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Getting Your Alt. Energy Portfolio in the Sweet Spot

Tom Konrad (AltEnergyStocks) submits: Mutual funds are often touted as an inexpensive way to achieve diversification.

With declining brokerage commissions, this is often no longer true. If you are interested in investing in alternative energy, is a mutual fund or ETF right for you?

Here are the currently available mutual funds and ETFs of which I'm aware with alternative energy type themes:

Fund Name	Emphasis	Mgmt Style	Turnover	Ticker	Load?	Expense Ratio
Guinness Atkinson Alternative Energy	Alternative Energy & Energy technology; International	Active	22%	GAAEX	No-load	1.98%
New Alternatives Fund	Renewable Energy & environment	Active	40%	NALFX	�4.75% under $25K	1.25%
Powershares Cleantech Portfolio	CleanTech	Index	low*	PZD	ETF	0.70%
Powershares Wilderhill Clean Energy	Greener and Renewable Energy	Index	6%	PBW	ETF	0.71%
Powershares	Nuclear and	Index			ETF	

Wilderhill Progressive Energy Portfolio	Advanced Fossil Fuels	low*	
		PUW	0.70%

* These funds are too new to have published turnover ratios, but I anticipate that they will have low turnover (<10% annual) because they are index funds.

Diversification reduces the company-specific risk of a portfolio, but market and sector risk remains. Most of these benefits can be captured with a 30 stock portfolio with greater benefit accruing to investors who make a conscious effort to choose dissimilar companies. So in order to determine whether a mutual fund, ETF, or stock portfolio is the most cost-efficient way to achieve diversification, I will compare the costs across portfolio sizes and time horizons.

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An examination of the chart reveals that at the minimum investments ($2,500 for non-retirement accounts) for …, it is always cheaper to buy one of the Powershares ETFs for a $15 brokerage commission than to pay the high expense ratios and possible load for the traditional mutual funds. Even the $1000 minimum for retirement accounts allowed by the GAAEX is only a bargain for holding periods less than three years, after which the nearly 2% expense ratio eats too much into the gains.

This demonstrates the well known advantages of using low-cost index funds (in this case index-ETFs) over traditional mutual funds. As we move to accounts in the tens of thousands of dollars with longer holding periods, however, even the low 0.7% expense ratios of the Powershares ETFs start adding up, and paying $15 a trade to buy a portfolio of 30 stocks begins to look better. If you consider that $15 a trade is fairly costly for most online discount brokers these days, and many offer free trades for qualifying accounts.

This leads to the following question: if your alternative energy portfolio is in the sweet spot to use the Powershares ETFs, which one(s) should you choose? The answer will depend mainly on what motivates you to invest in Alternative Energy in the first place. If you're most interested in Global Warming, you will gravitate towards PBW. PUW caters to investors concerned about energy security, and PZD companies focus most strongly on traditional environmental issues such as pollution. For a $3000+ portfolio, the extra commissions involved in splitting your portfolio between two or three will not have a significant impact on your returns. Or you could buy one, and then buy a different one when you have more money to invest.

Finally, if you have $20,000 or more to invest, and and can leave it there for a few years, what stocks should you choose? If you don't have time to educate yourself about alternative energy stocks, the simplest way to go about it is look at the holdings of the mutual funds or ETFs you would have bought, if they were not too expensive. PowerShares WilderHill Clean Energy (AMEX: PBW - News), PowerShares Cleantech Portfolio (AMEX: PZD - News) and PowerShares WilderHill Prog. Ptf. (AMEX: PUW - News) have lists of holdings that are particularly easy to use. It may strike you as strange, to buy a basket of stocks with so little research into the actual companies, but that is exactly what you are doing when you buy any index fund . . . this technique just lowers the fees if your account is the right size.

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