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Utilities Stocks Have Fallen off a Cliff. They Just Got Downgraded, Too.

By Jacob Sonenshine Follow Oct. 17, 2022 4:37 pm ET

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Utility stocks do well during hard times because people and businesses always need power and gas. Above, Con Edison workers are seen in New York City.
Kena Betancur / AFP via Getty Images

Now isn't a good time to buy utility stocks, strategists at Truist said, citing a web of factors that span recent trading patterns and the economic backdrop.

The bank's investment strategy team, headed by Keith Lerner, cut their view of the sector to Neutral from Overweight. "Technical trends have weakened recently, and fundamentals and valuations are mixed, warranting a neutral view," the team wrote in a research note.

Those elements are all connected, of course, but the technical picture helps illustrate how investors see the situation.

The Utilities Select Sector SPDR exchange-traded fund (ticker: XLU) has risen to around $77 a share three times this year, each time facing selling pressure at that level that knocked the price down. It is currently hovering at around $63, after falling from about $77 in mid September to a new low for the year of near $61 in early October.

The point is that there are few buyers at the resistance level. The selling continued even as the price had dropped. That signifies weak interest in stocks in the sector.

The Utilities Select ETF is outperforming the S&P 500 with a loss of11% compared with the market benchmark's 23% slide, but it is no longer as far ahead as it was earlier in the year. The reason for that is fundamental.

Utility stocks had run up to start the year because they're defensive. People and businesses always need utilities like power and gas, so utility companies' sales and earnings streams are fairly stable, unlike many others sectors, which see declines in profits when economic demand takes a hit. Utility stocks have made sense as worries about the economy have mounted in response to the Federal Reserve's policy of fighting inflation by raising interest rates to reduce demand for goods and services.

The problem is that the utility stocks had gained so much that the dividends they offered shrank significantly relative to the cost of the shares. Even with the latest decline in utility-stock prices, the Utilities Select ETF's dividend yield is still low, at 2.85%, according to FactSet. That can't lure in buyers when the ultrasafe 10-year Treasury note yields close to 4%.

We flagged that issue about a month ago. *Barron's* Andrew Bary wrote in mid September that utility dividend yields were too low and that it was time to move on from buying the stocks for the moment.

Right now, either the 10-year yield has to decline or utility stock prices have to keep dropping in order for share prices in the sector to start performing well.

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