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Title: Alternative Energy: An Investment in Hope

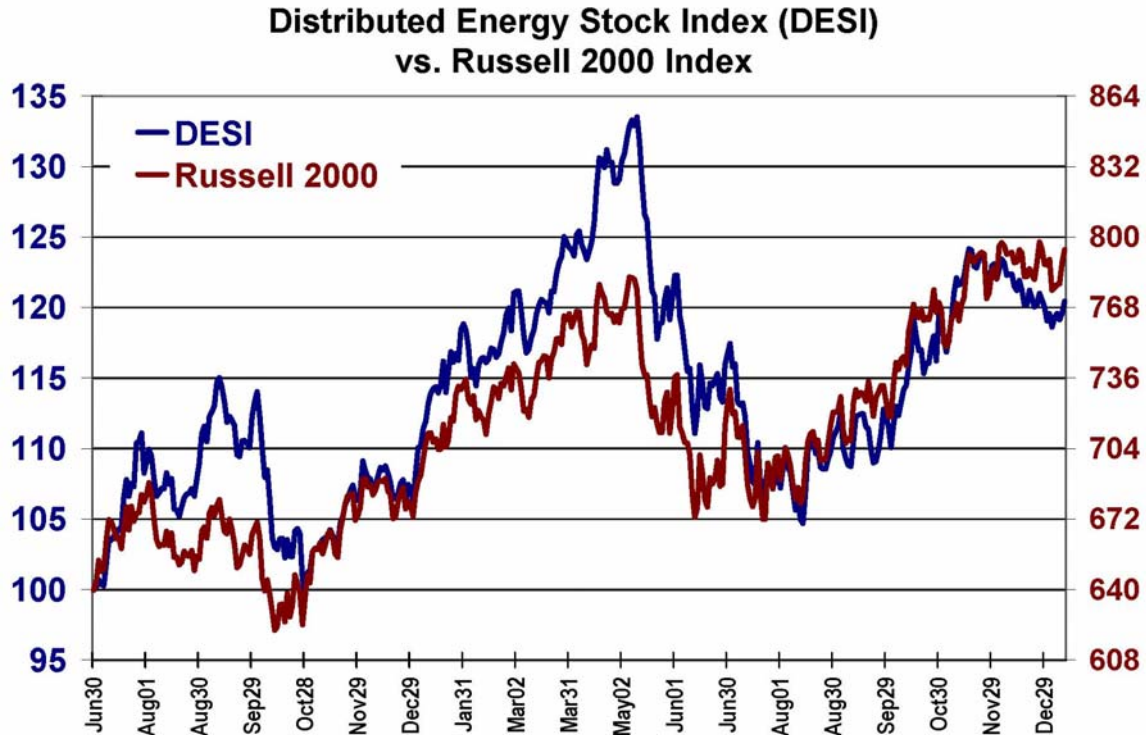
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Investors in alternative energy companies hope that their money helps protect the environment, weans the nation from its foreign oil dependency, creates 21st century jobs, and satisfies other socially responsible goals. Socially responsible investors hope to earn a return on their investment but are willing to accept slightly more risk if the investment benefits society.

Social responsibility and higher risk returns represent down payments on the future. Investors are willing to wait for emerging energy technology companies to figure out how to assemble the winning package. And wait we must! For the most part, the alternative energy sector is dominated by micro cap companies and niche players that have not turned a profit. Emerging alternative energy companies have done good work to bolster their sales operations and increase top line revenue over the past year, but operating margins remain thin to negative due to blooming cost structures and frequent management restructurings.


To this point, investors have forgiven much. The future of the sector is simply too dazzling to ignore, akin to the potential shown by Internet stocks in the early 90's but with real assets and technologies in play. As evidenced by the performance of DEFG's Distributed Energy Stock Index (DESI), the alternative energy sector continues to perform strongly with a 14 percent gain last year, and this on top of a double digit gain in 2005.




