CIF Sector Recommendation Report (Fall 2012)

Sector Utilities  

Review Period 10/4/12 – 10/17/12

Section (A) Sector Performance Review

Cougar Investment Fund Sector Review Spreadsheet

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Current Price</th>
<th>Beg. Price</th>
<th>Stop-loss Price</th>
<th>Target Price</th>
<th>% Cap Gain</th>
<th># Shares</th>
<th>Current Value vs. Sector vs. S&amp;P 500</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>$INX 1460.91</td>
<td>1450.99</td>
<td></td>
<td></td>
<td>0.68%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sector ETF</td>
<td>XLU $37.24</td>
<td>$36.59</td>
<td></td>
<td></td>
<td>1.78%</td>
<td>1510</td>
<td>$56,232.40</td>
</tr>
</tbody>
</table>

Current Holdings

![Graph showing performance of XLU and S&P 500](graph.png)
As you can see, the Utilities sector has actually performed quite well in comparison to the S&P 500 for our 2 week review period. The reason for this is that the S&P 500 dropped considerably in 4 consecutive days, bringing the return down 1.5%, while the Utilities were only down about a quarter of a percent to that point. The S&P 500 rebounded sharply, nearly catching the Utilities in the next few days, but the Utilities performed very well in the last day of the review period. It is understandable that the Utilities would outperform the S&P 500 for this time period given the fact that the Utilities are very defensive and the market had to make very significant gains just to recover what they lost.

There hasn’t been a lot of news for the utilities lately, but they have been performing well because there is a lot of uncertainty about the future of the economy. The election and pending fiscal cliff have many investors worried, so the defensive nature of utilities is fairly attractive for many people right now. The swing in the polls after the first presidential debate that saw Romney gain significant ground on Obama has been the main driver in the success of utilities lately. Romney is a big coal lover, and most of the large utility companies produce a large portion of their electric power with coal fire. If Romney wins the election, it would be beneficial for these companies as there wouldn’t be as much pressure to use cleaner energy and move away from coal production right now.

The biggest positive mover for the two weeks was NRG Energy Inc. (NRG) with a return of 5.7%. This didn’t necessarily correspond with any news in particular, but the stock is up 36% in the last three months after announcing a merger with Genon Energy. After losses in the 4th quarter of 2011 and 1st quarter of 2012, they bounced back nicely in the second quarter by surprising analysts with a 546.71% positive surprise. They still have low estimates for the next couple quarters, and the earnings announcement on the 31st will give us a much better idea of how well they are doing.

The biggest loser for the two weeks actually wasn’t much of a loser as each company in the sector had positive returns. Ameren Corp. (AEE) had the least return at only 0.33%. There doesn’t appear to be any large reason for this underperformance, and the stock falls in the outperform category by analysts. These opinions haven’t changed in the past few months, either. AEE releases their earnings on November 6th, and typically is very close to estimates as their largest surprise was only 35% in the past four quarters.

Duke Energy Corp. (DUK) is the largest holding in the sector fund XLU, at 9.21%. DUK had a return of 0.76% in the period, but was actually down slightly until the last day of the period in which it gained 1.10%. There was big news for DUK on October 12th as one of their subsidiaries is filing for an annual base revenue increase of 12% in North Carolina. If approved, this revenue
increase would bring the company’s annual ROE up to 11.25%, which is still below North Carolina’s limit of 12.75%.

The second largest holding in XLU is Southern Co. (SO), with a weight of 8.85%. SO performed closer to the sector as a whole than DUK, with a return of 1.5%. On October 18\textsuperscript{th}, SO announced the purchase of a 2.5 megawatt solar facility in North Carolina. The plant is expected to start operation later this month. Their stock price still slipped 0.3% on Friday, but this was much less than the 0.8% of the sector as a whole.

The utilities sector should continue to perform well through the rest of 2012 because of the uncertainty in the economy mentioned earlier. Until there is a resolution for the fiscal cliff and a winner in the election, defensive stocks have a good chance to outperform the market. There will be much bigger gains and losses in individual stocks over the next couple weeks as earnings will start to be released, but the sector as a whole should continue to do well and make small gains.

\textbf{Section (B)  Sector Holding Updates}

No holdings besides the XLU sector fund at this time

\textbf{Section (C)  Sector Recommendations}

As discussed earlier, I am fairly bullish on the Utilities sector at this time. This is more about the rest of the market than the utilities, as I think we will continue to see a lot of volatility in these uncertain times for the next couple of months. I think utilities are a very safe bet, and we will see them hold steady. Since we only hold XLU currently, we should stay put here. If we weren’t benchmarked against the S&P 500, I would consider moving some funds out of technology or other underperforming sectors and into utilities. Unfortunately, this is not an option we can consider.

\textbf{Section (D)  Sector Holding Recommendations}

No holdings besides the XLU sector fund at this time