All major electric utilities located in the Central region of the United States are reviewed in this Issue; Eastern-based electrics, in Issue 1; and the Western-based electrics, in Issue 11.

Electric Utility (Central) stocks covered in *The Value Line Investment Survey* increased 6.9% in value, on average since our last review three months ago, surpassing the 4.7% jump in the S&P 500.

Utilities, which have been one of the worst-performing sectors over the past few years, have started to recover of late due to elevated power demand from artificial intelligence (AI) innovations and data centers, along with the uptrend in interest rates pausing. While utility equities are typically seen as a safe competitive investment vehicle to U.S. debt securities for conservative investors, the artificial intelligence boom is changing this traditional landscape. Indeed, data centers are set to grow exponentially over the next few years, requiring record levels of electricity. Electric utilities are well positioned to take advantage of the AI boom, as well as bring in new types of investors. Too, the expectation of where interest rates will go next is starting to favor these equities in anticipation of the Federal Reserve's dovish pivot. And, the spread between the 10-year Treasury rate and dividend yields on electric utilities has narrowed since our last report.

Long-Term Prospects

Total return potential for electrics in the 3- to 5-year time frame is at the high end of what we've seen over the past couple of years. And, a number of equities continue to trade at double-digit discounts to historical valuations. But, we remain somewhat concerned with the macroeconomic backdrop, and utility investors should move forward with caution, despite a number of upcoming catalysts. We recommend buying electrics with annual total return potential of at least 12%. Investors should also keep an eye on utilities with above-average dividend growth prospects (4.5%), a strong balance sheet, and a well-diversified portfolio. While equities covered in the Electric Utility (Central) Industry do not stand out for price appreciation potential, the reduced risk of electrics adds to their appeal.

Macro Environment

Well-positioned electrics should rebound nicely for a number of reasons if interest rates begin to drop. Income-oriented investors closely monitor the spread between the yield on government bonds, such as Treasurys, and the yield on the typical electric utility. As interest rates have soared over the past few years, more and more investors have dropped utility equities in favor of Treasurys. But this may be reversing moving forward. What's more, higher interest rates, as well as wage, material, and fuel inflation, continue to negatively impact regulatory recoupments. Some stocks are better positioned than others, with rate cases and real-time pricing adjustments to minimize regulatory lag. And, the regulatory climate varies significantly by territory. Thus, it is important to be selective and look for equities with strong regional economies and regulatory environments. States that are committed to the AI infrastructure build-out and green-energy goals will probably fare better over the coming years. Indeed, *American Electric Power* recently filed a request in Ohio, which is one of the most-favorable climates regarding new data centers. The utility expects data centers to double the current power demand in the Ohio region by 2030.

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Artificial Intelligence Boom

As mentioned earlier, demand for power is expected to reach record levels over the next few years due to technological innovations and the copious amounts of electricity used by AI-focused data centers. A number of electrics anticipate that power demand will more than double over the next five years. *ALLETE* recently agreed to be acquired, in part to be better positioned for the AI boom and record power demand. As a small utility in public markets, *ALLETE* was struggling to raise the necessary capital for its transmission transformation and building the grid. The pending buyout would allow *ALLETE* to take advantage of the biggest demand jump in its history, and build the infrastructure for new data centers. These technological advancements are a strong catalyst for long-term prospects and have brought a whole new group of investors to electric utilities.

Conclusion

Utilities have outpaced the broader-market averages of late. Growing electricity demand from data centers, the emerging AI boom, and the prospect of lower interest rates in the near future are positive factors. That said, other macro challenges continue to negatively impact performance from the group. We recommend that investors stay selective when committing funds.

Utilities currently have strong long-term capital appreciation potential compared to the *Value Line* median. We recommend looking for equities with 12% or greater long-term annual return potential, and average dividend growth of 4.5% or more. The favorable risk profile of electric utilities is also worth considering. Investors should also take note of states with positive data center and green energy transition regulatory environments, as companies in these regions will likely be the best positioned for the future. As always, investors should look out for future rate-setting meetings.

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