cleantech: A Double Edged Sword?

Much has been made of the renewable energy and clean technology targets that China has adopted in recent years and the speed and determination with which the country has incepted entire industries in this space. China's 12th Five-Year Plan has climate change highlighted as the top environmental issue to address and includes targets for the reduction of energy intensity, the increase of renewables as a percentage of the energy mix, and the increase in forest cover, among other goals. As Thomas Friedman of the New York Times has frequently eluded to, China is not just motivated by environmental sensitivities, but also by a raw desire to establish a leadership position in emerging industries and beat the West at innovation.

Admittedly, I have been one of those enthusiasts touting the potential of cleantech investing in China. In the solar sector, China has a clear lead in pricing, which should not be a surprise to anyone. In the wind sector, China installed 16GW of wind power in 2010 to overtake the US in terms of total installed capacity with 41.8GW vs 40.2 GW for the US. Once China passes anyone, anywhere, there is no catching up.

Invariably, one would be led to conclude that investing in green stocks in China makes a lot of sense. On a macro level, I believe this is true.

However, as is the case with so many things, the devil is in the details. It might be hard to pick the Chinese winners, without having a full understanding of the domestic dynamics of regional and national competition, politics, and corporate culture. In other words, not all Chinese green stocks are going to be home runs and local expertise might need to be consulted to level the playing field for non-China based investors.

One strategy to counter the risks of investing in China directly, might be to invest indirectly by buying stock of non-Chinese companies that are active in China through partnerships with local companies or with local manufacturing capabilities. Being one step removed, might increase transparency and diversification, yet maintain exposure to the macro opportunity that is "China Cleantech."

Again, however, the devil is in the details. Chinese partners might have different goals than their foreign counterparts. Building national champions involves "winning." Perhaps in that light, a partnership is more something necessary and temporary rather than strategic and long-term. To give you a sense of what that might mean, I will highlight a painful experience we had to go through with one of our wind sector stocks, losing 50% of its value in an instance, as a result of its China dealings.

Sinovel, one of the largest wind turbine manufacturers in China, produces turbines based on the designs and components of American Superconductor (AMSC). In early April, AMSC announced that Sinovel had decided to refuse contracted shipments of wind-turbine core electrical components and spare parts for its 1.5 and 3 MW turbines, reducing its expected fourth fiscal quarter revenue to $42 million from a consensus forecast of $119 million. Furthermore, AMSC is reviewing $56 million in accounts receivable from unpaid shipments in the second, third and fourth quarters of fiscal 2010.

The announcement dropped a bombshell on investors and it looks like it might have surprised AMSC as well, as one of its largest shareholders and arguably a knowledgeable insider, was loading up on the stock just days before the announcement.

Interestingly, on Sinovel's website there is not a single mention of its partnership with AMSC, nor anything related to this issue. Under "Products" on its website, Sinovel shows its 1.5, 3, and 5 MW turbines. Recurring key words and phrases in its product descriptions are "independently developed" and "fully independent intellectual property rights," discounting to zero AMSC's contribution to its success. Though the jury is still out on the details, the term "partnership" does not seem the right descriptor. No matter how great the opportunity, investors are wise to temper their enthusiasm with stories such as this one, which might turn out to be endemic rather than incidental in regard to the Chinese Green Economy.

Green Offense vs. Defense

One of the key decisions a green stock portfolio manager has to make, in my view, is whether to tilt the portfolio towards the more "high octane" industries such as solar, wind, and other renewables, or whether to tilt more towards "defensive" green industries such as pollution control, waste management, and water. One way to track the results of that decision, is to compare the performance of the Ardour Capital Global Alternative Energy Index against a basket of exchange traded funds (ETFs) that diversify beyond renewable energy to include the aforementioned more defensive areas of the green stock universe.

For this comparison, our basket is made up of the following three ETFs: FTSE Environmental Technologies 50 (50%), Claymore S&P Global Water (25%), and Market Vectors Environmental Services (25%). On a year-to-date basis, Defense is winning the game, with the broader, more defensive basket up 4.34% through April 21st vs. 3.75% for the Global Alternative Energy Index. Granted, we still have 70% of the year to go, so a lot can happen before this score is settled.

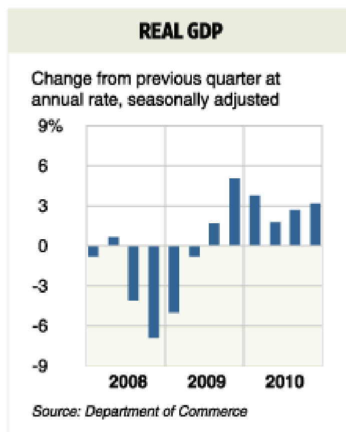
Financial Markets Data

Performance as of 03/31/11

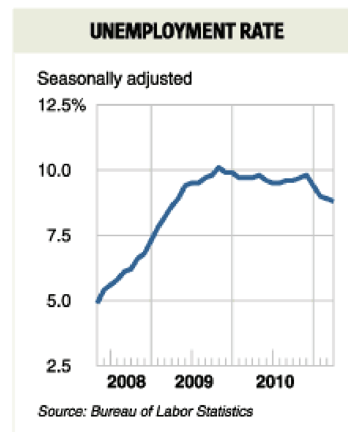
	quarter	yr-to-date	1-yr	3-yr avg.
S&P 500 Index	5.92%	5.92%	15.65%	2.35%
MSCI World Index	3.93%	3.93%	11.79%	-1.90%
KLD Global Climate 100 Ind.	7.28%	7.28%	14.68%	0.70%
WilderHill Clean Energy Ind. (PBW)	3.66%	3.66%	8.13%	-18.19%

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

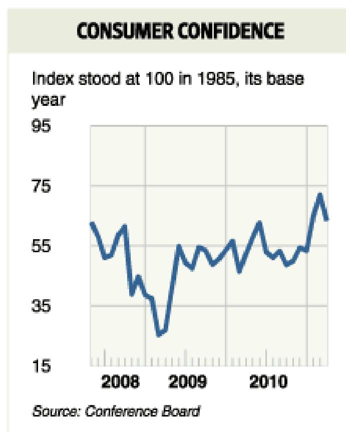
Economic Indicators



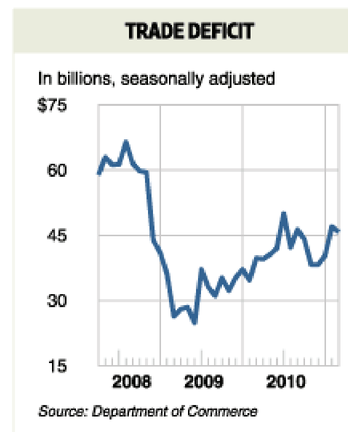
Q4: 3.1%



March: 8.8%



March: 63.4



February: $45.8 billion

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