Excerpt from ETF Zone, November 27, 2010
http://finance.yahoo.com/news/Socially-Responsible-ETFs-The-ifunds-1575371664.html?x=0&.v=1

Socially Responsible ETFs: The Other Value Investing

Socially responsible investment (SRI) is about investing in values. Socially responsible ETFs select companies based on political, social, environmental and corporate governance considerations. Can ethics and values be profitable? Or must investors forgo profits for the sake of their belief system?

Unethical behavior is not profitable. Accounting fraud, faulty risk management controls, and environmental sloppiness can send firms into bankruptcy. When companies are made responsible for injuries their products cause, shareholders are hurt. An ETF that comprised of companies avoiding these situations would be a winner.

But over the long term, some of the best performing investments are in sectors many investors find objectionable. Tobacco, alcoholic beverages, gaming machines, defense contractors, oil exploration and drilling companies are all often stellar performers. Investors in socially responsible ETFs must balance these realities.

There is no ultimate agreement about what constitutes socially responsible investment. SRI-focused ETFs take a variety of approaches to the challenge of investing in good without sacrificing financial performance.

One approach is to focus on a particular sector and invest in companies that develop alternatives to that sector. If the environment is a priority, for example, ETFs focusing on alternative energy are an option. There are many such funds. PowerShares WilderHill Clean Energy (NYSEArca:PBW - News) is one of the oldest and best established alternative energy ETFs. The 5-year chart below compares the performance of alternative energy fund PBW with the traditional energy providers, represented by the Energy Select Sector SPDR (NYSEArca:XLE - News).

The chart shows PBW losing out to XLE, particularly in the last year. XLE holds major oil producers like Exxon Mobile and Chevron and oil service companies like Halliburton. Luckily for investors in XLE, there is little exposure to British Petroleum. PBW by contrasts holds companies that aim to be cost-competitive with fossil fuels but often are not yet competitive and therefore are partly or wholly dependent on government subsidy. These companies are much smaller than the major holdings in XLE. They do not have proven cash flows. They tend to be more volatile.

….

Over the last decade alternative energy ETFs have mostly underperformed conventional oil and oil service funds, defense contractors and notorious carbon polluters in the power generation business. But this long-term trend may be under attack. Concern about the environment is heating up. Public disgust with corporate malfeasance is increasingly important. Environmentally friendly technologies are becoming more prominent and profitable. Socially responsible investment, when done properly, can bring strong returns.