



JPS Global Investments—The Quarter in Review

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Market Summary

The best thing to note about the third quarter of 2011 is that it is over. The S&P 500 Index closed at 1,131 on September 30th, down 14.4% from where it started the quarter. Thankfully, thus far October has brought some relief, with markets off their lows, but the future seems no less uncertain.

The talk in business and financial circles is focused on Europe's malaise and whether the economy is going to experience a double dip recession, perhaps of global proportions. Among ordinary citizens, the first dip never ended but the outlook is equally dim. As if the sovereign debt crisis in Europe – the story that will not go away – is not bad enough, investors now have to worry about troubles in Asia as well and whether China's decelerating growth rate can be parlayed into a soft landing or if something more dramatic is in store.

Volatility in the stock market reached heights not seen since March and April of 2009, when the market was near its bottom as a result of the 2008 Financial Crisis and pessimism reigned the day. In that type of an environment, trading is left to the high frequency trading crowd and day traders of various stripes, as other professional and individual investors increasingly remain on the sidelines. This leads to further volatility, as markets become less liquid and buy and sell orders have to move farther up or down to find their match.

At least you can always count on gold to provide a safe haven. Wrong! After setting a new record in

August, gold lost 12% of its value in 5 trading days. The culprits: a reduced fear of inflation, and a demand for cash to meet obligations. Moving away from the dollar in anticipation of the US credit downgrade was also a bad move. The dollar rallied 6% during the quarter and U.S. Government paper somehow became "safer," with yields demanded by investors on the 10-year Treasury falling to a record low of 1.72% on September 22nd.

Investors made approximately \$70 billion in net redemptions from US stock funds during the quarter, making it the 3rd worst quarter for flows in the last 5 years, only eclipsed by the 3rd and 4th quarter of 2008. I point this out, because individual investors have an uncanny ability to do the wrong thing with great consistency. Therefore, observing fund flows can give some insight into what not to do as a long-term investor. Granted, being a contrarian can be difficult in the short-term as invariably more selling leads to further price declines.

The flight from risky assets is not exclusive to mutual fund shareholders, however. Institutional investors have jumped on the risk-off bandwagon as well. The more risky an asset class is perceived, the greater the collateral damage, as the good companies get flushed out with the bad. Small Caps, Emerging Markets, Green Stocks, and Chinese ADRs were the greatest casualties, in that order. "When others are greedy be fearful and when others are fearful be greedy," one of my favorite Buffett quotes. Easy to understand, but oh so hard to follow!

Sustainable Investing Update

Solyndra(ma)

One would be hard pressed to concoct a story that does more damage to the Green Economy's image than the Solyndra debacle: a solar company that squandered a \$500 million taxpayer funded loan, then declared bankruptcy. Much like athletes need to be conscious of their role model status, so too should cleantech executives adhere to high standards of professional conduct, as ambassadors of a new sector that is fighting for acceptance. That point was obviously lost on the C-level team at Solyndra. Granted, the affidavit remains under seal and the CEO and CFO have pleaded the 5th so not all facts are known, but an FBI raid and Justice Department investigation generally don't bode well. Nor does it make sense to have whistling robots and spa showers in a company funded by tax payers and producing negative gross margins.

It is also quite clear that the administration, despite reservations from staff analysts, pushed the \$500 million dollar loan through so Vice President Biden could announce the approval during the September 2009 groundbreaking speech. However, where the opponents of renewable energy loan guarantees are wrong, in my view, is that this case is somehow unique to the solar industry rather than just another example of inappropriate corporate behavior with questionable government involvement and taxpayer money.

Solyndra never had a viable business plan. Its costs were too high, without its products having unique applications that would justify a higher cost. When solar panel price declines accelerated it was essentially game-over for Solyndra, as it was for Evergreen Solar and SpectraWatt. The other loan guarantees are not an apples to apples comparison with Solyndra, however. First Solar, for example, has a 30% operating margin and north of a billion dollars in cash and receivables on its balance sheet. Unfortunately, they had to let one loan application go to the tune of \$1.93 billion, due to increased application requirements that could not be met prior to the September 30th

deadline. Since the scandal broke, First Solar has lost over 40% of its market value, as have several of the other largest solar companies. The silver lining, if one can call it that, is that First Solar did get \$2.1 billion in the last few days of the loan-guarantee program and the Department of Energy showed some spine by sticking with its commitments to these and other projects. What is increasingly clear, however, is that Federal support cannot be counted on for renewable energy projects and successful companies and projects need to pencil out financially without it.

What *can* be counted on, is state-level support through Renewable Portfolio Standards, and rapidly approaching grid parity due to falling panel costs. Unfortunately for some companies (and their investors) but probably healthy for the industry long-term, a brutal shake-out is occurring. The industry in 2015 should be sounder than it is today and stock valuations will likely be significantly higher for the surviving companies.

Fukushima and Efficient Markets

Investors are wise to consider that what they know about a company might only be a small percentage of what there is to know about a company, its industry, and its future. Acknowledging that one has an informational blind spot and that it is hard to ascertain how large that spot is, allows one to conclude that every investment is inherently risky, making it all the more important not to miss the big red flags. With the benefit of hindsight, Tokyo Electric Power Company (TEPCO) clearly threw up some big red flags, yet was not trading at a discount to its industry peers, suggesting that the market is not efficient at pricing in environmental risk.

So what were these red flags that should have been so obvious, you might ask? For starters, in 2002 TEPCO admitted to a 20-year stretch of falsifying nuclear inspection records. That seems like a long enough time period to conclude that deception is part of the company's cultural DNA. Admission is often the first step in the process of improving one's behavior. In the case of TEPCO that did not hold. In 2007 internal investigations revealed

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numerous additional unreported safety incidents, yet no one was held responsible. Then in 2008, TEPCO misled the government about the extent of a nuclear fuel leak at its Kashiwazaki plant.