Hope will be challenged in 2007 though, with the market for individual stocks expected to be volatile. Investors in the sector should pay close attention to potential game-changing trends that

are expected to intensify this year, with each trend offering opportunities and challenges for the alternative energy sector. These trends include:


Regulatory/ Political: Politicians and regulators at all levels of government are tripping over themselves to enact new initiatives to promote alternative energy. There is every expectation that new energy legislation will be passed by Congress this year. The agriculture bill is up for re-authorization which should mean that bio fuels will receive a major boost. Look for states with resource portfolio standards (RPS), mandating an increasing amount of renewable energy produced in that state as a percentage of the overall portfolio, with the percentage ratcheted up another notch this year and into 2008.

 Downside: Political incentives imply political risk, constraints and bureaucracy, and more volatility. In other words, what can be given, can be taken away.


Energy Prices: Energy prices are the number one driver of consumer actions over the mid- to long-term, and consumers will look for alternatives to traditional energy sources when prices become too expensive. Most experts agree that we will be in a relatively high-priced market for years to come given growing international demand and tightening capacity; however, the day-to-day gyrations of energy prices such as oil are impossible to predict. Higher electricity prices, which are regulated, are easier to predict, and are likely given the record number of rate cases around the country.

 Downside: The sensitivity of this sector to energy prices results in treating alternative energy companies more like a commodity provider rather than a technology play. This presents additional risks to investors who are looking for growth opportunities. Also producers of alternative energy – such as ethanol – consume a significant amount of energy in the process. Therefore increasing prices are a two edge sword, increasing opportunity and increasing pressure on operating margins.

Reliability: With aging transmission and distribution grids, combined with increased summer peak demand, there is an increased likelihood of electricity brownouts and blackouts. Reliability is the second biggest driver of consumers looking for alternative sources if perceived to be a recurring problem. Big blackouts can send the share prices of alternative energy stocks skyrocketing, especially for companies that offer small-scale generators, energy storage or power quality solutions.

 Downside: Outages make newspaper headlines but it is not a sustainable trend. The impact on alternative energy providers dissipates over time when it appears that the utilities have the situation under control and consumers turn their attention to the “issue of the day”.

Environmental: The environment and global warming have started to register as important issues in the national consciousness in a significant way. This may be the most sustainable trend to impact the alternative energy sector. Most political pundits now predict that the nation will have either a cap and trade or taxation system tied to carbon before the end of the decade. States and local municipalities are already acting with either green building initiatives or other mandates to reduce their pollution footprint. In turn, these mandates collectively will have a large and mostly beneficial impact on the alternative energy sector.

 Downside: Most customers are interested in low cost, reliable energy sources. Alternative or “green,” sources are usually secondary considerations when making energy purchases. Therefore

