

# Utility Stock Prices and Interest Rates

## UTILITIES SECTOR REPORT

### For more information:

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Higher dividend-paying stocks historically have tended to exhibit a strong relationship between their dividend yields and long-term interest rates (i.e., 10-year Treasury bond rate). If long-term interest rates rise (all else being equal), many utilities could potentially see significant declines in share price. However, we believe that by owning quality utility stocks in appropriate amounts, investors have the ability to earn a competitive total return over the long term.\*

Assuming a 1-for-1 relationship between changes in long-term interest rates and utility stock yields, an immediate upward shift in long-term interest rates by 0.5%, 1.0%, 1.5% and 2.0% would imply the following price declines:

Increase in Interest Rates		+0.5%	+1.0%	+1.5%	+2.0%
Yield	5.0%	5.5%	6.0%	6.5%	7.0%
Annual Dividend	\$0.50	\$0.50	\$0.50	\$0.50	\$0.50
Stock Price	\$10.00	\$9.09	\$8.33	\$7.69	\$7.14
Price Decline		-9.1%	-16.7%	-23.1%	-28.6%
Equivalent Years of Dividends		1.8	3.3	4.6	5.7

While this example is hypothetical, it is important to note that despite the recent increase in interest rates, today's rates are still relatively low by historical standards. If we do see a more prolonged period of rising interest rates, this could hurt the share prices of utilities. Additionally, utility stocks have generally performed well despite interest rates moving higher this year (we believe this is due to their defensive nature during economic uncertainty). This solid performance in the face of rising interest rates could increase the risk of a downward move in utility stocks if interest rates continue to ascend, since utility stock prices tend to move in the opposite direction of interest rates.

### In the Short Term:



### The opposite is also true.

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Please see important disclosures and analyst certification on page 2 of the report.

## A Case History

History provides us with examples of what can happen. From 10/15/93 to 11/07/94, the yield on the 10-year T-bond increased rapidly from 5.17% to 8.03%. During this time, the S&P 500 Utilities Index\*\* declined over 23%. However, the long-term performance of this index has been much better. Over the last several decades, the S&P Utilities index has provided mid-single-digit average annual total returns.

## What Investors Should Do

We believe utilities still have a place in investors' portfolios because they typically provide both the potential for dividends and, when bought with other stocks, diversification. In fact, we follow several utilities with a Buy rating for growth-and-income investors. However, investors should understand that prices of utility stocks can decline significantly over the short term (without a change in company fundamentals) due to increases in long-term interest rates. Please see your financial advisor for a portfolio review, if necessary, to help ensure your portfolio is properly diversified.

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\*It is important to remember there are risks to investing in stocks. Share prices and returns will vary, so investors may lose money. Investing for short periods makes losses more likely.

\*\*The S&P 500 Utilities Index consists of 29 companies within the S&P 500 Index. The S&P 500 Index is based on the average performance of 500 widely held common stocks. These are unmanaged indexes and cannot be invested in directly. **Past performance is no guarantee of future results.**

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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**

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