



## JPS Global Investments—The Quarter in Review

July 2011

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### Market Summary

When the markets set sail for the 2<sup>nd</sup> quarter of 2011, the S&P 500 Index stood at 1,325, at the close of the quarter the price level was 1,320: a decline of 0.4%. Though this anemic price change suggests a calm sea, that assessment could not be farther from the truth. Any investor who was trying to hold a steady course through this quarter, was certainly tested.

If a regular reader of financial reports, you may be familiar with the term “risk on, risk off,” describing investors’ substitution of risky assets such as stocks, commodities, and corporate bonds for risk-averse assets such as Treasury bills and the dollar. This reduces any diversification benefits of holding different types of assets and results in a whipsaw pattern of price movements based on the sentiment of the day. In fact, the term “sentiment of the day” is probably grossly understating the speed at which risk appetite changes on Wall Street, with high frequency traders aiming at trading speeds of a pico-second, or one trillionth of a second. It is my understanding that they are not quite there yet.

Even the Pros realize that the current environment is a difficult one in which to make money. Goldman Sachs reported that its second quarter revenue from trading bonds, commodities, and currencies fell 53% from a year ago. This is not so much the result of a deterioration of skill level, but rather a diminished appetite for putting money at risk. In a broader context, trading volumes on the New York Stock Exchange and the Nasdaq were

down more than 30% in the quarter compared to a year ago. Rather than an indication of reduced greed and short-termism, it is more a reflection of investors fleeing to the sidelines, unable to find bandwagons to jump on to.

The real sovereign debt crisis across the Atlantic and the fabricated, but nevertheless really dangerous debt ceiling crisis in the US have been discussed ad infinitum in the press and I feel I do not have a fresh contribution to make to that discussion today. Suffice it to say that if either of these lingering stories takes a turn for the worse, we might see severely adverse reactions in the financial markets. To quote Larry Summers, former Secretary of the Treasury, and Ben Bernanke, the Fed Chief, on the failure to raise the debt ceiling: “It would cause a cascade that makes Lehman Brothers look like a very small event” and “[it would be] a calamitous outcome.” These gentlemen are generally even-keeled and not your typical doom & gloom characters, so let’s hope Congress heeds their warning.

Turning to the green economy sectors, they participated in the “risk-off” declines, but unfortunately not in the “risk-on” rebounds. The WilderHill Clean Energy Index, comprised of renewable energy and clean technology companies, declined by 16.1%. The decline was broad based, extending beyond the recently troubled wind and solar sectors to LED lighting, materials, and smart grid. In this context, one has to temper short term expectations for green stocks. I continue to believe in the long-term potential of these sectors, however. As we sow the seeds for financial success

with our “buys” we are aware that the harvest of our “sells” remains largely on the horizon and patience much prevail.

### **Sustainable Investing Update**

#### **Natural Gas - Is it Green?**

Is natural gas a viable bridge energy source in the transition to a low carbon economy? This is a question that invariably surfaces in the world of green energy investing. As so often is the case, the answer is neither a resounding “yes” nor a dismissive “no,” but rather a “maybe, but.” What is undeniable, however, is that it will take time for renewable generation to ramp up, and as such fossil fuels will continue to be a large component of the energy mix for the foreseeable future. Therefore, in my view, it makes sense to substitute natural gas for coal from both an energy security and carbon reduction vantage point. In the US, natural gas would be a domestic fuel source and it has about half the carbon content per unit of energy as coal.

In the United Kingdom’s power generation sector, greenhouse gas emissions in millions of tons of CO<sub>2</sub> equivalent, dropped 28% from 1990 to 2009, according to the UK Department of Energy and Climate Change. Some of the core contributors to that decrease are an increased use of gas powered plants as a result of the “Dash for Gas” in the 1980s and early 1990s, an increased use of nuclear in more recent years, and the 2008-2009 economic downturn. Assuming that there is little appetite for more economic downturns and nuclear energy (at least in the Western economies), natural gas becomes appealing.

In the US, shale gas is transforming the supply dynamic of the natural gas industry. Though the supply and proved reserves have become untethered from their historic trajectories, new demand has not grown at the same pace, resulting in gas prices that are near historic lows. This in turn, should lead to demand creation. As an environmentally conscious, or opportunity-driven but risk-averse green investor one should be very careful when investing in the shale gas boom.

To understand the environmental risk and impact, one has to understand the process of shale gas extraction: large amounts of water are pumped into the well to crack the rock and extract the gas; approximately 5.5 million gallons per well according to Chesapeake Energy (equivalent to 8 minutes of New York City water consumption). A “fracking” fluid is used to crack open the gas seams in the rock and allow the gas to flow up through the well.

Though the shale is far below the water table, ground water contamination could happen above ground from either the waste water disposal ponds, accidents with the fluid injections, leaks in the well walls, etc. The industry claims the technology is safe, but it would be naïve to take that as a given in a post-BP Gulf disaster, post-Fukushima world.

There is also a strong grassroots backlash, certainly fueled by not-in-my-back-yard feelings, deep-rooted suspicions of the industry, and media coverage such as from the movie *Gasland*. Nevertheless, the opposition is real and passionate and investors are wise to consider that, prior to investing. That is not to say investors should shy away all together, the macro opportunity is large and the green economy fit, in my view, is there.

Our approach has been to look for a company with a transparent record and culture, a smaller player less likely to have skeletons in the closet, and one that has competitive wellhead costs. We settled on EQT, which we have owned since May of 2009. So far, our investment thesis has panned out nicely, though we remain vigilant of adverse environmental developments on an industry or company level that could change our level of comfort with EQT.

