CIF Sector Recommendation Report (Fall 2012)

Sector: Utilities  Review Period: 11/15/12 - 11/28/12

Section (A)  Sector Performance Review

<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</th>
<th>vs. Sector</th>
<th>vs. S&amp;P 500</th>
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</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>$149.93</td>
<td>$155.49</td>
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<td></td>
<td>4.02%</td>
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<td>Sector ETF</td>
<td>XLU</td>
<td>$34.73</td>
<td>$34.27</td>
<td>1.40%</td>
<td>1510</td>
<td>$32,472.50</td>
<td>-2.62%</td>
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Current Holdings

Utilities Sector vs. S&P 500 (11/15/12-11/28/12)
Over my 2-week review period, the Utilities sector has been the most underperformed one. It has done vastly worse than the other sectors. Most analysts a year ago would guess that with the threat of a looming fiscal cliff, investors would flock towards the utilities sector for high dividend rates and steady growth. However in 2013, investors will see a sharp increase in the capital gains tax that will decrease the amount of dividends they can effectively earn from “safe” sectors like the XLU. While the top capital gains tax will increase 10%, the top dividend rate will rise more than 25%. Basic economics tells us that the demand for all stocks will decrease, but stocks that provide dividends as the main source of income will see an even further drop in demand.

Although it is long forgotten already and news is scarce, many utilities companies were negatively affected by hurricane sandy and missed their earnings estimates as a result. Furthermore, many utilities companies operating on the east coast will see a drop in earnings estimates for Q4. As an example, Morningstar Direct believes that Dominion Resources Inc. (D) will see a drop in Q4 earnings of about $.05.

The biggest gainer was Atlas Energy (ATLS) with a gain of 5.69%. The biggest loser was Ameren Corporation (AEE) with -1.87%. I didn’t see any substantial news behind any of these moves. Atlas has been growing very fast for the last year and has made a name for itself as a
fast-growing utility. Ameren recently announced Q3 reports that negatively surprised investors as it missed sales estimates by -6.47% and EPS by -5.67%, according to Reuters.

The two largest holders in the XLU are Duke Energy Company (DUK) with 9.54% and Southern Company (SO) with 8.77%. Some recent news on Duke: Cramer recommended buying it on November 21st and the CEO/President, James Rogers announces his departure on November 30th. He will remain with the firm until the end of 2013. Some recent news on Southern Company: Over the third quarter, revenues have decreased 7%. Southern actually missed sales estimates by more than 15% on Reuters in Q3. Although it’s not as recent, in late October, Southern also announced an Alliance with KBR Inc. to develop new a coal technology amidst a political environment threatening to hurt the industry. Neither Duke nor Southern Company has made substantial movements during my 2-week review period.

Throughout the remainder of December, dividend tax rates will remain unchanged. However many companies in the sector are decreasing their dividend yields in addition to paying “special dividends” this month. Many analysts claim that the drama over increased dividend rates is overrated and that in the long term, investors don’t have anything to worry about.

Section (C) Sector Recommendations

Since we currently have no sector holdings, I recommend we continue to hold the ETF. Right now I am bullish about the utilities sector. Even with the increased tax rate on dividends, I still believe investors will flock to this sector for fixed income. Compared to other forms of safe, fixed income, many of the best utility stocks are undervalued and I think investors will begin to see that in the coming months. I’m not bullish because I believe the fiscal cliff is scaring many investors away from this sector right now. After the fiscal cliff has passed in January, I will have a much better idea about which direction this sector is heading.
Sources:

Yahoo Finance

Reuters

Morningstar Direct