



Reaves' CEO Rhame: Despite High-Rate, High-Inflation Market, Utilities Are Worth A Look

Friday, March 3, 2023

Chuck Jaffe, in this episode of The NAVigator podcast interviewed Jay Rhame, chief executive officer at Reaves Asset Management, president of the Reaves Utility Income Fund. Read the Q&A below as Jay says that the dividend-growth potential for utility companies makes them a viable investment option in today's high interest-rate, high inflation market. While those conditions typically are not ideal for utilities, Rhame says utility stocks are reasonably valued; he



Jay Rhame

also discusses infrastructure stocks, again pointing out that their consistent dividend-paying strategy and potential to grow dividends makes them attractive in a market where yields on fixed-income have improved.

The podcast can be found on AICA's website by clicking here: <https://aicalliance.org/alliance-content/pod-cast/>

CHUCK JAFFE: We're talking infrastructure and utilities with Jay Rhame, chief executive officer at Reaves Asset Management, welcome to The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today it's pointing us in the direction of Jay Rhame, chief executive officer at Reaves Asset

Management, which runs the Reaves Utility Income Fund, ticker symbol UTG. You can get more information about the firm at ReavesAM.com, and about the fund at UtilityIncomeFund.com. To learn more generally about closed-end funds, business-development companies, and interval funds go to AICAlliance.org, the website for the Active Investment Company Alliance. Jay Rhame, welcome to The NAVigator.

JAY RHAME: Thanks for having me.

CHUCK JAFFE: This is a really interesting time to be talking about utilities and infrastructure. And I'll point out that the fund, of course it's the Utility Income Fund, people think utilities but I know that you invest a lot in infrastructure stocks, I want to start however on the utilities side. Because with higher interest rates investors typically move away from utilities because they're capital intensive and they're interest rate intensive, and rising interest rates impact utilities more than a lot of sectors. Because hey, if bonds become more attractive and I'm a yield seeking investor, I don't have to use utilities to do it. So give us first your take on utilities in this environment, because rates are up and yields are up but utilities have not necessarily suffered the way some people would have expected them to.

JAY RHAME: Yeah, that's right, rates are up. I think actually it has impacted utilities so far this year. If you look at the performance of the sector versus some other defensive sectors that did well in 2022, you can see that the rise in interest rate has impacted the returns somewhat. But what's interesting is higher interest rates don't necessarily impact the net income earned by most utilities, interest expense is a full passthrough to the customers. They're regulated monopolies so they earn regulated returns, and higher interest rates mostly don't affect the returns that these companies earn, but like you were saying, it affects the preference for utilities by income investors. If the 10-year continues rising, it's up past 4% today, if it continues going up pretty quickly, of course it's going to impact income sectors. Last year what we saw was a big increase in rates but utilities did pretty well, and in that case I think it was more of a concern about inflation. Utilities are actually an okay sector to own during an inflationary time and that's primarily because, yes, you get to today's income but you can get pretty reliable, pretty consistent 5-6% type dividend growth year in, year out. That growth potential, that at least potential to keep pace with inflation over time can be attractive versus fixed income. This year obviously we've seen a bit of a reversal of that, but primarily

I think it's that dividend growth characteristic which enables a utility to be competitive even in a higher interest rate environment.

CHUCK JAFFE: Again, the utility doesn't necessarily suffer much in the way of loss in net income but you running the fund have to generate income for the shareholders. Has it pushed you more towards infrastructure companies and away from utilities in this circumstance?

JAY RHAME: A little, it really is valuation dependent. Last year with utilities being relatively strong, [inaudible] S&P 500 was down 20%, utilities were about flat, so naturally that creates more bargains in the rest of the market versus utilities. But in general utilities, a lot of companies trade them about 15, 16, 17x earnings, yielding between 3-4%, and I think that's a fairly good value for the companies right now. So while there are some bargains in other infrastructure areas for sure, utilities aren't necessarily overvalued.

CHUCK JAFFE: Let's talk a little bit about some of those bargains in the infrastructure side, because just as the playbook would say you want to move away from utilities in higher rate, rising rate environments, this seems to be a time when a lot of people are moving towards infrastructure stocks because there's a lot of demand, there's a lot of capital expenditure that was put off that now is coming back into play, et cetera. So how much have you seen opportunities coming up in infrastructure?

JAY RHAME: Well, I think a lot of it too is investors have been focused on companies that have the ability to grow that aren't necessarily tied to economic growth, so certainly seeing some of that in midstream where the demand for new production obviously saw commodity prices up pretty big last year, but most of the companies have done a good job reducing the amount of commodity exposure they have. They really have the opportunity to invest in pretty high-return projects, some of those companies have been interesting. Once sector we like a lot are the wireless towers, and they as you would I guess expect as an interest rate sensitive sector or REIT, they did poorly last year. There's concern about some slowdowns in wireless tower revenues, the antennas and [inaudible] from the Sprint and T-Mobile takeover. But getting past that, they're companies that basically have long-term contracts which go up with inflation ever year. And so you, in higher inflationary times, you kind of have guaranteed revenue growth leading to higher margins and better income for those companies. Performance has not been very strong, but going forward a lot of these companies yield as much as they've ever yield before. American Tower for example yields over 3% for the first

time in a long time, and they're going to be able to grow that distribution 10% or more per year for a while, so it's getting into pretty attractive territory.