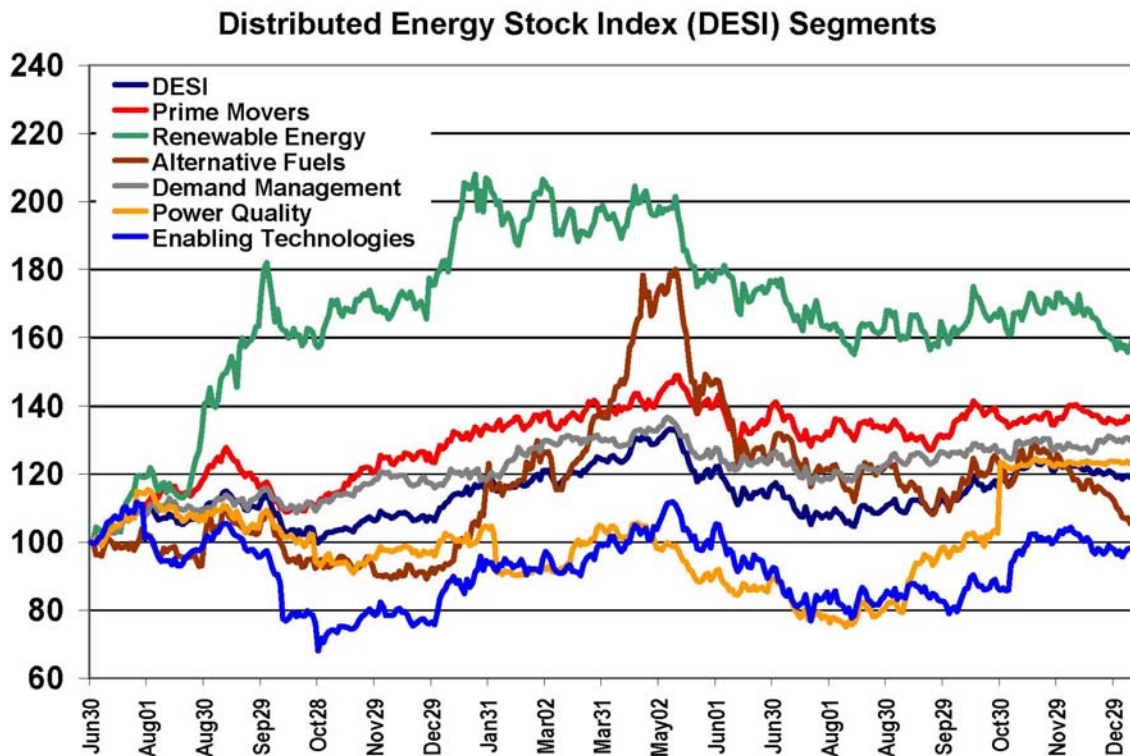
the alternative sources must be competitive with traditional sources to play a significant role in the future.

Each of the above trends has the potential to produce big winners and losers in the alternative energy sector over the next several years. The underlying dynamics of the sector are sure to produce another volatile year driven more by oil prices and speculation than market fundamentals. Day traders are a dime a dozen in this sector.

For investors new to the sector, three strategies are recommended to build a portfolio in this space but reduce the risks associated with alternative energy investments.

Strategy One: ETFs: There are a number of exchange traded funds (ETFs) traded on the major stock markets with an alternative energy focus, including the WilderHill Clean Energy Index (AMEX: ECO) and the NASDAQ Clean Edge U.S. Index (NASDAQ: CLNX). The advantage of index funds are multi-fold, including: diversified portfolios, low fees, sector-focused and traded on major exchanges.

Strategy Two: Segments: Another beginning investment strategy is to build your own portfolio focused on segments or sub-sectors of the alternative energy space. The Distributed Energy Stock Index has six segments, including 1) prime movers/ combined heat and power, 2) demand management and energy efficiency, 3) power quality and storage, 4) renewable energy, 5) enabling technologies and 6) alternative fuels. Each segment represents five or six publicly traded companies.



A segment strategy is focused on the notion that “alternative energy” is actually a system or network of solutions that provide value to the end user. Specifically, investors should look for

segments that the wider market has not properly valued or that promise cross-over opportunities to manage other networks or grids, e.g., telecommunications.

Strategy Three: Large Caps: The third strategy is to purchase shares in large cap companies that have made major commitments to alternative energy technologies. These companies include: Honeywell, General Electric, Florida Power and Light, and Archer Daniels Midland, to name a few. While the focus on alternative energy is certainly diluted within these large companies, so is the risk. To even be considered “alternative energy” companies, though, the company should have an easily broken out business unit(s) and revenue stream(s) that represents at least 10 percent of the company’s overall revenue. Otherwise, it is hard to justify the investment as related to alternative energy.

There remains a lot of uncertainty around long-term winners and losers in the alternative energy sector. 2007 should prove to be a pivotal year for many small companies. For the alternative energy sector overall, this year could very well represent the long-awaited tipping point that marks a sharp growth trajectory. That hope must be balanced against the uncertainties and realities that particular companies are facing. Investor hopes to make a difference and a return will certainly be tested. Always remember to do your research and select investments that are consistent with you’re your objectives and the risks you are willing to take.

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