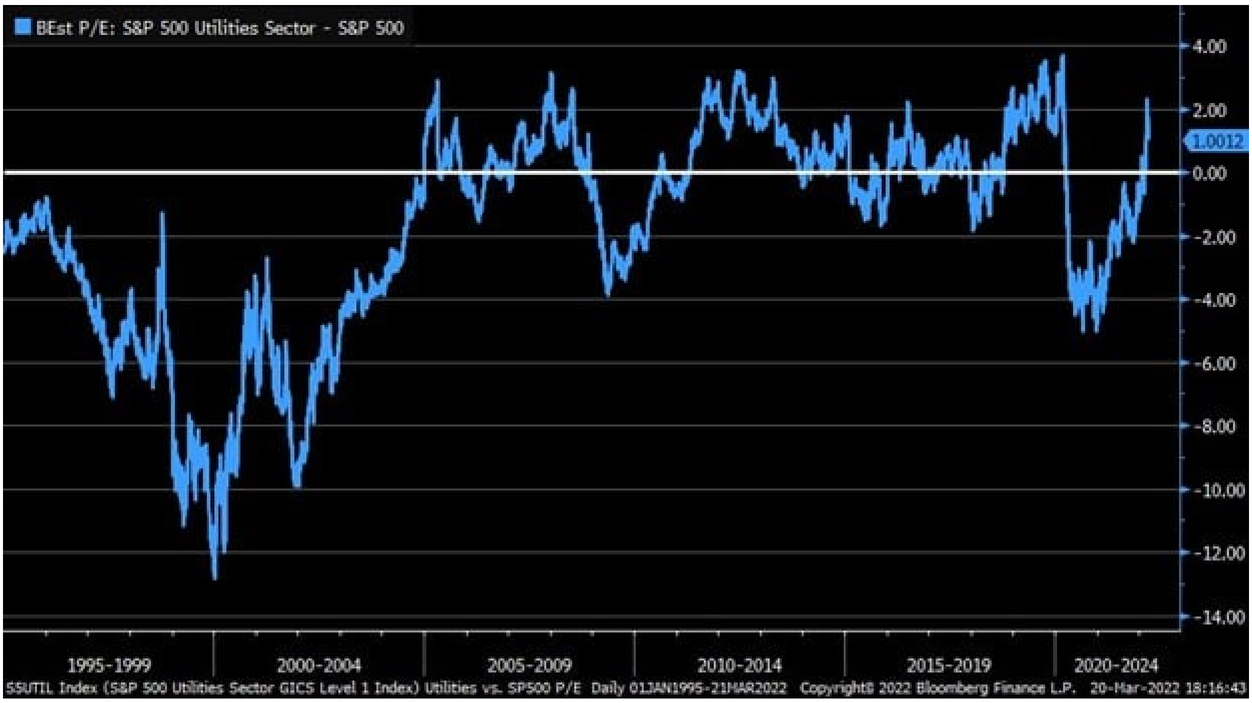
RIA Advice

Five Utilities To Hedge Risk

The idea of hedging risk tends to get away from investors during a relentless bull run as we?ve recently experienced. However, investing isn?t a one-way game. Protecting gains when the tide turns is equally crucial as participating on the way up.

This year, amidst a hawkish Fed, geopolitical risks, and high inflation, we have seen value and low-beta stocks outperforming the market. For instance, the price of the popular Utility sector ETF, XLU, has fallen about 1% year-to-date compared to 6% for the S&P 500 index.

While investors tend to consider Utility stocks as value, that is not always the case. For example, the largest holding of XLU is NextEra Energy (NEE) which trades at a P/E ratio of 32.4, well above the S&P 500 P/E of 25. The graph below shows NEE is not the oddball with an above-market P/E ratio. In fact, at a ratio of 25.75, the Utilities sector has a higher aggregated P/E than the market (S&P 500).



