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Smart money is on energy efficiency

By John Authers

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Shale's impact can be seen in the startlingly lower prices of natural gas in the US. It has made rich those who invested in the sector's pioneers. For example, shares in Continental Resources, one of the major operators in shale, were at one point up sevenfold from a 2008 low.

Also benefiting have been the operators of the infrastructure and pipelines needed to direct the new US flows of fuel. This sector is controlled by so-called master limited partnerships (MLPs), which have the additional benefit for investors in the current environment that they pay out a high yield. The Alerian index of MLPs, the widely accepted benchmark for the sector, has tripled since its 2008 low, and has even gained a third since its 2007 high. As its yield is more than twice that of the S&P 500, this popularity could endure.

However, these moves show that the first upheaval caused by shale is already in the price, and it is not clear what the next steps will be. Speculation that the US may become a net energy exporter is not fanciful, but it may yet be premature.

Other countries could try to exploit their shale resources on a similar scale, with Russia the most likely candidate to start first. It has a culture as an energy producer, wide open spaces, copious shale and a political system that can squelch environmental objections. China and Brazil are also likely candidates. Densely populated Western Europe, with less shale and more entrenched environmentalism, is the least likely to follow suit.

This spasm of activity has put to rest the fears that "peak oil" production had arrived, fashionable during the price spike five years ago. But there is a limit to how far supply can be increased, and political and economic limits to the environmental damage that can be tolerated.

Once popular bets on alternative energy technologies have now fallen out of favour. Ethanol production led to a spike in agricultural commodity prices, for example. That leads to a new theory; that the next five or 10 years will be devoted to a bid to improve energy efficiency. This at least is the argument put by Sarbjit Nahal of Bank of America Merrill Lynch in an exhaustive 196-page tome aimed at guiding equity investors through the energy efficiency "mega trend". It might well make sense.

Mr Nahal breaks energy efficiency down into different economic sectors, with transport, accounting for half of world liquid fuel use and due to consume 60 per cent more by 2035, far the most important. Over the next five years or so, there is limited scope for substitution out of oil. That means instead that the biggest beneficiaries will be railway, bus and light transit operators and their manufacturers.

The biggest pressure will come from China and India, projected to account for 60 per cent of extra demand over the next quarter-century. Both have capitals already choked by pollution. These countries are a good bet to invest in making their energy use more efficient.

Meanwhile US energy consumption remains 60 per cent higher than for any other OECD country. Shale has bought it time but the need to cut back on energy use will force it towards greater efficiency, Mr Nahal argues. He points out that the US tightened fuel economy standards for cars last year; good news for companies involved in producing smaller engines and energy-efficient tyres.

The theme plays out throughout the economy. Buildings are important. High-tech companies spend fortunes cooling down their data centres, so maybe air conditioning manufacturers benefit if they make their machines more energy-efficient; more efficient semiconductors could reduce the energy used by devices; lighting can be made far less fuel-intensive. Thus Mr Nahal's tips include counterintuitive names like Kone, the elevator maker, as well as more logical names like BorgWarner, a maker of fuel efficiency tools for cars, or Delta Electronics, a Taiwanese maker of products to improve the energy efficiency of IT devices.

Who will win? Trends like this are "mega" not only in their scale, but also in the time they take to play out. The winners may not even exist yet – investing in an "internet" mega-trend before Netscape went public two decades ago required taking the plunge before Google or Facebook even existed.

But the ructions that shale has driven, and enduring high crude oil prices, show there is money to be made. The next wave could well centre on improving efficiency.