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ELECTRONIC INVESTOR

An Alternative to Alternative Fuels

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YOU'RE COOKING WITH GAS, SO WHY NOT INVEST in it, too? Natural gas is bouncing near the bottom of its seven-year price range; and, many consider it the best way to limit carbon-dioxide emissions while meeting the growing demand for electricity. Can it help grow your portfolio as well?

No question but that wind and solar are the fair-haired kids of government energy policy. But each has at least one big problem: The wind does not blow nor does the sun shine every day. These energy sources can fluctuate widely and require backup by a steadier source to ensure an unbroken flow of electricity nationwide.

"When you see more wind turbines and solar farms built, your first thoughts should turn to gas," says Elliott H. Gue, editor of The Energy Letter (www.energyletter.com), a biweekly analysis of energy alternatives for hard-asset investors at KCI Investing's (www.kciinvesting.com) e-zine hub.

Gue just returned from the U.S. Energy Information Administration's (EIA) annual conference, where he was puzzled by Secretary of Energy Steven Chu's focus on renewables -- with scant mention of oil, gas, coal or nuclear power: "This is striking to me because these four sources account for nearly 93% of U.S. primary energy consumption; and, according to the EIA's own estimates, will still make up more than 90% of the total in 2030."

The oil supply obviously is problematic, and a decade is needed to bring a nuclear plant online. Coal is America's most plentiful fuel, but its carbon emissions make it as politically popular as cigarette smoke. As a result, natural-gas turbines are the logical choice for backing up renewables and meeting the world's growing appetite for electricity, concludes the Federal Energy Regulatory Commission (www.ferc.gov/legal/staff-reports/06-19-08-cost-electric.pdf).

Combustion-type and combined-cycle turbines are proven performers on the grid and emit relatively small amounts of carbon. They're also the cheapest way to generate electricity, notes FERC -- cheaper even than wind or coal. While growing smartly, renewables will meet only a fraction of world energy demand by 2030, predicts EIA (www.eia.doe.gov/oiaf/ieo/world.html). Natural gas and coal will continue to dominate power generation (www.eia.doe.gov/neic/press/images/08-08-figure1.gif).

An obvious way to play it is with one of the dozens of petroleum exploration and production (E&P) companies -- from Anadarko Petroleum (ticker: APC) to XTO Energy (XTO). Of course, like most highly elastic commodities, natural gas can be a wild ride. This time last year, many investors bet long with Chesapeake Energy (CHK) CEO Aubrey McClendon, who resolutely invested in his company's stock, even as its price reached nosebleed levels. When gas tumbled about 75% last fall, McClendon's stake was nearly wiped out (http://online.wsj.com/article/SB122385842864427455.html). If the founder of the nation's largest independent gas producer can't predict the fuel's price, who can?

NATURAL GAS IS A CRAPSHOOT, with myriad betting options -- like the pass/don't pass line for field-service providers like Halliburton (HAL) and Schlumberger (SLB). Demand for drilling rigs and field services also rises and falls with petroleum prices -- just not as precipitously. Likewise, integrated petroleum companies like ExxonMobil (XOM), Chevron (CVX) and British Petroleum (BP) have done well since oil and gas prices snapped back. But theirs is a sophisticated mix of not-always-synchronous upstream and downstream businesses whose profits are subject to expropriation by tinhorn dictators overseas and Congress at home.

But uncertainty also creates trading opportunities, notes Gue, who prefers energy storage and distribution companies that are less susceptible to commodity price swings. He recommends the master limited partnerships (MLPs) -- Kinder Morgan Energy Partners (KMP), Regency Energy Partners (RGNC) and Enterprise Products Partners (EPD) -- that are building pipelines and storage facilities to accommodate demand growth.

Certain utilities are positioned to profit from lower feedstock prices, higher demand and even carbon-emissions legislation, notes Roger Conrad, editor of Utility Forecaster (www.utilityforecaster.com): "What we hear from a lot of utility executives is that there's a dash for gas; in part, to reduce carbon emissions ahead of some kind of carbon-credit system."

He likes Dominion Resources (D), Florida Power and Light (FPL) and Duke Energy (DUK) for their managements, strong balance sheets and low debt. They can benefit both from growth in their regulated rate-payer businesses and the commercial sale and distribution of electricity over the national grid. They also sport relatively high yields.

Also likely to profit are those who build or supply parts for power plants and the energy grid, says Ed Mitby, energy analyst for Van Eck Global (www.vaneck.com), whose firm sponsors energy funds like Coal ETF (KOL) and Solar Energy ETF (KWT). Besides building contractors like Jacobs Engineering (JEC) and Fluor (FLR), Mitby likes Quanta Services (PWR), which specializes in the integration of wind, solar and gas-generation facilities. A dozen or more utility and energy ETFs can help spread risk, but again, avoid those like United States Natural Gas (UNG) that are too closely tied to the commodity's price, warns Conrad. He prefers Petroleum & Resources (PEO), a closed-end infrastructure fund.

Besides government sites, industry trade groups like the 75-year-old American Petroleum Institute (www.api.org) and the Natural Gas Supply Association (www.ngsa.org) offer free data and links to other resources. The Oil & Gas Journal (www.ogj.com) is a century-old observer of the petroleum industry offering some free news and research, with deeper analysis with an $89-a-year subscription. More extensive reports are sold by its parent PennEnergy Research (www.pennenergy.com). Similarly, Oil and Gas International (www.oilandgasinternational.com) offers upstream (E&P) news and analysis for subscriptions that begin at $389 annually.

Investor beware, says Gue. All supply/demand projections imply more clarity about the future than anyone really has. That said, the natural-gas market is big, growing more in absolute terms than renewables, and has more than enough pure plays, funds and volatility to satisfy long, short and hedging strategies.