In the effort to buy value stocks versus assuming we own them; this week?s screen looks for five Utility stocks trading at attractive valuations versus the sector and the market. In addition to low valuations, we are seeking companies with relatively low debt and a demonstrated ability to grow sales and earnings. These companies should continue to outperform the broader indexes if risk-off sentiment continues further into this year.

Screening Criteria

Sector = Utilities

We considered the following factors when screening:

- Positive dividend yield
- Current and forward valuations
- Sales and EPS past 5-years
- EPS next 5-years
- Debt levels

The stocks on this list carry a dividend yield of over 2.5%. They encompass a wide range in size, from the largest with a market cap of $48.2b to the smallest of $2.6b. While they all trade at a P/E below that of XLU, some hover near deep value territory, with others are trading closer to the sector P/E.

Ticker	Market Cap. ($b)	P/E	Forward P/E	Long Term Debt/Equity	EPS Next 5 yrs.	Dividend Yield
AEP	$48.2	19.1	18.0	1.40	6.1%	3.3%
EVRG	$15.0	17.0	17.2	1.01	5.1%	3.5%
FTS	$28.6	18.3	16.0	1.36	5.1%	3.5%
OTTR	$2.6	14.9	18.9	0.74	9.0%	2.6%
UGI	$7.4	7.2	10.6	1.25	7.2%	3.9%

Real Investment Advice

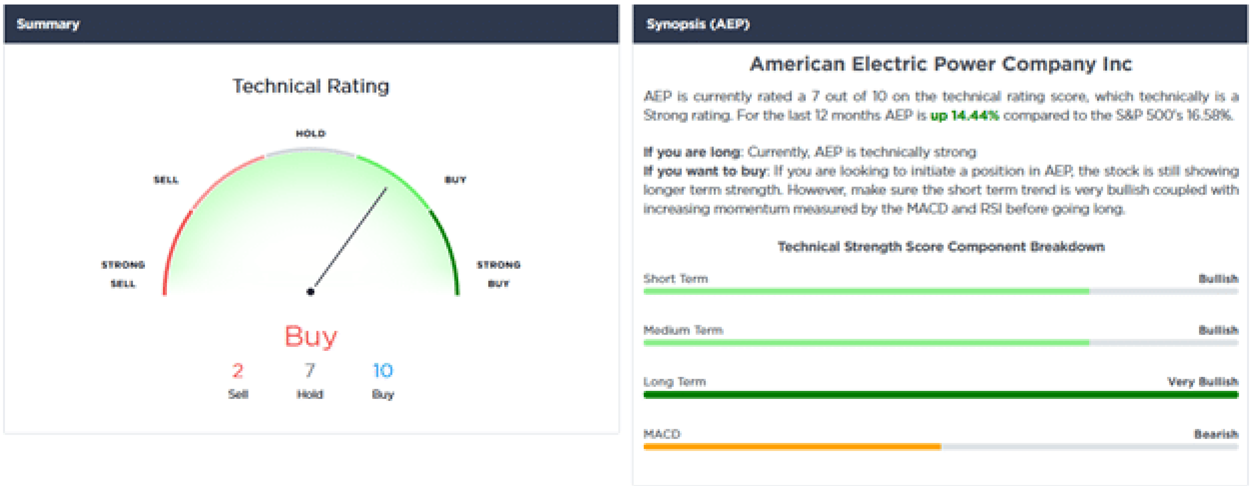
Company Summaries (all descriptions courtesy Zacks)

American Electric Power (AEP)

American Electric Power Company, Inc. is one of the largest investor-owned electric public utility holding companies in the United States. AEP s electric utility operating companies provide generation, transmission and distribution services to the retail customers in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia.

AEP has the highest P/E and forward P/E in this scan. However, they are moderately below that of the market and XLU. AEP is the sixth largest publicly traded utility and constitutes 4.75% of XLU. Therefore, it will be more correlated with XLU than the other stocks in this scan.

