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Indexing & ETFs

Alternate-Energy Funds: Tempting but Volatile

As energy prices soar, fund companies are rushing to roll out new products focused on alternative energy sources.

Small investors getting squeezed at the pump may see such funds as a good hedge against higher energy costs. But alternative-energy investments can be extremely volatile. And, as investors have seen this year, high oil prices don't always translate into great performance for wind- or solar-power stocks.

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These funds join a slew of other young alternative-energy ETFs, including PowerShares Global Clean Energy Portfolio and First Trust Nasdaq Clean Edge U.S. Liquid Series Index, both launched last year.

Some professional investors are diving into the sector. Carol Miller and Dean Kartsonas, managers of Federated Capital Appreciation Fund, started buying alternative-energy stocks early this year and now devote roughly 4.5% of assets to these holdings. One of their top holdings is First Solar, a stock which also plays a starring role in each of the new solar ETFs.

The Federated managers say the industry has great growth potential. Solar power can grow 50% a year between now and 2012 and still represent less than 1% of world-wide power production, Ms. Miller says.

But the more-established alternative-energy ETFs have lately given investors a rocky ride. PowerShares WilderHill Clean Energy and the First Trust clean-energy ETF, for example, are both down about 19% this year through Thursday.

The new solar ETFs are likely to be similarly volatile. ….

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There are other risks for investors. If economic growth slows and energy prices fall, these holdings will likely get hurt. And some argue that an index-based fund may not be the best vehicle for alternative-energy investing because active stock pickers can help sort the winning technologies from the losers.

"They're not all going to work," Ms. Miller says. "Some are pie in the sky."