

Investing in the Utilities Sector

UTILITIES SECTOR REPORT

Buy-rated Companies:

- **Alliant Energy** - (LNT-Buy; \$50.40)
- **Ameren** - (AEE-Buy; \$73.96)
- **American Electric Power** - (AEP-Buy; \$86.10)
- **Atmos Energy** - (ATO-Buy; \$118.87)
- **CenterPoint Energy** - (CNP-Buy; \$28.49)
- **Duke Energy** - (DUK-Buy; \$96.71)
- **DTE Energy** - (DTE-Buy; \$112.14)
- **Essential Utilities** - (WTRG-Buy; \$37.05)
- **Energy** - (EVRG-Buy; \$53.35)
- **MDU Resources** - (MDU-Buy; \$25.20)
- **NextEra Energy** - (NEE-Buy; \$63.91)
- **NiSource** - (NI-Buy; \$27.66)
- **Southwest Gas** - (SWX-Buy; \$76.13)

Source: FactSet. Prices and opinion ratings are as of market close on 3/28/24 and are subject to change.

For more information:

Individuals can obtain the full research report with full disclosures on any of the companies mentioned in this report by contacting a local Edward Jones financial advisor, or write to: Edward Jones, 12555 Manchester Road, St. Louis, MO 63131. Information about research distribution is available through the Investment Services link on www.edwardjones.com.

Despite being among the smallest industries in the stock market, we believe utilities can be an important holding in investors' portfolios. Utilities tend to pay a relatively high percentage of their earnings to shareholders in the form of dividends. In many cases, utility dividends grow slowly over time. This growing stream of income can help investors reduce the impact of inflation. Additionally, utilities display defensive characteristics since most customers view their services as essential. For that reason, we believe that traditional regulated utilities are among the companies least affected by changes in the health of the economy. This typically leads to more stable earnings in periods of economic downturns relative to many other industries. In the market pullback we saw in 2022, utility stocks acted defensively. However, in 2023, utility stock performance was very weak relative to the broader market. Utility stocks now trade at a price-to-earnings ratio that is below that of the broader market. We view utility stocks as an important piece of a diversified portfolio, and we believe clients have an opportunity to buy quality utility companies at reasonable prices.

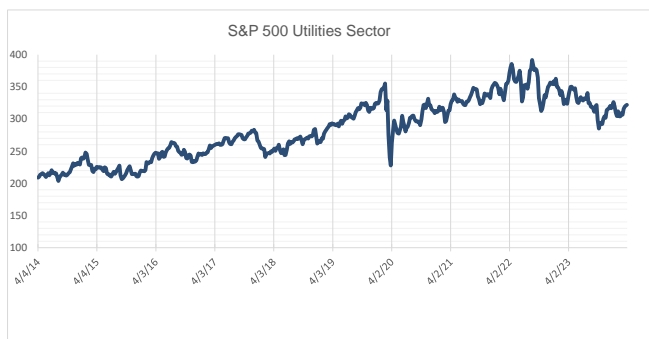
In this report, we will discuss developments in the utility industry and our current view on utility fundamentals, as well as discuss how valuation has changed over the past several years:

- We believe utility industry fundamentals will remain healthy and supportive of reasonable earnings and dividend growth.
- Utility stocks now trade at a price-to-earnings ratio that is below that of the broader market. We believe clients have the opportunity to buy quality utility companies at reasonable prices.
- The S&P 500 Utility Index displayed defensive properties in the market downturn despite the increase in interest rates investors saw in 2022. However, in 2023, utility stock performance was weaker than the broader market, as interest rates continued to rise.

Why have utility stocks done well over the long term?

Utility investors have generally enjoyed good performance over the past decade (see **Figure 1** on the next page) as well as consistent dividend growth from many utility companies. We believe a combination of utility-related factors, as well as macroeconomic issues, have created and sustained this positive environment. Within the utility sector, companies increased their emphasis on infrastructure and environmental investments, which has led to improved earnings growth (as utilities are allowed by regulators to earn a specified return on approved investments). This, combined with many utilities' management teams refocusing on core regulated businesses, has been attractive to investors.