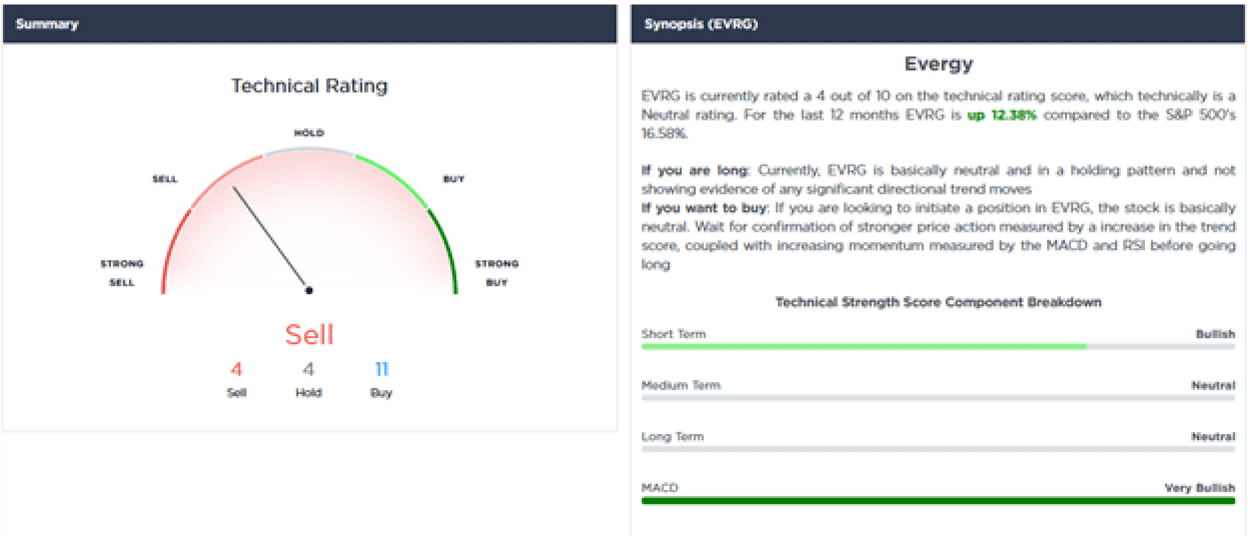
Passive investors blindly buy sectors instead of individual stocks. If passive investors continue to chase value via utilities, AEP should benefit more than the other stocks in this scan. As we show below, AEP has the highest technical rating of the five stocks.



Evergy (EVRG)

Evergy, Inc., through its operating subsidiaries, Kansas City Power & Light Company and Westar Energy Inc., provides clean, safe and reliable energy primarily in Kansas and Missouri. Evergy, Inc., formerly known as Westar Energy Inc., is based in Kansas City, United States.

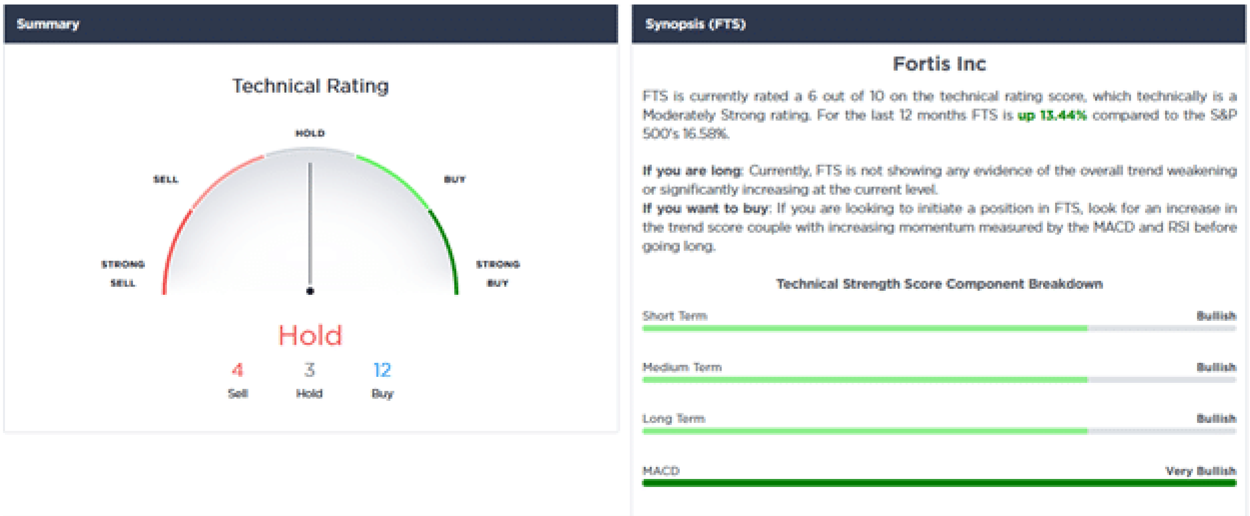
Of the five stocks in this scan, EVRG has the lowest expected growth rate for the next five years. That said, they have a better debt/equity ratio than larger utilities and a nice .75% pickup in dividend yield versus XLU.



