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Utility Stocks Aren't Acting Like The Havens They're Supposed Be. Here's Why.

By Lawrence C. Strauss June 12, 2020 12:29 pm ET

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Although utility stocks offered some relative safety during Thursday's steep stock selloff, the group has underperformed during much of the pandemic over the last three months.

The Utilities Select Sector SPDR ETF (ticker: XLU) fell 3.9% on Thursday, ahead of the S&P 500's drop of 5.9%—offering some protection form the storm.

In recent months, however, the sector hasn't always lived up to its reputation as a defensive haven for investors in difficult stock markets.

Since the S&P 500 peaked on Feb. 19, utility stocks, as measured by the exchange-traded fund, have a return of about minus 15%, versus minus 11% for the broader market.

During the second quarter, which until Thursday had seen big stock market gains, utility stocks have trailed as well. As of Thursday's close, the group had returned about 6%, compared with around 16% for the S&P 500.

True, since the market bottomed on March 23, stocks overall had been in an upswing, which doesn't always play to the strength of utilities.

What gives?

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Charles Fishman, a utility analyst at Morningstar, points out that “utility valuations in February were at record highs,” and that “commercial and industrial electricity demand reductions and delay in investment due to the pandemic” have weighed on these stocks as well.

In May, power demand in the U.S. was down 8% year over year, according to Morgan Stanley. That follows a 5% drop in April.

But even after lackluster performance recently, utility shares still aren’t cheap. The stocks in the Utilities Select Sector SPDR ETF trade at about 19 times their current fiscal year profit estimates, according to FactSet. That’s above their five-year average of a little below 18 times.

However, earnings estimates for the utility ETF have held up in recent months. The mean analyst estimate for 2020 earnings is $3.22 a share, slightly below where it was at the end of last year, according to FactSet.

One aspect of utility stocks that the market doesn’t appear to giving a lot of credit to is dividend safety. As *Barron’s* argued in an April story, regulated utilities have some insulation, given how they are often allowed by regulators to earn a reasonable return on their investments.

Utility dividend cuts in the sector have been few and far between.

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