Excerpt from Seeking Alpha, February 4, 2010
http://seekingalpha.com/article/186721-reviewing-green-etf-performance-for-2009

Reviewing Green ETF Performance for 2009

When we look at the performance of green ETFs in 2009, most rose 30-40%, easily beating the S&P 500's gain of 28.8%, but underperforming the Nasdaq's gains 43.9% and a multitude of individual stocks.

Green stocks that outperformed in 2009 include:

LED Lighting: Cree (CREE) (255%) and Dialight (100%)

Smart Grid: EnerNOC (ENOC) (308%); Comverge (COMV) (128.6%)

Energy Efficiency: Johnson Controls (JCI) (64.64%); Baldor Electric (BEZ) (57%)

Energy Storage: BYD Company (BYDDY.PK) (439%); Maxwell Technologies (MXWL) (252%).

Geothermal Heat Pumps: LSB Industries (LXU) (69.9%); WaterFurnace (WFIFF.PK) (60.22%)

Investors chose "non-traditional" green sectors, buying shares in energy efficiency, grid and energy storage stocks, and even geothermal heat pumps, rather than solar and wind stocks. And this shift is reflected in the performance of the green ETFs.

PowerShares WilderHill Clean Energy ETF (PBW)

PowerShares Global Clean Energy Portfolio (PBD)

The WilderHill Clean Energy ETF (PBW) was the first clean energy ETF - as the first mover, it's the most well known and widely invested in ETF, but its share price rose only 30% in 2009.

PBW invests across the spectrum of clean energy companies that trade on US exchanges, while its sister ETF - Powershares Global Clean Energy Portfolio (PBD) - invests globally. PBD rose 39% in 2009. Both ETFs reached record highs in 2007 and then dropped about 60% in the 2008 crash.

And both ETFs fell prey to shifting investor preferences in 2009.

During the 2008 crash, clean energy stocks suffered as nervous investors shied away from young, high-growth stocks in capital-hungry sectors. Confidence recovered in 2009, but investors steered clear of many solar stocks because of concerns about over-supply and the steep drop in prices. Wind stocks did somewhat better, but also lagged because of their exposure to the credit crunch.

In 2009, the outperforming clean energy subsectors were energy storage (batteries, electric cars) and smart grid, which were new areas for significant government support. In a year when government stimulus programs were the backbone of the economy, that's where the investors were.

Thus, the clean energy sector as a whole - unlike previous years - didn't move as one unit. The industry's subsectors are becoming substantial and deep, and we expect greater variability between them going forward.

Taking PBD as an example, Energy Storage stocks were the stars, rising 120% on average in 2009. BYD Company (a Warren Buffet investment on the Hong Kong exchange), which makes batteries and electric cars, soared 439%, and ultracapacitor manufacturer Maxwell Technologies advanced 252%.

Energy efficiency/smart grid stocks rose 48%, led by Taiwan-based Epistar with a 315% gain, and US companies EnerNOC and Cree, which rose 308% and 255% respectively.

Solar stocks gained 30% on average even though the group contained the index's five worst performers: US-based Energy Conversion Devices (ENER) fell 58.1% and Germany's Q-Cells (QCLSF.PK) fell 54.3%. Wind stocks gained 36% on average.

Thus, PBD lost out on investors' shift toward energy storage and efficiency stocks because the index is heavily weighted toward solar and wind: it contains 9 energy storage stocks, 17 energy efficiency stocks, 25 solar stocks and 18 wind stocks.

Four stocks were added in the quarterly index reshuffle, including newly listed energy storage firm A123 Systems (AONE) and wind project developer China Longyuan Power. Among the five stocks that were dropped were Evergreen Solar and troubled wind developer Theolia.

Don't count these ETFs out going forward however - 2010 could be a banner year for clean energy companies in general, including solar and wind. The top 10 holdings are quite different between PBW and PBD, but both include compelling companies across all the clean energies - American Superconductor, Cree, Trina Solar (TSL), Ormat, Itron (ITRI) - all stocks on our "short list" and poised for strong performance in 2010.

Major economies pledged about $200 billion in clean energy stimulus funds, much of which will hit company coffers in 2010 and 2011. Those that gain the most will drive share price performance in the months ahead.

PowerShares WilderHill Progressive Energy (PUW)

The lesser known PUW has actually been the best performer of the WilderHill indexes. The ETF, which gained 61% in 2009, consists of transitional technologies that improve the use of the dominant conventional sources we use today (coal, oil, natural gas). The companies in the index help de-carbonize polluting energy sources by cleaning them up, reducing emissions and making them more efficient.

Although renewable energy stocks have the most sex appeal, PUW gives investors exposure to more nitty gritty companies that are making materials lighter, recycling batteries, building the smart grid, efficient lighting - in other words, everything *except* renewable energy.

PowerShares Global Progressive Transportation Portfolio (PTRP)

September 2008 was a tough time to launch a new ETF, just preceding the market crash! But in a year when the US made its first serious commitment to upgrading the nation's rail system, PTRP rose 52%.

The index invests in innovative, energy efficient transportation - businesses that stand to benefit substantially from a societal transition towards cleaner, improved means of moving goods and people. It emphasizes solutions that make both ecological and economic sense and includes stocks around the world.

You'll find a combination of modern high-speed rail technologies and old-line railroads and many of the exciting newcomers in alternative vehicle technologies, from bicycles to advanced batteries and electric car-makers.

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Conclusion

If you're very familiar with the individual companies in the field, look carefully at the ETFs' holdings to choose between them. Look at the mix of large and small companies in the fund - does the fund emphasize large or small caps? Smaller companies are more volatile, but have the potential for higher returns. Pick funds that match your comfort level.

And look at the weightings of individuals stocks - more concentrated funds - which contain fewer, heavily weighted stocks - outperform only if those top stocks happen to be winners.

Also consider sector weightings - is the fund heavily weighted toward solar, when you expect batteries and smart grid to outperform?

If you're not very familiar with the companies/sectors, hedge your bets by buying small amounts of several funds including more general (clean energy) and more specific funds (solar). As with mutual funds, review the long term performance, not just one year. You might want to stick with funds that have been around longer and have more assets - there's a reason why some ETFs are more popular than others.

All the funds we talked about will give you strong exposure and good diversification within their sectors, and most beat the S&P for the year.

Even though a fund outperforms one year, that doesn't mean it will outperform the next. For example, since most well-established clean energy players aren't in the US, domestic-only funds contain a greater percentage of more volatile stocks. That means US funds tend to outperform in good years, and under-perform in bad. While PBW underperformed nearly all the global funds in 2008, it outperformed the three global funds in 2007.

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