Figure 1



Source: FactSet, 3/28/24. S&P 500 Index is based on the average performance of around 500 widely held common stocks. S&P 500 Utility Index consists of 30 utility companies within the S&P 500 Index. These are unmanaged indexes and cannot be invested in directly. Past performance is no guarantee of future results.

On a separate plane, macroeconomic factors, such as a historically low-interest-rate environment and a corresponding lack of options available to investors to generate current income, helped boost utilities in most years since the financial crisis. Many investors have used utilities and other defensive sectors as substitutes for bonds, as equity dividend yields often exceeded bond yields for the same company. This philosophy worked well in an ascending market for utility stocks, as some investors were happy to realize significant capital appreciation in addition to healthy and often rising dividend payments. Over time, utility stocks have often reacted to increases and decreases in interest rates. Utility stocks typically have seemed to perform well when interest rates fall (or there is an indication that they will not rise further) and fall when rates rise. Recently, utility stocks have performed poorly, largely due to the significant increase in interest rates, in our view.

Utility company fundamentals remain solid

In our view, utility industry fundamentals remain healthy and supportive of reasonable earnings and dividend growth for the next several years. Regulated utilities hold virtual monopolies in their service territories, and they earn an allowed return on approved investments, of which there are hundreds of billions of dollars' worth needed in the U.S. The national average for allowed returns for both electric and gas utilities remains at just under 10%, a level that we believe will enable utilities to sustain profit growth.

Additionally, many utility companies have realized that infrastructure spending to update, maintain, repair and expand power lines, pipes and power plants is a lower-risk way to grow earnings than diversifying into nonutility businesses. Companies have identified

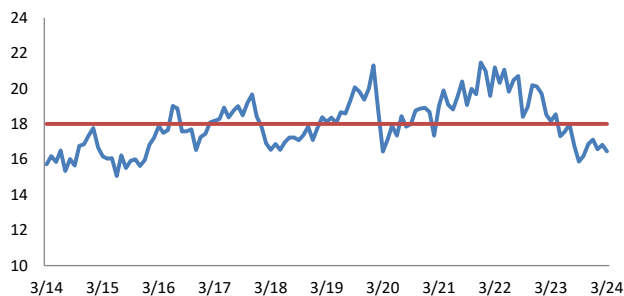
projects that they are able to finance and that can potentially lead to higher earnings. We have seen companies focusing on such investments and divesting ancillary, nonutility businesses, leading to more stable, reliable earnings. We believe well-managed utilities can increase earnings at 5% to 6% annually on average for the foreseeable future, with corresponding dividend growth.

Valuations are below historical averages

On a price-to-earnings basis, the S&P 500 Utility Index is now trading below its historical average (see **Figure 2**). Additionally, when viewed relative to the broader market, utility stocks are trading below the S&P 500 based on their price-to-earnings ratio (see **Figure 3**). We believe utility stocks remain an important piece of a well-diversified portfolio. Based on current valuations, we think clients have an opportunity to buy quality utility companies at reasonable prices.

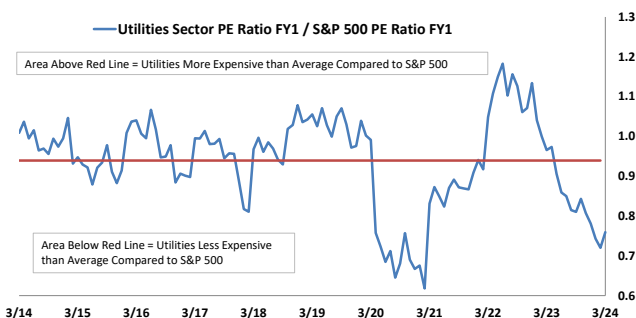
Figure 2

S&P 500 Utilities P/E Ratio FY1



Source: FactSet, 3/28/24. The S&P 500 Index is based on the average performance of around 500 widely held common stocks. The S&P 500 Utility Index consists of 30 utility companies within the S&P 500 Index. These are unmanaged indexes and cannot be invested in directly. Past performance is no guarantee of future results.

