

Friday Favorites- American Electric Power (AEP)

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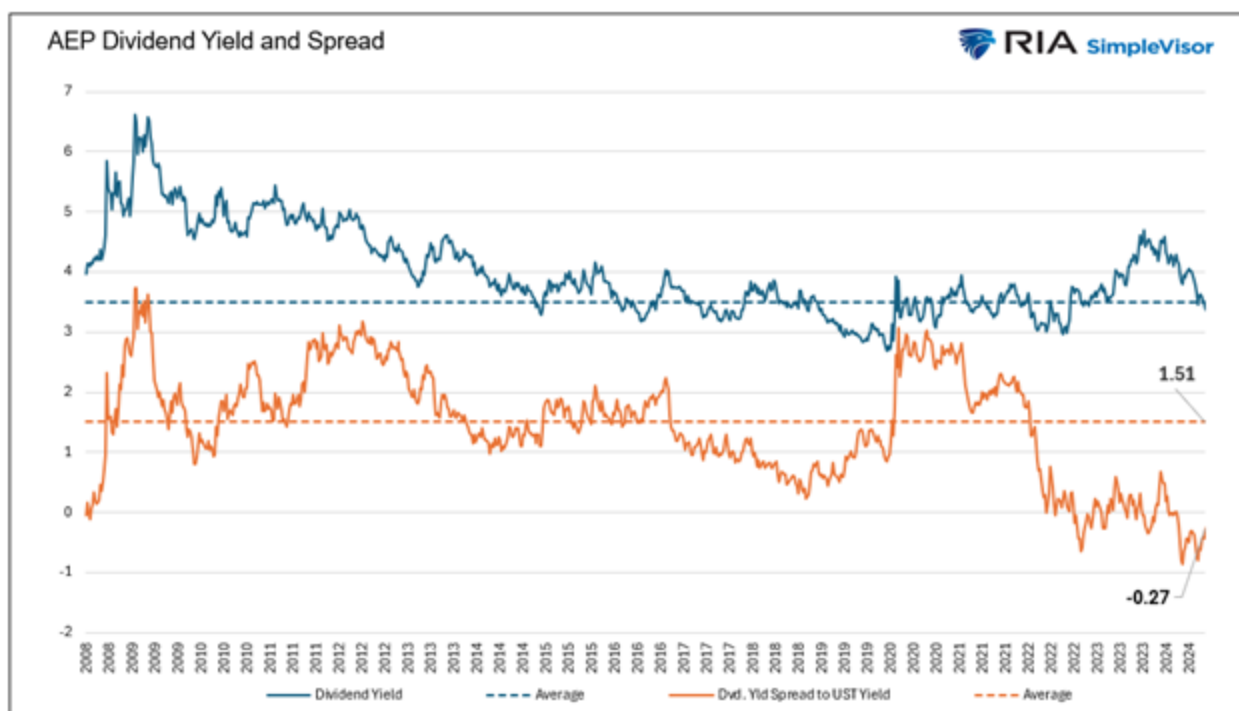
This week's Friday Favorites builds on a theme we've discussed recently: the relationship between dividend yield and Treasury yields for cash cows. Our article, [Cash Cows and Treasury Bonds](#), goes into more detail on the matter. Last week, we presented Ford, which currently has a historically elevated dividend yield and an above-average spread to Treasury yield.

However, a few stocks from the article reside on the other side of the ledger, with lower-than-average dividend yields and dividend yield spread to Treasuries. American Electric Power Company (AEP) is one of them.