Fortis (FTS)

Fortis, Inc. is engaged in electric and gas utility business. The Company offers regulated utilities comprised of electric and gas as well as engages in non-regulated hydroelectric operations. It operates primarily in Canada, United States and Caribbean. Fortis, Inc. is based in St John?s, Canada.

Fortis looks very similar in many valuation ratios to AEP. It is a slightly smaller company, but it is based out of Canada. Because of their Canadian domicile, currency-hedging and different regulatory regimes can result in measurable differences between the performance of AEP and FTS.

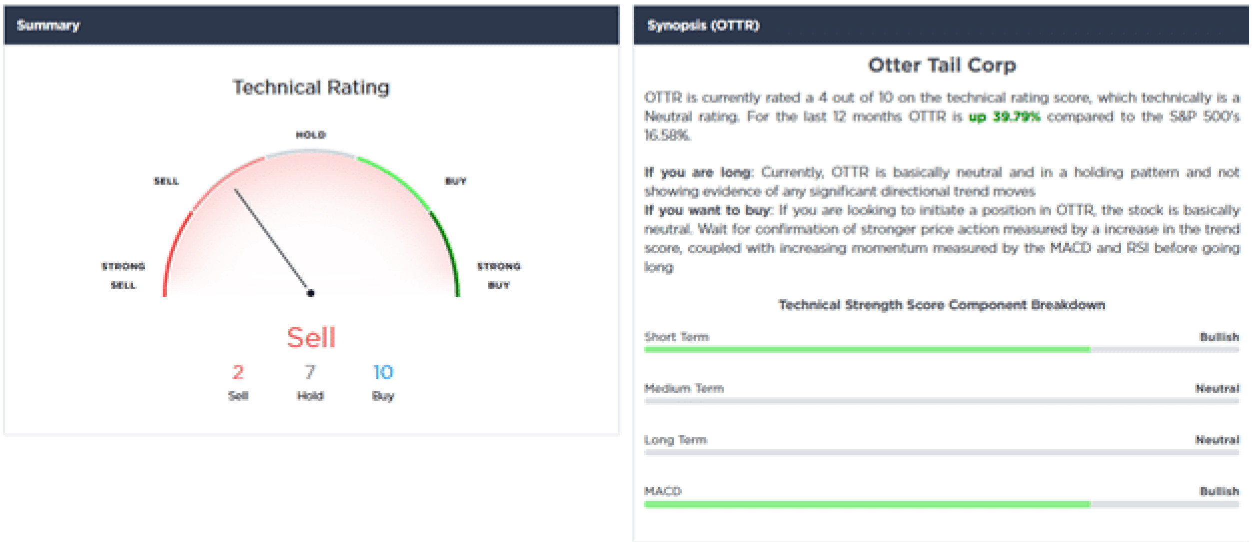


Otter Tail (OTTR)

Otter Tail?s primary business is the production, transmission, distribution and sale of electric energy. The Company, through its subsidiaries, is also engaged in other businesses which are referred to as Health Services Operations and Diversified Operations.

