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PUW: Progressive Energy Stocks Progress Toward Cleaner Energy

As oil prices closed in on $120 per barrel over the last few weeks, energy funds of all kinds percolated to the top of the PowerShares Momentum TrackerTable. PowerShares WilderHill Progressive Energy (PUW) was one of them. The fund rose five spots on the table last week, bringing it up 17 spots from 10 weeks earlier. If high energy costs continue, and consumers and governments maintain their recent focus on environmental sustainability, PUW could easily erase its losses thus far in 2008 and climb its way to the top of the table.

PUW was designed to complement its more idealistic counterpart, PowerShares WilderHill Clean Energy (PBW). Rather than investing in stocks of entirely clean energy companies as PBW does, PUW invests in stocks of companies that are progressing in that direction. Many of the firms listed in the fund's portfolio don't have a particularly "green" reputation, but the WilderHill Progressive Energy Index (which PUW tracks) has determined that they are in fact taking considerable steps toward cleaner and more sustainable energy production and consumption.

While PBW invests in the technologies and businesses that could someday provide truly clean and renewable energy for the world, PUW provides a stake in the technologies and businesses that are serving as imperfect intermediaries, weaning the world off dirty and inefficient forms of energy. The theory is that until solar, wind, thermal and other clean energy sources take the place of coal, natural gas and nuclear, the best bet to reduce pollution in the short term may be to invest in the coal, gas and nuclear firms that are relatively progressive environmentally. Only about 3% of the world's current energy comes from renewable, zero-carbon-emissions sources, so despite all the hype around alternative energy lately, there's still a long transition ahead to truly clean energy.

PUW recently had 42 holdings, with an average market capitalization of $3.8 billion. The fund's holdings can be sorted into the six categories adopted by the WilderHill Progressive Energy Index: alternative energy (biofuels, natural gas, nuclear fuel, methanol and so on), better efficiency (power management, demand reduction), emissions reduction (end-of-pipe pollution control, waste reduction), new energy activity (carbon trading, nanotechnologies, waste-to-energy systems, efficient appliances), low-polluting utilities (hydropower, nuclear power) and conversion and storage (advanced batteries, fuel storage).

Stocks falling into the alternative energy camp have the strongest presence in PUW's portfolio, taking up almost a third of the fund's assets. The fund's six largest holdings fell into that category recently. Top among them are Southwestern Energy (SWN), a natural gas exploration and production firm, and USEC (USU), which supplies low-enriched uranium for about 150 nuclear reactors around the world. Although neither natural gas nor nuclear energy is a genuinely clean source of energy, each offers a cleaner alternative to sources such as coal and oil when used properly. USEC, for instance, is favored in part thanks to its program converting Russian nuclear warheads into power-plant feedstock.

With a nearly 58% return, PBW easily outpaced PUW's less than 16% gain in 2007, largely due to the astronomical heights reached by shares of many solar energy firms. Clean energy was hot in 2007, as the global economy kept chugging along and global warming took center stage in the mainstream media, and investors felt confident investing in nascent alternative energy firms.

The ecological outlook hasn't changed since December 31, but our economic situation has shifted considerably. Now that the U.S. stock market has fallen and economies around the world are slowing, investors may be less enthusiastic about investing in the generally high-risk stocks in PBW's portfolio. Most solar energy firms remain heavily reliant on government subsidies, and politicians may be less likely to dole out funding to such programs as budgets tighten and constituents cope with unemployment and high gas prices. In stark contrast to last year's stellar gains, PBW was down more than 24% year to date through April 29.

It may be that PUW's slightly more cautious and pragmatic approach will be more appealing during such an economically uncertain period. After all, even if the most promising approaches to alternative energy turn out to be too costly or otherwise unfeasible, the firms represented in PUW's portfolio will likely keep on doing what they've always done—in progressively cleaner ways.

But while PUW's holdings might be considered mainstream compared to other alternative energy stocks, most of the companies represented in the fund's portfolio are small, narrowly focused stocks that are likely to be far more volatile than the giants found in many conventional energy funds. PUW offers a unique and potentially high-growth take on the future of energy, but such an innovative approach is sure to come with high risk—so investors would be wise to keep any stake here moderate.