

# ACUITY'S Insights



## Covering Sustainable Investing: The Acuity Clean Environment and Social Values Funds

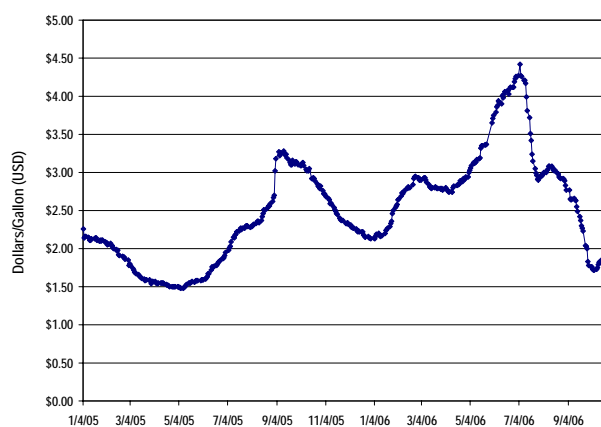
### INVESTMENT FOCUS

4<sup>th</sup> Quarter 2006

#### Ethanol: A Viable Investment Theme?

As crude oil and gasoline prices soar, it comes as little surprise that interest in alternative fuels has escalated in recent months. Ethanol, in particular, has received a great deal of attention following the phase out of Methyl Tertiary Butyl Ether (MTBE) as an oxygenate additive in U.S. gasoline. This decision was made based on concerns surrounding potential health risks associated with the use of MTBE, which arose after high levels of the chemical were discovered in the U.S. water supply. As a result, use of ethanol (a biodegradable and non-toxic substance) as an oxygenate additive has nearly doubled over the past three years, causing supply to become very tight. Ethanol prices consequently soared to a record high of US\$4.42 in July of this year, representing a 150% increase in 12 months.

Exhibit 1: Average U.S. Ethanol Price/Gallon



In addition to the elimination of MTBE, high oil prices and geopolitical instability have led to government action. Most notably, the U.S. Congress provided a solid foundation for the ethanol industry last year by enacting the Energy Policy Act of 2005, which requires oil refiners to nearly double their biofuel use by 2012. The market has become further strengthened through the formation of numerous Renewable Fuel Standards (RFS) around the world as well as President Bush's declaration that the U.S. is "addicted to oil". The momentum for ethanol has been similar in Canada. For example, the federal government supports increasing our consumption of renewable fuels to 5% by 2010. The Ontario government has been more aggressive, aiming to reach the 5% target by 2007.

Is ethanol a viable investment theme? To answer this question, some understanding of the science and policy underlying its use is necessary. As an oxygenate, ethanol is added to gasoline to aid in the reduction of emissions from combustion engines which in turn helps in meeting local air quality standards. The production of ethanol, however, is highly energy intensive and is therefore largely dependant on carbon based power generation. As a result, the benefit of using ethanol on a full life cycle basis (considering energy and environmental benefits/costs) is worthy of technical debate. From an investment standpoint, however, the science is somewhat moot, given the strong policy framework driving ethanol use and likelihood of even more stringent ethanol mandates in the future.

While the industry has historically been controlled by farmer co-ops, the new policy framework has fundamentally altered the landscape and resulted in a number of initial public offerings. Given the inherent margin risk in ethanol production (similar to petroleum refining) initial valuations were unsustainably high and have since corrected significantly along with ethanol prices. We believe the future is bright however, with 33 new ethanol facilities forecast for construction in the U.S. by the end of 2007 and more capacity to come on by the end of the decade.

This backdrop, coupled with our positive view on energy prices and environmental regulation, leads us to believe that there will be opportunity for investment in the sector, particularly once the initial euphoria has worn off. In the meantime, we anticipate strong demand for corn as an input to the ethanol industry and view fertilizer companies such as Agrium (AGU) as beneficiaries of stronger corn prices given the crop's high nutrient needs.