CHUCK JAFFE: Three percent in a time when it was, what I've said on my show with TINA, There Is No Alternative, right?

JAY RHAME: Right, right, right.

CHUCK JAFFE: Everybody was on the arm of TINA, there's no alternative, you've got to go to stocks. And now a lot of investors are on the arm of PATTY, which is Pay Attention To The Yield. And 3% on a stock like AMT sounds great, until you recognize that, wait, hold it, my high-yield savings account is paying me 4.75% or something right now. So help people understand why you then want to take the additional risk, in terms of what's the return prospects, and will we see, whether it's utilities or infrastructure, will we see them live up to their historic returns even in these turbulent times?

JAY RHAME: Well, it's a question of how long that savings account stays at the 4%+.

CHUCK JAFFE: That's true too.

JAY RHAME: Because I can be very confident that American Tower is going to grow their dividend by 10% per year or whatever utility's going to grow 5 or 6% for a long time, and eventually that growth will crossover where your yield on cost is just higher than what it otherwise would have been in a savings account. And so for me it's a question of how sure are you that rates are going to stay high for a long time versus companies that are getting to valuation points that are very attractive to where you're very confident that growth's going to occur for the next five to 10 years.

CHUCK JAFFE: Let's talk about one extraneous worry for the industries that we're talking about, which is there's a lot of geopolitical risk. A lot of stuff going on in Washington that would at least make folks nervous at the surface level. Does any of it make you nervous? Is that a bigger concern for you than it has been in the past?

JAY RHAME: I would say for utilities, the benefit of being a utility investor is that utilities are regulated at the state level. Now of course there's federal influence but all the regulatory rules are made by the state, and so that's the specific governor, that's the regulators, either they appoint or the regulators are elected in some cases. Very different rules and regulation and rates of return in every state, and that's kind of the benefit. If something goes poorly in Jersey, that doesn't necessarily mean the utility in the California's in trouble. Around the

world it's different, utilities are regulated at the national level. So a poor ruling in the UK is going to affect every single utility, at least it's going to affect every single stock. The federal politics don't matter as much for utilities, they certainly matter for most other sectors, and that's probably going to be an overhang on many stocks for a long time. But for utilities, really the biggest thing from a federal side is tax credits, the Inflation Reduction Act, at least from a utility perspective really provides potential for a lot of growth. They have the tax credits for electric vehicles that potentially it spurs demand there. Just as an anecdote, two electric vehicles is about the same electric demand as one household. So the sector overall, electric demand in the US hasn't really grown since about 2005. So with that tax credit you have the potential for electric vehicles to really take off and demand to really grow. Beyond tax credits and tax policy, it's really the individual state level, and there's always states that are getting harder, there's states that are getting more constructive, and I think that's one of the benefits of being professional, studying these sectors, really studying the regulatory dynamics, because they are often changing pretty wildly state to state.

CHUCK JAFFE: Jay, this has been really interesting. Thanks so much for joining me on The NAVigator to talk about it.

JAY RHAME: Thank you.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, I am Chuck Jaffe, you can check out my hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. On Facebook and LinkedIn @AICAlliance. Thanks to my guest, Jay Rhame, chief executive officer at Reaves Asset Management, president of the Reaves Utility Income Fund, ticker UTG. Get information on the firm at ReavesAM.com and about the fund at UtilityIncomeFund.com. The NAVigator podcast is new every Friday, ensure you don't miss anything by following along on your favorite podcast app. We'll see you again next week, and until then, happy investing everybody.

Recorded on March 2, 2023

To request a particular topic for The NAVigator podcast please send an email to:

Website: [AICalliance.org](https://www.aicalliance.org) ◇ **Phone:** (888) 400-9694

TheNAVigator@AICalliance.org

Click the link below to go to the home page of Active Investment Company Alliance to learn more:

<https://AICalliance.org/>

Disclosure: *Views and opinions expressed are for informational and educational purposes only as of the date of production/writing/speaking and may change without notice at any time based on a multitude of factors. Speaker's/presenter's/author's opinions are their own and may not necessarily represent the opinions of AICA, its Board, or its staff. Materials may contain "forward-looking" information that is not purely historical in nature, such as projections, forecasts, market return estimates, proposed or expected portfolio composition, and other items. Listed closed-end funds and business development companies trade on exchanges at prices that may be above or below their NAVs. There is no guarantee that an investor will be able to sell shares at a price greater than or equal to the purchase price or that a closed-end fund's discount will narrow. Non-listed closed-end funds and business development companies do not offer investors daily liquidity but rather offer liquidity on a monthly, quarterly or semi-annual basis, often on a small percentage of shares. Closed-end funds often use leverage, which can increase the fund's volatility (i.e., risk). Actual distribution amounts may vary with fund performance and other conditions. Past performance is no guarantee of future results. This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. Shares of closed-end funds are subject to investment risks, including the possible loss of principal invested. Closed-end funds frequently trade at a discount to their net asset value (NAV).*