Figure 3

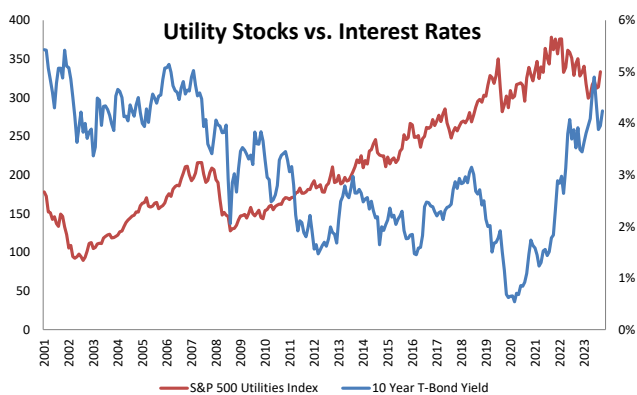


Source: FactSet, 3/28/24. The S&P 500 Index is based on the average performance of around 500 widely held common stocks. The S&P 500 Utility Index consists of 30 utility companies within the S&P 500 Index. These are unmanaged indexes and cannot be invested in directly. Past performance is no guarantee of future results.

What about interest rates?

Let us look closer at the relationship between utility stocks and interest rates (the 10-year Treasury yield). We believe that investors should be aware that, historically, utility stock prices and the 10-year Treasury yield have tended to have an inverse relationship. This means that when interest rates rise, utility stock prices tend to move down, and vice versa, although there have been exceptions to this. In 2023, utility stocks were seemingly heavily influenced by the direction of interest rates, with utility stocks falling as interest rates rose (see **Figure 4**). In recent years, we believe the low-interest-rate environment was an important factor in pushing utility stocks higher, since many investors buy them for their dividend yield. However, in 2023, with interest rates rising, utility stock performance was very weak.

Figure 4



Source: FactSet, 3/28/24. The S&P 500 Index is based on the average performance of around 500 widely held common stocks. The S&P 500 Utility Index consists of 30 utility companies within the S&P 500 Index. These are unmanaged indexes and cannot be invested in directly. Past performance is no guarantee of future results.

Should I adjust my portfolio as interest rates move?

We think it is appropriate to periodically review portfolios and rebalance sector weightings. Certain life events or macroeconomic changes can demand timely examination of portfolios. We are aware that many investors have a weighting in excess of the firm's recommendation to utilities, and we understand that there may be individual reasons why this is appropriate. Importantly, we recommend investing based on principles and not trying to move in and out of stocks based on predictions, whether for the economy, the stock market as a whole, or interest rates in particular. We believe in diversification and quality and advocate owning a portfolio of dividend-paying

stocks for the long run, through the ups and downs of the interest-rate cycle.

Even professionals find it very difficult to predict the direction and magnitude of interest rate changes, so we would not recommend making major changes to portfolios based on predictions. We continue to believe utility stocks have some attractive characteristics, and we believe they should be part of a diversified portfolio, regardless of short-term movements in interest rates.

While utilities offer a number of positives for investors, we note the risk of having too heavy a weighting in any one sector. For those investors whose utility holdings are significantly higher than our recommendation, we suggest looking to the Edward Jones Equity Income Buy List for ideas in other sectors. The Equity Income Buy List consists of a mix of dividend-paying stocks from different sectors recommended by the Edward Jones Securities Research Department. The list is designed to provide an above-average dividend yield and the potential for rising income.

Within the utility sector, we suggest diversifying across the sector in one or more ways. Investors can diversify geographically (where the utility is located) to reduce weather and regulatory risks. They may also diversify by type of utility (electric, natural gas, water). Finally, investors may find value in staggering the months the quarterly dividends are paid.

