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Overseer's Undercurrent - The Sun in NASDAQ

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For those of us without the inclination or means to invest in the stock market, stock indexes are a useful and entertaining fiction, not unlike the constellations described in horoscopes. Basically, you take a group of publicly traded companies - however loosely related in terms of size, location, industry sector, or trading platform - and combine them into a defined entity called an "index." Then you follow their ups and downs through the financial universe of daily stock market trading.

Like groups of stars identified by the ancients, these indexes take on a character of their own. The most famous, of course, are the Dow Jones Industrial Average (DJIA, a.k.a. the Dow) and the Standard & Poor's 500 (S&P). The Dow represents brand-name "Blue Chip" stocks. S&P exhibits a newer, more technology-driven benchmark against which individual investors and mutual fund managers can measure their own performance. Each provides an accepted metaphor for understanding how the market, or some subset of the market, behaves on a daily basis. How much they reflect or predict the greater economic reality is a matter of conjecture.

Currently, both the Dow and S&P are behaving a bit like Jupiter in retrograde - wreaking havoc with investment portfolios all across the land. When Jupiter is in retrograde, astrologers say, expansion is impeded and things that seemed like sure bets get sidetracked - like the proposed FPL/Constellation merger or the housing market. When the Dow and S&P are in retrograde, similarly, all bets are off.

There are new stock indexes created all the time, each of which tries to slice out some portion of the equities market, such as technology or financial services, for closer scrutiny. Many of these indexes also form the basis for investment vehicles called exchange-traded funds (ETFs). According to the financial seers, ETFs better track the movements of specific market sectors than the broader DJIA, S&P 500, or Russell 2000, allowing for a targeted, yet still diverse, investment portfolio. They are also easier to get in or out of than mutual funds.

Increasingly, both indexes and associated ETFs are narrowing their focus. In the past month alone, we?ve been introduced to several new stock indexes that try to identify emerging subsectors within the energy business.

As I pointed out in a previous column (Circuit, May 12, 2006), traditional utility indexes, such as the Dow Jones Utilities, simply do not reflect the realities of the new energy marketplace. These new indexes provide a frame to view the emerging energy technology industry.

There is a new NASDAQ Clean Edge index, comprising 45 stocks of companies that make or support solar energy, biofuels, and batteries (you can track its daily motions via the NASDAQ ticker symbol CLEN). Financial advisers Merriman Curhan Ford & Co. introduced a Next-Generation Energy Index of 30 companies with a similar focus (NGE.X). And I just learned about several new bundles under the heading of Ardour Global Alternative Energy Indexes with at least 30 companies involved (the North American subindex is AGINA).

These entrants join the already established 40-stock WilderHill Clean Energy Index (ECO) and the niche Distributed Energy Stock Index of 38 companies (DESI). WilderHill, which has been informally published since 1999 and more formally since August 2004, is considered the granddaddy of this trend. WilderHill is also creating a new global index to incorporate companies such as Danish wind turbine developer Vestas, which is not traded on the U.S. markets.

Each index slices the market differently, but commonly defined segments include alternative energy (i.e., renewables), distributed generation, environmental technologies, energy efficiency, and enabling technologies.

As a result, there is quite a bit of overlap among these indexes in terms of the companies they track. About a dozen firms, such as fuel-cell innovator Ballard Power Systems, solar firm SunPower, and ethanol maker Pacific Ethanol, appear in all four of the indexes (Ardour has not yet revealed its constituent stocks). But each index tries to distinguish itself through certain selection criteria (amount of market capitalization or trading volume), its stock-weighting methodology, and its analysis of the subsectors that back up its choices and offerings.

This can be a high-stakes game. WilderHill, for instance, is associated with an ETF that has grown from about $190 million in investments at the start of 2006 to well over $600 million.

Admittedly, that's really not so much money in terms of the overall market for mutual fund investments (or even the project finance market for a single big power generator), but it's the tip of a huge potential marketplace. And it represents a significant new capital infusion for emerging technology companies that are making the transition from venture capital to public equity. Even if these companies are not yet profitable, and many are not, their inclusion in an index provides potential investors with a yardstick to measure at least some aspects of their growth potential.

Rob Wilder, who is behind the WilderHill index, said that these new tools reflect "innovative companies that are just emerging. They're trying to grow as fast as they can." Traditional utilities generally are not interested in innovation, he said, leaving a market opening for those who are applying new technologies to modern needs.

"I was very interested in finding who had the best technology and who had the intellectual property" that would redefine the energy business, Wilder said. Putting them in an index "helps them stand out."

Jamie Wimberly, CEO of the Distributed Energy Financial Group and co-creator of DESI, points to the WilderHill grouping as a seminal influence. "What Rob did was give institutional investors a vehicle to get into this sector in ways they couldn't before," he said.

Part of the reason that DESI was created last year was to put that same kind of focus on distributed energy technologies. "We think this is real and this vision has social benefits associated with it," Wimberly said. "We're witnessing a slow but sure transformation from centralized operation of the grid to a smart grid. With an index you can start thinking about that change and get away from a standard-industry-code way of looking at the economy."

What had been missing was the bridge between those with money and those with new ideas.

Ron Pernick, cofounder of Clean Edge, Inc., also sees creation of indexes and ETFs as positive for both investors and the companies that are carving out a niche in clean technologies. "Driving this sector is a very real confluence of forces," he said, citing rising fuel prices, decreasing costs of alternative technologies, government policies, and capital interests.

Clean Edge estimates that global revenues associated with clean energy were $40 billion in 2005 and will grow to $167 billion by 2015. DEFG this week issued results of a survey that shows professionals believe the distributed energy sector will have positive income growth this year, and that it represents a good investment.

For me, a professional nonparticipant in the stock market, the value of these indexes comes less as investment vehicles and more as a way to understand how the energy industry is evolving. They are useful for identifying which companies will be capturing new economic opportunities as well as contributing solutions to social problems while meeting energy policy goals.

Stock price indexes are not the only way to judge the value of these firms and measure their success or failure, but like the daily horoscope, they are readily accessed in newspapers and on the Internet.

WilderHill Clean Energy (ECO), www.wildershares.com
Merriman's Next-Generation Energy (NGE.X), www.merrimanco.com/NGEindex
NASDAQ Clean Edge (CLEN), www.cleanedge.com/CEindex.php
Distributed Energy Stock Index (DESI), www.defgllc.com
Ardour Global Indexes (AGINA), http://www.ardourglobalindexes.com

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