All major electric utilities in the western region of the United States are reviewed in this Issue; eastern-based electrics, in Issue 1; and the remainder in Issue 5. Since our last review of the Electric Utility (West) group three months ago, utility stocks covered in *The Value Line Investment Survey* declined by 0.7% in value on average versus a 7.3% gain in the S&P 500. The industry's Timeliness rank has moved to 86 (of 93) from 84.

During the past year, utilities under our coverage have fallen 7.4% on average versus a 7.7% increase in *The Value Line Arithmetic Index*. Rising interest rates through much of 2023 pressured utility stocks. The equities had a decent end-of-year rally in mid-October, only to reverse course through February. Another run-up into May was erased in June/July. While the group hasn't been able to sustain much of a rebound, the bleeding stopped when the uptrend in rates paused.

Treasurys provide a competitive investment vehicle, so it's important to be cognizant of the spread between bond rates and the dividend yields on utilities (recently 4.03% on average). The 10-year Treasury yield peaked in mid-October at 4.98%, fell sharply to 3.88% in late December, and now stands at 4.28%. While the aforementioned spread is important, expectations of where rates are headed next is of more consequence. Another major factor is the economic backdrop. This is a defensive industry with low-Beta stocks that tend to outperform when investors rotate out of economically sensitive, higher-Beta equities.

Utility Portfolio Considerations

While many equities within the Electric Utility (West) Industry remain depressed relative to their highs of a few years ago, we're not overly bullish on this group. If interest rates fall, it's highly likely that well-positioned utility stocks will perform well over the intermediate term. But, we think it's doubtful that the overly favorable backdrop for interest-rate sensitive stocks, often witnessed over the past several years, is on its way back. If interest rates on government bonds normalized to the mid- to high-single-digit range, electrics would be deemed relatively overvalued.

Utility investors can help their cause by being disciplined buyers. New commitments should be made when the midpoint of the annual total return projections are no less than 12% (the median for the group now stands at 10.5%). It would also be a good practice to emphasize utilities with above-average dividend growth prospects. We'd put the industry median at about 4.5% for that measure. Keeping a well-diversified group of dividend-paying stocks is a good practice. And, sticking to utilities in an average or better regulatory climate, with a service area that exhibits solid growth prospects makes sense.

At present, we like *Portland General Electric*, as it possesses the aforementioned qualities. We also think *Sempra Energy* and *Pinnacle West Capital* should be on investors' watch list because they have solid longer-term fundamentals. We'd like to see slightly lower entry points so that they could be picked up at an average potential annual total return level of 12% or better. The lever for the former equity is at about 11.5% while the level for the latter stands at 10.5%.

Topical Considerations

Headwinds electrics are facing include high interest rates and costs. Due to how the regulatory mechanisms work, certain spending can rapidly be passed on to consumers, while others cannot and have to go through a regulatory process. The lag before recoupment may be as short as a few weeks, but in some instances can drag on for a few years.

INDUSTRY TIMELINESS: 86 (of 93)

Another challenge is the level of authorized return on equity (ROE) that's being set by some regulators. They're looking back to a time of historically low interest rates and using that stretch to price returns in the present. Note that the ROE applied to investments made in grid infrastructure (known as the rate base) is what drives profits in these regulated monopolies. Utilities recoup their investment plus a return on it through the approved delivery rates they bill for.

High purchased power costs during peak demand have been exacerbated by the shuttering of western coal generation. Also, under mild weather conditions, the supply of "green" energy, including hydro and wind, can be diminished. The impact is exacerbated since open-market power purchases are often not an automatic or rapid pass-through to consumers. This situation may represent an opportunity, as more generating capacity under utility ownership makes sense.

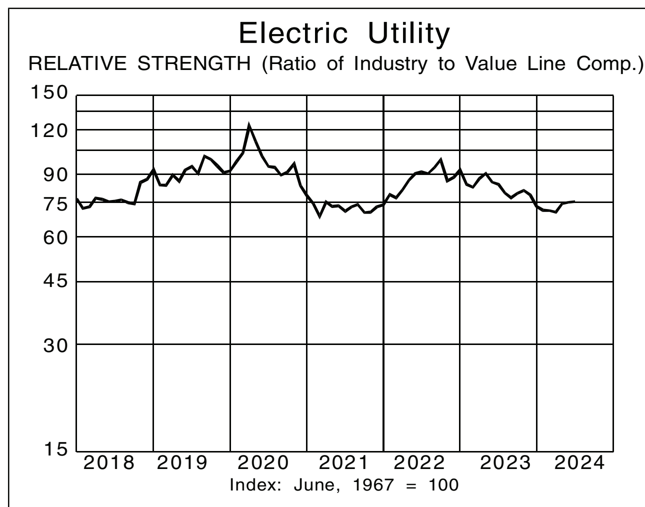
Lastly, with *PG&E Corp.* back within our coverage, and *Edison Int'l* embroiled in some new wildfire lawsuits, a discussion on business risk in California remains topical. Regarding the lawsuits impacting *Hawaiian Electric* and now *Xcel Energy*, we'd refer subscribers to the respective company reviews.

The California Wildfire Fund of 2019 is a form of insurance for the state's electric utility holding corporations (*Sempra Energy* is the third), funded by the companies and their customer base up to $21 billion. Pre-2019 disasters are not covered and individual claims are paid after a $1 billion deductible is incurred. The fund covers catastrophic losses, but not gross negligence. With this added protection, bankruptcy risk for California electrics is much lower.

Conclusion

For individual utilities, regulatory climate and the overall health of the underlying regional and local economies encompassed within a service area are key variables. Progressive renewable-energy goals within a state territory may also be a plus.

Anthony J. Glennon



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