Factors in evaluating utility companies

We look at many factors when developing ratings for our utility coverage. Important factors include the degree of reliance on nonutility businesses, regulatory treatment, and growth potential. We generally prefer companies that derive a very high percentage of their earnings from regulated utility businesses (rather than the nonutility businesses some companies in the industry are involved in). **Duke Energy (DUK)** has divested the vast majority of its nonutility businesses over the course of many years and now earns nearly all of its income from its regulated utilities. We also look for companies that operate under supportive regulatory treatment. **Essential Utilities (WTRG)** is an example of a company that operates under supportive regulation in most of its service territories. The majority of its earnings come from Pennsylvania, which tends to be very supportive of utilities. Finally, we analyze potential for growth at utilities with a preference for those that we believe have significant investment opportunities that can lead to faster growth. **NextEra Energy (NEE)** operates a Florida utility with opportunities to invest

not only in new customer connections as Florida's population grows, but also in the hardening of its utility infrastructure to combat hurricanes and other storms that occur in the state. Additionally, NextEra develops renewable power projects (primarily wind and solar power) for other utilities.

Environmental, Social and Governance (ESG) Considerations

Investor focus on ESG risks in the utilities sector tends to be primarily on the environmental component of ESG. Social issues, like the health and safety of employees and talent development within an organization, along with governance concerns, such as the quality of the board of directors and corporate ethics, are certainly important. However, given the environmental impacts that can occur from burning fossil fuels to produce electricity and for heating purposes, most investor interest tends to be directed to a utility's environmental profile. Investors often look at issues such as how much coal-fired generation (the most pollution-intensive large-scale form of electricity generation) and natural-gas-fired generation (a somewhat cleaner-burning fossil fuel) a utility currently uses and the impact this may have on the environment in the form of greenhouse gases and other pollutants. However, along with risks from fossil-fuel-based electricity generation comes opportunity. Utilities are allowed to earn a return on investments in new infrastructure, which includes new solar and wind-powered generation. As utilities retire coal and other fossil-fuel-fired generating plants in the coming decades, we expect them to benefit from growth in both renewable power generation and transmission lines to connect these new generating assets to the existing grid. We believe most of the companies we recommend do a good job managing ESG-related risks.

Risks besides valuation

Despite their regulated nature, utility stocks carry various risks that investors should consider. Risks to the relative performance of utility stocks would include better-than-expected or faster overall economic growth, evolving or new legislation concerning environmental guidelines and/or renewable power sources, and rising long-term interest rates. Utility-specific risks would include the potential for declining allowed returns, rate-case fatigue as companies repeatedly seek reimbursement of capital spending, fluctuations in commodity prices, and managing regulatory relationships.

Valuation -- Methods used to evaluate the attractiveness of utility stocks include traditional measurements such as price-to-earnings (P/E), price-to-book value (P/B), and P/E relative to the summation of our earnings growth outlook and the dividend yield (PEGY), both on an absolute basis and relative to competitors.

Risks common to all utilities include

- Rising long-term interest rates can negatively impact the share price as alternative investments become more attractive.
- Adverse regulatory or legal decisions, as well as significant changes in commodity prices such as for electricity and natural gas, can negatively impact earnings, cash flow and the share price.
- A weak economy can reduce demand and thus negatively impact earnings, cash flow and the share price.

Please see the individual research reports for additional information, including disclosures, analyst certifications, valuation and risks specific to each company.

Analyst Certification

I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

Mike Doyle, CFA

Required Research Disclosures

Analysts receive compensation that is derived from revenues of the firm as a whole which include, but are not limited to, investment banking revenue.

Other Disclosures

This report does not take into account your particular investment profile and is not intended as an express recommendation to purchase, hold or sell particular securities, financial instruments or strategies. You should contact your Edward Jones Financial Advisor before acting upon any Edward Jones Research Rating referenced.

All investment decisions need to take into consideration individuals' unique circumstances such as risk tolerance, taxes, asset allocation and diversification.

It is the policy of Edward Jones that analysts or their associates are not permitted to have an ownership position in the companies they follow directly or through derivatives.

This opinion is based on information believed reliable but not guaranteed. The foregoing is for INFORMATION ONLY. Additional information is available on request. Past performance is no guarantee of future results.

In general, Edward Jones analysts do not view the material operations of the issuer.

Diversification does not guarantee a profit or protect against loss in declining markets.

Special risks are inherent to international investing including those related to currency fluctuations, foreign political and economic events.

Dividends can be increased, decreased or eliminated at any time without notice.

An index is not managed and is unavailable for direct investment.

Edward Jones - Member SIPC