MANAGER INTERVIEW

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INVESTMENTS

Prospects Promising for the Alternative Energy and Water Sectors

In a December 2009 Calvert webinar, Calvert's Lily Donge joined two members of the portfolio management team of the Calvert Global Alternative Energy Fund (CGAEX) and the Calvert Global Water Fund (CFWAX) to discuss the topic of emerging trends in green investing. Green investing has generated a lot of news and interest in the investment potential of companies involved in alternative fuel sources, sustainable energy and renewable resources.

What is your view of the overall outlook for alternative energy companies?

Lily Donge: We believe the outlook is quite positive for above-average growth in companies involved in green businesses. There are three fundamental drivers that support "going green" and, subsequently, green investing.

The first is economic, which will result from the rapid increase in world population. By 2020, the world population will reach 8 billion people. With limited natural resources versus a large increase in energy demand, we must rethink how we use resources and energy.

The second driver is how businesses are responding to institutional and political challenges to use resources more effectively. Businesses have benefited by being more efficient and managing resources more wisely. Johnson & Johnson, for example, met carbon emission reduction goals five years early, resulting in $30 million in annualized energy savings.

The third driver is an understanding of what is going on from a governmental and public policy standpoint and how companies will respond. There are three important dates to keep in mind that will significantly affect global green policies and regulations. The first is January 2013, which is when discussion points from the recent UN Climate Change Conference in Copenhagen will need to be finalized. The second period is between 2013 and 2030, which is when the transition from traditional energy to non-fossil fuel energy is scheduled to take place. The final date is June 5, 2050, World Environment Day, by which date regulators are looking for developed countries to cut 80% of carbon emissions.

So this combination of economic, political, and public policy factors point toward strong demand for green energy.

What does this all mean for green investing?

Jens Peers: With all of the factors that Lily just discussed putting increased strain on natural resources, such as oil, water, and agricultural commodities, we see continued investment opportunities in the alternative energy sector and the water sector.

Although alternative energy investments have grown substantially over the past couple of years, the share of true renewables as part of overall electricity generation is still less than 3.5%. We believe that there is significant potential for even more growth and a far larger share of overall energy generation.

We see even more need to invest in water. This is a limited and declining resource for which there is no substitute. There are also significant imbalances on the distribution of supply globally. This, combined with tightening environmental regulations, bodes well for water investment.

Investment wise, we see opportunities in water and wastewater treatment, especially in China and India, both of which are experiencing high economic growth and stress on current water supply and infrastructure. The United States also looks attractive, with its comprehensive fiscal stimulus packages.

Despite forecasted future demand in the alternative energy sector, we still have not seen an accompanying rise in stock prices. When do you see alternative companies starting to outperform traditional energy stocks?

Jens Peers: Growth in alternative sectors is forecast to be significantly higher than in traditional sectors. In alternative energy, this has not yet been followed by increased investor interest and a subsequent pick-up in valuations, which remain lower than expected. We anticipate, though, that as a result of the UN Climate Change Conference in Copenhagen and solid first quarter 2010 profit numbers, valuations will begin to go up in the first half of 2010.

Do you foresee a time when alternative energy will be cost effective without subsidies?

Colm O'Connor: This really depends on what alternative energy sector you are talking about. Wind energy is already cost effective, particularly in windier regions, such as off the coast of Scotland. The problem is that the pricing of past contracts is still in effect, lagging current prices. Solar energy still has a way to go, but by the year 2015, we expect to see price parity in locations that have high electricity costs, such as Italy or even California. For other areas, it will take slightly longer, so we are looking at 2017 or 2018 for price parity.

Can you give some examples of specific companies you think are attractive right now?

Colm O'Connor: Well, government financial support through subsidies can certainly benefit company earnings, so we factor that into our company analyses. Two companies that benefit greatly from government subsidies and support are Iberdrola Inmobiliaria, the world's largest wind farm operator, and Itron, the leading provider of metering data collection and data software. The smart meters that Itron produces are highly supported by governments globally.

Jens Peers: In the water industry, one company that we find attractive is Consolidated Water, a water utility and water technology company based in the Caribbean. Its strategy is to build plants and negotiate long-term water supply contracts at set prices. It then benefits from population growth, economic growth and increasing efficiency/lower production costs through technological advances, which will help boost profitability. It is currently attractively valued due to some business issues, which have been resolved, letting it focus on growth again.

What areas within the alternative energy sector and the water sector are you most bullish on?

Jens Peers: In terms of specific areas of focus within the energy sector, we see substantial opportunities in wind, solar, fuel cell, and biomass in renewable technology, as well as in the utility sector. We expect more mature technologies such as geothermal, hydro and biomass to become 10% to 20% more efficient and wind and solar should become between 15% and 50% more efficient by 2020. Investment in renewable energy is supported by easier and cheaper availability of financing for large wind and solar farms.

Within the water sector, we see opportunities across the entire water cycle, including water treatment as well as water infrastructure. ■