OTTR is a much smaller company than the others in this screen. They also are expected to grow at the fastest rate. Given the small size of OTTR, it is not well invested in by passive investors. This may be to its benefit if the market continues declining and passive investors sell.

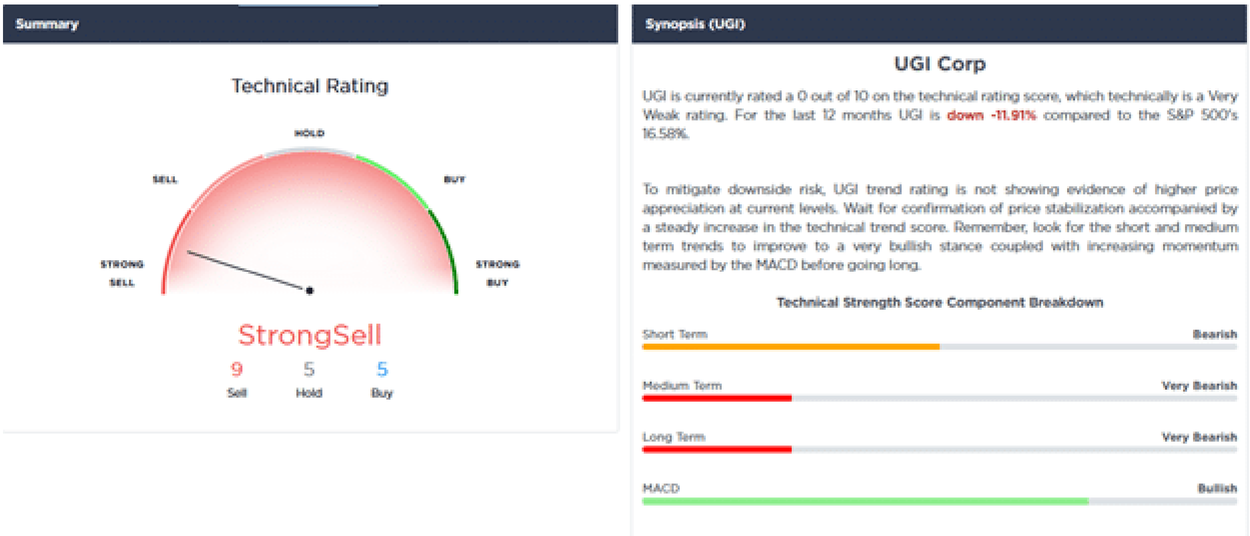
It is worth noting OTTR has the lowest dividend yield in the group but the highest growth rate. Investors should expect to make up in price what they give up in dividends.



UGI Corporation (UGI)

UGI Corporation is a holding company that, through subsidiaries, distributes, stores, transports and markets energy products and related services. They are a domestic and international retail distributor of propane and butane (which are liquefied petroleum gases (LPG)); a provider of natural gas and electric service through regulated local distribution utilities; a generator of electricity; a regional marketer of energy commodities; an owner and manager of midstream assets; and a regional provider of heating, ventilation, air conditioning, refrigeration and electrical contracting services.

UGI is the value play within this group sporting a P/E below 10. The company also has the highest dividend yield of the group. Shares in UGI are down over 20% this year and below pre-pandemic levels. UGI is diversifying into renewable energy sources, potentially offering much higher than industry returns. However, the renewable energy sector has been volatile. UGI appears to have the most reward and the most risk of the five companies. We warn you, however, UGI has bearish technical outlooks, in large part due to its poor performance this year.



Five for Friday

Five for Friday uses stock screens to produce five stocks that we expect will outperform if a particular investment theme plays out in the future. Investment themes may be relevant to the current or expected market, industry and/or economic trends. Investment themes may not always represent our current forecast.

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.