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THE GURU'S CORNER

## Utility player

### Commentary: Utilities benefiting from rising energy prices

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**NEW YORK (S&F) -- You might think that electric utilities, as consumers of energy, would perform more strongly when energy prices are falling.**

However, during the past ten years utility stock prices have shown a marked tendency to move in parallel with the Amex Natural Gas Index ([XNG: news, chart, profile](#)).

The 1997-1998 period was the only exception. (Coal is the most widely used fuel to produce electricity, but natural gas is favored for new generators because it's considered to have fewer environmental costs than coal or nuclear, and because we have a greater ability to meet our needs with domestic production than is the case with oil.)

Apparently, utilities have succeeded in passing along higher energy costs to their consumers.

The charts below show that the Dow Jones Utility Average ([26099800: news, chart, profile](#)) has been in a long-term up-trend since October, 2002. Similarly, so have natural gas producers. The Dow Jones Utility Average recently closed near 271 -- approximately 4 percent above the trendline that has represented a support to prices since October 2002.

There is of course no guarantee that utility stock prices will continue to rise. However, as I discuss below, there are fundamental conditions in the industry that could lend support to utility stock prices if the broader stock market should decline.

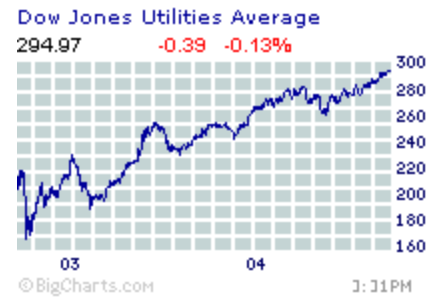
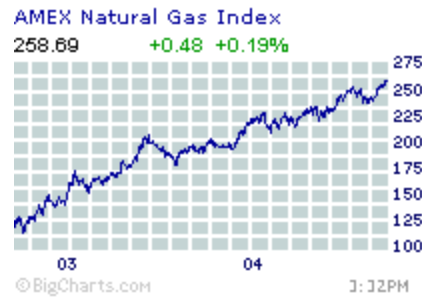
- Dividend yield: The stocks in the Dow Jones Utility Index now pay 3.6 percent per year in dividends. This is low by the historical standards of utility stocks, but quite high compared to dividend payouts elsewhere in the market. (For example, the Dow Jones Industrial Average ([INDU: news, chart, profile](#)) currently pays 2 percent.)
- Supply/demand balance relatively favorable to producers of electricity-From 1982-1999 the maximum generating capacity fell from 130 percent of peak demand to below 110 percent of peak demand. Since then, relative generating capacity has increased to 112 percent of peak demand, which is lower than at any time before 1997.
- Energy consumption per person in the U.S. has remained fairly constant during the past 20 years. In contrast, the growth in energy consumption per dollar of economic production (GDP) has been falling by 1.9 percent per year since 1970 (after adjusting for inflation). The implication is that population growth likely presents a floor under energy demand. However, the utility sector is likely to grow more slowly than the economy if past trends towards increasing energy efficiency continue.

### Recommendations

The above-average dividend yield could add price stability to utility stocks, and also

compensates in large measure for the relatively low potential growth rate in the industry. Trends towards restrictions in energy supply will probably aid the sector, since they have during the past ten years.

An excellent vehicle for utility investment is the Utilities Holdr



([UTH: news](#), [chart](#), [profile](#)). This exchange-traded fund has a dividend yield of 3.9 percent and a very low expense ratio of 0.1 percent per year. Its price action has tracked that of the Dow Jones Utility Average.

Long term investors could take positions at any time. Investors with more interest in attempting to buy market dips might wait for a pullback of 4 percent from current levels, down to \$76/share.

*Marvin Appel is a doctor of medicine in addition to holding an academic doctorate in statistics. He applies his background in computer research and mathematical modeling to create asset allocation strategies for the [Systems and Forecasts](#) newsletter.*

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