#### **EVs**

About a year ago I wrote a blog post on Tesla’s IPO. At the time, I expressed some reservations about the potential of high-end all electric vehicles. Since then, the stock is up about 50%, though 20% below its November 2010 high. I still don’t feel quite comfortable with Tesla, granted we missed out on a nice run. The company’s sales

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have been increasing steadily quarter over quarter, but so has its net losses. The increased losses are largely a result of increased R&D spending. Losses are predicted to last through at least 2012.

There are some silver linings: Tesla has a \$169 million electric powertrain systems contract with Toyota for the RAV4 EV. Toyota also bought a \$50 million stake in Tesla. Perhaps, the company has a future as an electric drive systems supplier to established car companies. Furthermore, Elon Musk, the man behind Tesla, is a formidable guy to bet against. Mr Musk founded PayPal and certainly continues to dream big, with ventures such as Tesla and Space Exploration Technologies, a company developing commercial space transport.

So what's my problem? Mainly, I am not convinced that electric cars are going to take off just yet. Why would you want to have a car that could strand you on the side of the road when you run out of juice with no charging station in sight? Gas stations are so ubiquitous that you don't really have to map them out along your planned route, before getting behind the wheel. A car like the Chevy Volt has a back-up internal combustion engine, which might make a lot of sense.

The second problem is price. The Nissan Leaf (\$33,000) and Chevy Volt (\$41,000) have reached total sales of 3,708 and 2,745 respectively, since their launch a little under a year ago. The Tesla Model S will cost about \$50,000. Essentially a luxury car price, so the question is how many drivers of higher-end mass market vehicles are willing to make the switch? I checked on Edmunds.com and found 9 makes and 45 models in the Model S' price range. Many of these brands have quite loyal customers. Granted, Tesla has surely done their research, so maybe they are banking on margin rather than volume.

Finally, is an all-electric car really that efficient? A Prius (over 1 million sold in the US to date) has a 1.5 Kwh battery and the current Tesla has a 56 Kwh battery. That's a lot more battery to go from 42 MPG to all-electric. The question is whether it is realistic to put so much battery power onto the

roads, or if the (plug-in) hybrid is actually a smarter, more cost effective solution.

Though we are not invested in Tesla for now, we do have exposure in the space through our investment in BYD in China. They are also in the EV game, but have other lines of business as well, namely cell phone parts & assembly, and rechargeable batteries. Additionally, they are moving ahead with electric drivetrains for buses, which could be a big market. This stock has had a great run up in late 2009, in which we participated, and then a substantial retreat in the last year, in which we also participated, unfortunately. As long-term investors we still believe in the company's potential, though wishing BYD would give us a smoother ride.

### **Energy Efficiency - Indirect Plays**

Smart Grid companies had outshone renewable energy stocks in recent quarters, but during the second quarter they declined roughly by the same order of magnitude as the energy generation companies. The First Trust NASDAQ Clean Edge Smart Grid Infrastructure Index, a proxy for the smart grid sector, was down approximately 6%. Few, if any, themes in the green stock universe seem to be immune from investors' current lack of appetite for the Green Economy. Though this has not deterred us, our recent additions in energy efficiency technologies have been companies that comprise a more indirect exposure to the sector and as such are less likely to be thrown out with the bathwater, as investors are exiting green stocks.

Examples are International Rectifier and Power Integrations, which make efficient power systems & components and ASML, which makes semiconductor manufacturing equipment for Intel's new 3D highly energy efficient chip design. Not only does it make sense from a diversification perspective to go a little more "indirect" in the Smart Grid space, from a technology perspective, Smart Grid overlaps with the semiconductor and power electronics space and should be approached in that context.

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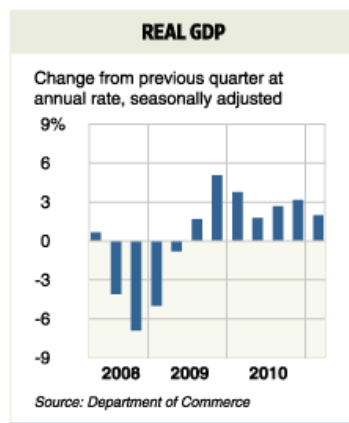
## Financial Markets Data

### Performance as of 6/30/11

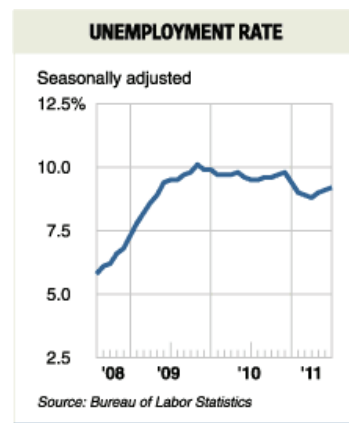
	quarter	yr-to-date	1-yr	3-yr avg.
S&P 500 Index	0.1%	6.02%	30.69%	3.34%
NASDAQ Composite	-0.27%	4.55%	31.49%	6.55%
MSCI World Index	-0.53%	3.38%	27.43%	-1.29%
WilderHill Clean Energy Ind. (PBW)	-16.43%	-13.38%	8.96%	-23.01%

All returns are Price Return, with the exception of S&P 500 Index returns, which are Total Return.

## Economic Indicators



**Q1: 1.9%**



**June: 9.2%**



**June: 58.5**



**May: \$50.23 billion**