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Global Regulation Trend Favors PowerShares Global Clean Energy

The U.N. Climate Change Panel last year proposed a goal of reducing greenhouse gas emissions 50% by 2050—a reduction believed to forestall temperature increases large enough to cause widespread famines, droughts, species loss and coastal flooding. Achieving that goal would cost more than $45 trillion, according to a report released last week by the International Energy Agency. The job would require massive investments in alternative energies such as wind, as well as construction of around 1,400 nuclear power plants, the report claims. Assuming 3.3% global economic growth between 2010 and 2050, the IEA projects that it would take the equivalent of 1.1% of the world's total GDP to achieve the U.N.'s goal.

If governments and corporations around the world take the goal seriously, the alternative energy sector can expect much of that $45 trillion to be headed its way. PowerShares Global Clean Energy ETF (PBD), which shot up 26 positions on the PowerShares Momentum Tracker in the last two and a half months, offers one of the most expansive takes on clean energy investing. The fund's portfolio recently included holdings from every continent except Antarctica, with around 20 countries represented altogether. About 28% of assets were invested in U.S. stocks and 19% in German shares, while stocks in Spain, China, France, Denmark and Japan each took up between 5% and 10% of assets.

The stocks in PBD's portfolio are very different from those found in conventional energy ETFs. In fact only about 2% of the fund's assets recently were invested in stocks in the energy sector, according to PowerShares. Shares of firms involved in the wind power, solar power, energy storage and biofuels industries make up the bulk of PBD's portfolio, and many of those companies are more associated with the industrials, information technology or utilities sector than energy.

Recent top holding Energy Conversion Devices (ENER), a manufacturer of rooftop solar panels and the nickel hydride batteries used in hybrid cars, typifies the kinds of stocks in which PBD invests. Energy Conversion was primarily focused on research and development until recently, but now the company is trying to transform itself so that it can effectively manufacture and distribute the fruits of its R&D machine. The firm's fiscal third quarter report, released last month, suggests the transition is moving along smoothly: Its solar business saw a 30% increase in gross margin on sales, as investments in production capacity led to greater efficiency. The company's stock rose 90% for the year through June 6. Energy Conversion represents the only U.S.-based stock in PBD's recent top five—the others are European and are primarily involved in the wind power industry.

PBD's international breadth might serve investors well in the near future. For one thing, many of the world's most innovative and fastest-growing alternative energy firms are overseas. Their stocks fly under the radar of clean energy ETFs that invest solely in stocks traded in U.S. markets.

Moreover, foreign governments have pushed investments in clean power more aggressively than the U.S. has. In fact, on the same day the IEA released its report, U.S. senators killed a global warming bill that would have required polluters to purchase permits to produce carbon emissions. Things are likely to change no matter who ends up in the White House next year, but for now it seems unlikely that the U.S. government will help spur any substantial increase in domestic spending on clean energies. And if the U.S. economy continues to drag, PBD's exposure to a range of international markets may help offset losses from domestic stocks.

To understand what makes PBD distinct from other clean energy ETFs, it helps to compare the fund with PowerShares Wilderhill Clean Energy (PBW)—a similar but much more concentrated and narrowly focused fund. PBD's portfolio recently included 88 holdings, with about a quarter of its assets invested in its top 10 stocks. Meanwhile, PBW's portfolio included only 47 holdings, and its top 10 accounted for about 36% of assets.

The funds also differ in the kinds of stocks in which they invest. PowerShares recently classified about 55% of PBD's portfolio in the industrials sector and around 15% in the information technology sector. PBW had only a third of its assets in industrials and almost another third in IT.

The most important difference between the two funds is geographic. PBD is truly global, while PBW invests only in foreign stocks that trade as ADRs on U.S. markets. As a result, PBW recently held only about a quarter of its assets in foreign stocks, compared to PBD's 70%.

So far in 2008, PBD's approach to clean energy has fared better than PBW's. Both funds took massive dives in January, but by June 6, PBD was down only about 8% for the year while PBW had fallen more than 20%. The discrepancy between their performances caused PBD to be ranked 30 spots higher than PBW on the PowerShares Momentum Tracker Table last week.

This week will mark the one-year anniversary of PBD's inception, so the fund still has little history with which to judge it by. One thing that appears certain, however, is that this fund holds the potential for extreme volatility. PBD offers exposure to dozens of up-and-coming clean energy firms that appear to hold great growth potential. But the future of clean energy is likely to be shaped by unpredictable political, environmental and technological developments—so investors would be wise to take a cautious approach.

PERFORMANCE

Period*	Mkt. Return (%)	+/- Index**
1 week	-4.27	-4.16
1 month	+1.08	+1.82
3 months	+13.27	+13.29
YTD	-11.67	-11.17

*Through 6/11/08
**S&P 500
Source: Morningstar

PORTFOLIO

Top Holdings*	
Energy Conversion Devices	3.03%
REpower Systems	2.84%
Nordex	2.78%
Vestas Wind Systems	2.64%
Theolia	2.48%
ErSol Solar Energy	2.46%
Babcock & Brown Wind	2.42%
Zoltek	2.42%
EDF Energies Nouvelles	2.41%
Greentech Energy Systems	2.30%

*As of 6/5/08
Source: PowerShares.com