We all know what happened in 2011. Today TEPCO is trading at 0.24 times its book value. The Yomiuri Shimbun newspaper estimates that TEPCO's liabilities from the accident will exceed \$59 billion and that the company is effectively a zombie company on government life support. The point is not so much the obvious observation that TEPCO turned out to be a lousy investment, but that investors should be on the lookout for the next TEPCO. Scanning your portfolio for environmental risk, might uncover some risky holdings and present an opportunity to sell at a time when the market does not yet discount environmental risk.

Where is the Bottom for Green Stocks?

I wish I had an answer to this question. As measured by the Ardour Global Index – which is made up of companies in clean energy, energy efficiency, and the water sector – green stocks are down 39.8% year-to-date as of September 30th, and 12.3% below their March 6, 2009 low during the darkest days of the financial crisis. It is fair to say that the optimism of the pre-2008 environment for a rapidly developing green economy has faded. Political, economic, and industry specific headwinds have combined into a gale force, hitting green investors head-on. It seems the world's perpetual crisis mode leaves no room for dealing with long-term problems. Who cares about energy security and the health of the planet in 2030, when people are wondering whether tomorrow they will have a euro, an economy, and a job?

That doesn't mean, however, that the towel should be thrown in on investing in the Green Economy. Price-to-earnings multiples in the mid-single digits across entire industries usually spells opportunity. Yes, the next couple quarters look dismal for solar companies, and wind companies, and pollution control companies, as EPA regulations are slowly being dismantled or delayed. Cleantech companies are not immune either, as they tend to be smaller,

have high betas and get lumped together with clean energy. But those circumstances merely create the conditions that allow investors to selectively pick up good stocks of companies that will be around a few years from now and will likely face a better environment (a worse environment is hard to imagine).

Even when taking the view that this time of crisis is also a time of great opportunity, it does not necessarily follow that it is wise to load up on the riskiest of stocks. Yes, these stocks present greater upside than when everybody loved them. However, in times of crisis another group of stocks falls into attractive valuation range: industry-leading blue chips. In *Security Analysis* (1940), Benjamin Graham noted that only in exceptional cases industry-leading, profitable companies can be bought at or below their intrinsic value. I am not saying he would agree that blue chips are exceptionally cheap right now, but they certainly are more attractively priced now than during more "normal" times.

As an example, we recently invested in Siemens. Energy is about a third of that company's revenues and a good portion of that is wind energy, both on land and offshore. Siemens also is a big player in rail transit, including high-speed trains. Recently, it has sold its 34 percent stake in a nuclear-power joint venture with Areva of France, which was the final step in a gradually unwinding of its nuclear business over the last decade. As recently as May, Siemens traded at \$145 per share on the New York Stock Exchange. When the stock dropped below \$100, courtesy of a tough 2011 to 2010 earnings comparison and the Euro crisis, the opportunity seemed too big to pass on.

As the constant crisis ebbs and flows, I am on the lookout for additional companies that fit the Siemens bill, as this might be a unique time to welcome them to the portfolio at reasonable prices. Though as a net buyer of stocks, these are exciting days, I look forward to the day where we can talk about how a strong rally has created rich valuations and stocks seem overvalued. Until then, patience and delayed gratification will have to persist.

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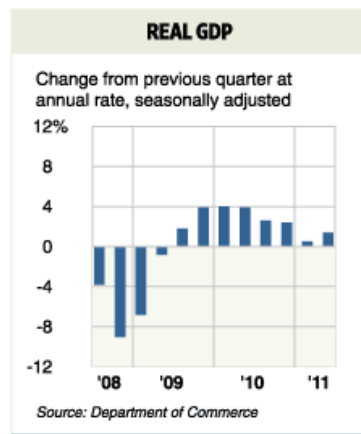
Financial Markets Data

Performance as of 9/30/11

	quarter	yr-to-date	1-yr	3-yr avg.
S&P 500 Index	-13.87%	-8.68%	1.14%	1.23%
NASDAQ Composite	-12.91%	-8.95%	1.97%	4.91%
MSCI World Index	-17.90%	-15.12%	-8.04%	-1.63%
Ardour Global Index (Green Stocks)	-34.80%	-39.83%	-40.08	-28.02%

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

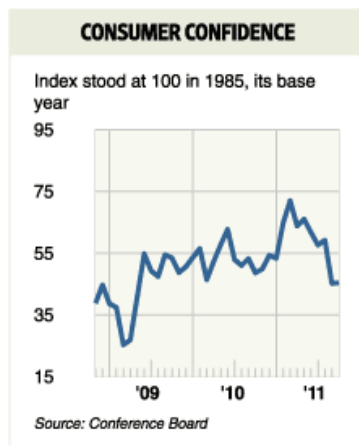
Economic Indicators



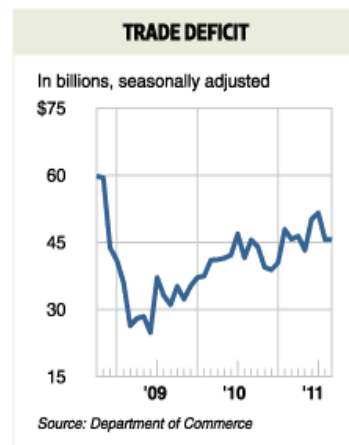
Q2: 1.3%



September: 9.1%



September: 45.5



August: \$45.61 billion