Cleaning Up

Canny investors should look at underpriced clean technology stocks, say IRAKLI MENADBE and NICHOLAS MERZEAU

AS THE EARLY months of 2010 have shown, this year should prove to be a very interesting one to anyone who is – like you – involved in hedge funds. As the managers of the I2BF-Arbat Technology Fund, a hedge fund focused on the clean technology sector, we see it facing the same challenges as both the technology industry and broader equity markets, as a whole.

2010 could either be a year of continuation for the broad economy or mark a significant relapse. Negotiating this environment will prove tricky as it will require constantly assessing and processing new information. There is the constant risk of sovereign defaults as budget deficits and debt levels reach alarming levels in a number of regions, as well as the general sustainability of world economic growth and the manner in which the central banks will deal with liquidity created in 2009.

This liquidity has been positive for the clean technology sector and should remain so for some time. The recently announced Obama tax credits, which are funded by the $787bn economic stimulus package enacted in February 2009, are designed to defray up to 30 per cent of the cost of new investments in manufacturing facilities to produce clean energy products.

The European Commission has set an ambitious mandate to achieve 20 per cent of electrical production from wind and other renewable sources by 2020, although the lack of sustainable economic growth in the region could threaten these targets.

As with many other sectors, China has forged forward to establish itself as a leader in renewable energy. The government has established a renewable energy target of 15 per cent of total energy generated in 2020, up from nine per cent in 2008.

So while countries such as Germany and other European markets may end up growing slowly in 2010, the Chinese (and other Asian clean-tech markets such as India and Japan) are expected to catch up faster than previously predicted.

As a result, companies that have a greater exposure to the Asian market will benefit the most.

Copenhagen and the aftermath has not changed the regulatory environment and so far there is little to see of a major economic impact, except the (re)stated will of government to support renewable initiatives. We will see if this stands the test of a need for fiscal consolidation.

The I2BF-Arbat Technology Fund uses a risk-adjusted return-focused investment process, built to perform in all market environments in a consistent, systematic manner. It is a unique methodology combining quantitative, thematic and fundamental disciplines. This was the backbone of our 2009 success. We managed to navigate our way through the pessimism of 2009; now we view the Federal Reserve Bank's forecasts as wildly optimistic and have prepared accordingly.

The main challenges last year to I2BF, as with the rest of the industry, were on the asset-raising side, especially for new funds. Fortunately we were able to get around this issue with significant outperformance in the first quarter of 2009. This was down to our long/short investment approach, which is able to withstand some of the most volatile movements in specialist clean-technology stocks. We also identified which subsectors and companies had been excessively discounted and thus offered the best return opportunities while maintaining good risk management and reducing volatility.

As a result we managed to almost double our AUM just in time for the March 09 rally, which lasted into 2010. The fund's assets have grown from $6m at launch to over $26m to date. H *i2bf.com*

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WHY CHINA WILL LEAD

In 2009, China became the world's largest manufacturer of wind turbines and solar panels. That is not to say that we have witnessed a large shift towards renewable energy in terms of clean power produced relative to fossil fuels in China, but it does say that as the country grows it will continue to take the lead in the manufacturing of alternative energy technologies.

Furthermore, as it is already the biggest market for power equipment owing to double digit electricity demand growth on an annualised basis, it is likely that China will continue to add power-generating capacity multiple times the scale of more mature power markets such as the US and Europe.

Lastly, accommodating lending and government policies towards renewable energy do, and will most likely continue to, play a key role in the growth of China's renewable energy manufacturing sector until such practices may reach overcapacity or other market re-adjustment realities.