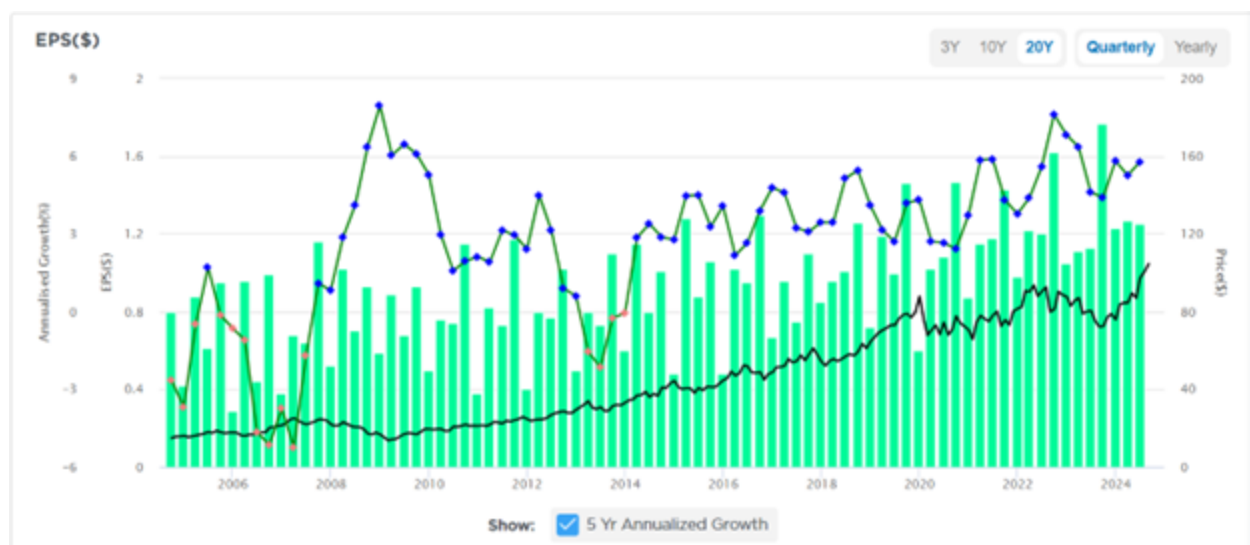
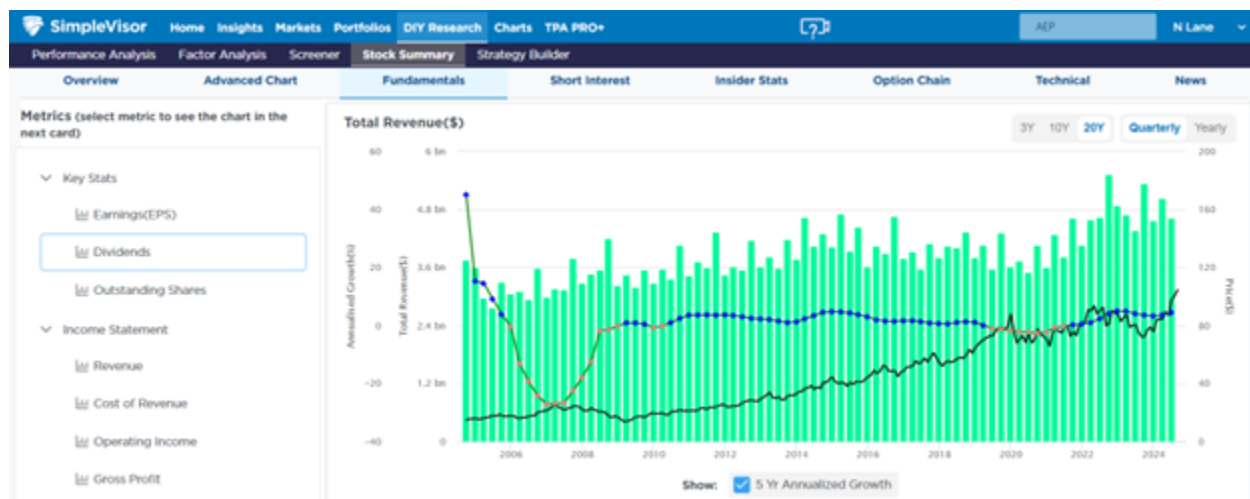
Dividend Yield Analysis

AEP trades at a dividend yield 27bps below that of the 10-year treasury and significantly below the historical spread of +1.51%. Given that information alone, one might conclude that the stock is overpriced, but that doesn't seem true. AEP's dividend yield is nearly in line with its 5-year average of 3.57%.

AEP's stock price has risen nearly 30% this year, but as mentioned above, the stock doesn't appear overvalued due to its proximity to the historical dividend yield. Given the level of Treasury yields compared to recent history, the logical conclusion is that treasury yields are too high. Treasury yields need to decline another 178bps for the yield spread to reach its 5-year average. That would put the 10-year yield at 1.87%, a level last seen in February 2022.



Fundamentals



The first two graphs show that AEP's revenue and EPS are steadily growing. The pace of 5-year annualized growth has picked up amid the inflation of the past couple of years, and EPS growth is outpacing revenue due to expanding margins.

AEP generates plenty of cash flow to cover its dividends. The stock pays out roughly 63 percent of its earnings as dividends, which aligns with its 5-year average. AEP trades at a moderate P/E compared to the last 5 years; however, the P/E is somewhat elevated compared to the long-term average, as shown below. Its PEG ratio is lackluster at 2.8, meaning investors are paying up relative to the forward P/E and growth expectations for the next 3-5 years. However, the stock's investors are more likely concerned with dividend yield and safety than earnings growth.



Technical

The first graph below highlights AEP's strong rally so far this year. The price has continued to form a series of higher lows, which began in late 2023. More recently, it's become slightly overbought. The stock is just shy of 2 standard deviations above the 50-DMA. Meanwhile, the MACD and RSI are elevated and beginning to turn over. There's likely a better buying opportunity near the 50-DMA at \$98.

The second graph gives more perspective to this year's rally. Although a sharp advance, much of it has been a recovery from the bearish trend throughout 2022 and 2023. The stock isn't showing signs of slowing down, but RSI hasn't been this overbought since the previous top. Similarly, MACD is getting elevated but has yet to show signs of weakness. We'd look for a temporary pullback before making an entry, but the stock seems clear of a larger correction for now.



Disclosure

This report is not a recommendation to buy or sell the named securities. We intend to elicit ideas about stocks meeting specific criteria and investment themes. Please read our [disclosures](#) carefully and do your own research before investing.