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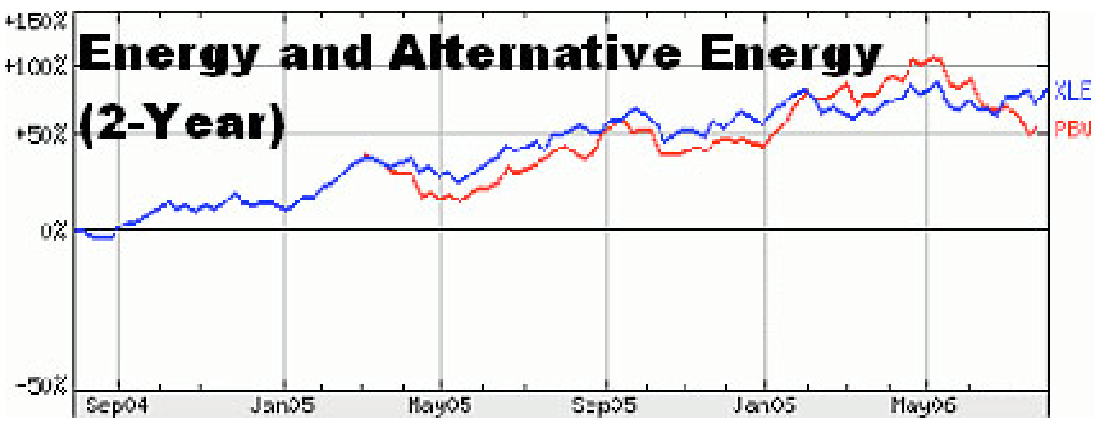
Good Time To Get Into Clean Energy ETF

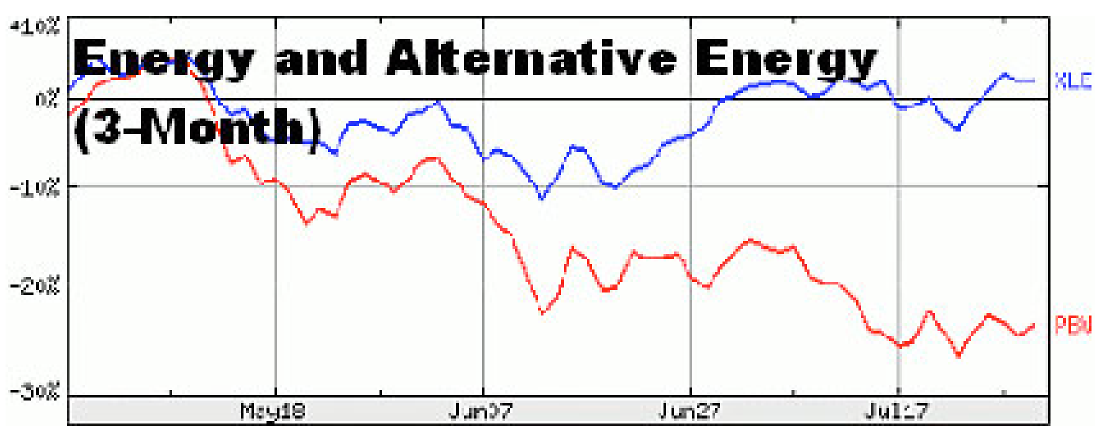
Jonathan Bernstein, ETFZone 08.02.06, 6:00 AM ET

Historically, the alternative energy ETF **Powershares Wilderhill Clean Energy** has traded in tandem with more traditional oil- and gas-focused energy funds. But over the last three months, this has changed.

While traditional energy ETFs have outperformed the market, **WilderHill Clean Energy** (amex: PBW - news - people) has sold off sharply. This recent divergence may provide investors with an opportunity to diversify by adding PBW to a portfolio of conventional energy assets.

The two charts below compare the performance of alternative energy PBW with the more traditional **Energy Select Sector SPDR** (amex: XLE - news - people). The first chart compares the two on a two-year basis. The second chart compares the two on a three-month basis.





As the charts above show, PBW has fallen sharply over the last three months. XLE is close to unchanged but still has outperformed market benchmarks, down 2% to 5% during this period.

Although technically they have demonstrated similar performance (presumably because both benefit from higher oil prices), fundamentally the energy and alternative energy industries, as represented by XLE and PBW, have some key differences that affect performance.

First, XLE holds some of the largest companies in the world--vertically integrated and diversified oil majors like **Exxon Mobil** (nyse: XOM - news - people) and **Chevron** (nyse: CVX - news - people). By contrast, PBW holds some of the smallest companies in any ETF, and some of the smallest publicly traded companies period. Two of PBW's top ten holdings, **Mechanical Technology** (nasdaq: MKTY - news - people) and **UQM Technologies** (nyse: UQM - news - people), have less than $100 million in market capitalization. In fact, the combined market cap of the top ten holdings in PBW is under $5 billion, and half of that is from a single company, **International Rectifier** (nyse: IRF - news - people). By contrast, Exxon, the largest holding in XLE, has a market cap of $400 billion.

Second, companies held in XLE are some of the most profitable and cash-rich companies in the world, with Exxon, for example, earning about $10 billion a quarter lately. By contrast, most companies in PBW are losing money, and on very little revenue.

Third, PBW is invested almost entirely in highly experimental, technology-focused companies. While these small companies, like the oil majors, stand to benefit directly from higher oil prices, even more important for their success are regulatory changes, subsidies and a more global perception of the need for alternative energy solutions.

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In the current environment of decelerating growth, higher inflation and war, a defensive growth sector fund like XLE, with exposure to crude, clearly remains a core holding for investors. But high oil prices and the increasing importance of alternatives to conventional energy sources make the development of new technologies inevitable. A right-sized investment in PBW at these levels makes a good complement to a traditional energy portfolio.