# The safest area of the stock market is getting obliterated by rising interest rates

Matthew Fox Oct 3, 2023, 6:23 AM PDT

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**One of the most defensive areas of the stock market has been obliterated by rising interest rates.**

**Utility stocks are down 24% year to date and are the worst performing sector of 2023.**

**The high-yielding nature of utility stocks is seeing intense competition from 5% cash returns.**



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One of the most defensive areas of the stock market has been obliterated by rising interest rates this year.

The utility sector is down a whopping 24% year to date, as measured by the Utilities Select Sector SPDR ETF, making it the worst performing sector of 2023 so far. The sector was down 5% alone on Monday.

The sharp decline has come amid an ongoing rise in interest rates, with the 10-year US Treasury yield jumping from 3.75% at the start of the year to 4.73% today.

Investors have often flocked to utility stocks during periods of market and economic stress because of their high dividend yields, but that allure has faded now that cash offers a risk-free return of about 5%. The Utilities Select Sector SPDR ETF currently offers a dividend yield of 3.77%, which is more than double the S&P 500's 1.50%.

Not only have utility dividend yields often outpaced the S&P 500, but they've also been higher than bonds for nearly two decades.

"The average monthly yield for the S&P 500 Utilities sector since December 2004 was 3.3% versus the average 10-year yield of 2.8%," CFRA Research chief equity strategist Sam Stovall told Insider on Monday. Today, investors can get one full percentage point more in yield from Treasury bonds than from utility stocks.

The sector is also defensive because utilities usually have regional monopolies, with regulators often granting them small price increases over a multiyear time frame, allowing for low but steady growth. And during periods of economic stress, consumers' top priority is to pay their monthly utility bill to keep the lights.

But after a period of stellar outperformance in 2022, when the sector was down just 1% compared to the 19% decline seen in the S&P 500, that has completely unraveled. Since the start of 2022, the utility sector is down 22% compared to a 10% decline for the S&P 500.

Part of that has to do with the fact that utility companies rely on a lot of debt to fund their operations and build out their energy production capacity, upgrade their grid, and improve their reliability. And all that debt, most of which was financed during a period of near-zero rates, is set to add to costs once utilities take on new debt or refinance existing debt at higher rates.

The debt-to-equity ratios of the three biggest utility companies — NextEra Energy, Southern Company, and Duke Energy — are all elevated relative to other sectors, currently between 1.6x and 2.0x.

And the regulated nature of utilities limits their ability to pass those higher rate-related costs on to consumers as they have to get approval to raise their prices, which are typically fixed for a multiyear period.

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The inverse relationship between interest rate movements and utility stocks is well documented, and Stovall offered insight on just how reliable this negative correlation is.

"Since 1970, there has been a negative 19% correlation between the monthly price change for the S&P 500 Utilities sector and the change in the 10-year yield, implying that whenever the yield goes up, there was a high likelihood an inverse reaction by the sector," Stovall said.

For investors that piled into utility stocks over the past couple of years in search of defense, the pain has been real and at this point the only remedy is a sharp decline in interest rates. And that might not happen anytime soon.

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