### NEW & NOTABLE

#### New Wind Power Milestone Reached in the U.S.

The American Wind Energy Association (AWEA) reported this summer that wind energy capacity in the U.S. has sailed to new heights. Commercial wind farm capacity has now passed 10,000 MW, representing sufficient energy to power over 2.5 million homes under typical conditions. This figure also equates to emission reductions of 16 million tons of carbon dioxide, 73,000 tons of sulphur dioxide and 27,000 tons of nitrogen oxides, through displacement of other forms of generation.

Although wind power currently accounts for less than 1% of U.S. power generating capacity, the industry is gaining momentum. Following the installation of the first commercial wind farm in California in the early eighties, it took nearly two decades for wind power to reach 2,000 MW. In 2006, however, new installations alone are expected to reach 3,000 MW – exceeding the power of the entire U.S. wind fleet in 2000.

The even better news is that the growth is expected to continue. Driven in part by concerns over the volatility of fuel prices as well as the proliferation of renewable portfolio standards in a number of U.S. states, the AWEA believes installed capacity will reach 15,000 MW by the end of 2007 and 25,000 MW by 2010. Should this rate of growth be sustained to 2020, U.S. wind energy capacity could reach 100,000 MW, representing 6% of the country's power supply (roughly equivalent to hydropower's contribution today.)

The Canadian wind market also reached an important milestone this summer. Installed wind capacity now exceeds 1,000 MW, making Canada the 12<sup>th</sup> country in the world to surpass this target. Moreover, Canadian commitment to wind energy appears robust for the foreseeable future, with an additional 250 MW of capacity expected by the end of 2006 and more wind energy contracts being awarded by provincial governments (i.e. 1190 MW in Quebec and most recently 325 MW in B.C.).

## **“Show Me the Money”- UNEP Report Links Sustainability with Value Creation**

The United Nations Environment Programme, Finance Initiative (UNEP FI) recently released the second report in its materiality series - an initiative designed to identify the most important environmental, social and governance (ESG) factors that contribute to company value.

Commissioned by the Asset Management Working Group – a group of 14 financial services companies (of which, Acuity is a member.) -- “Show Me the Money” builds on the findings of the first materiality report published in 2004. For this round, the group drew on the expertise of 22 financial services firms around the world to analyze research reports written by 10 sell-side stock brokerages, representing a number of different sectors and issues.

“There is robust evidence that ESG issues affect shareholder value in the long and short term,” according to the report.

## **Contributors**

***Martin Grosskopf** – Investment Analyst and Manager of Sustainability Research, Acuity Investment Management*

***Rachel Davies** – Investment Analyst, Acuity Investment Management*

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“Investors who do not pay attention to environmental, social and governance issues are taking unnecessary risks with their portfolios [while] investors who do pay attention are probably improving the risk/return relationship.”

A copy of “Show Me the Money” may be obtained at:  
[http://www.unepfi.org/work\\_programme/investment/amwg](http://www.unepfi.org/work_programme/investment/amwg)

## **COMPANY SPOTLIGHT**

*Highlighting Acuity's Clean Environment  
& Social Values fund holdings*

### **Suncor Energy Inc.**

Headquartered in Edmonton Alberta, Suncor (SU) is an integrated energy company focused on making synthetic oil from the Western Oil Sands.

SU is entering an aggressive growth phase that we believe will materially boost its earning capacity. By positioning itself as an integrated oil sands operator, SU has the ability to double its production within 5 years. Perhaps more importantly, the company believes it can sustain these higher production levels for over 50 years, with virtually no geopolitical risk. We believe this profile sets SU apart from its North American peers.

In addition to its financial and operational strengths, we believe SU is an industry leader on a number of social and environmental indicators. For example:

- SU sets aggressive targets for environmental performance and heavily invests in renewable energy. Through these initiatives, the company lowered its greenhouse gas emission intensity 21.4% between 2000 and 2004.
- SU comprehensively reports on its environmental performance and corporate social responsibility, which is verified by an independent third party.
- SU maintains excellent relations with the communities in which it operates. The company's commitment to developing mutually-beneficial relations with its Aboriginal stakeholders is particularly noteworthy. For example, SU consults with Aboriginal entrepreneurs to identify business opportunities and commit to purchase agreements.