

PATRIZIA

Navigating the Nexus: Macroeconomics and Infrastructure Investments



12 March 2025

In our latest comprehensive analysis, we explore the significant impact of macroeconomic trends on the stock market, with a particular focus on the infrastructure stocks. This report provides an in-depth look at how different phases of the economic cycle - including recovery, boom, slowdown and recession - affect utility stocks. We examine shifts in stock characteristics from defensive to cyclical, highlighted by case studies of major companies such as PPL Corporation, Eversource Energy, First Energy and Dominion and analyse the performance risks in these companies losing their defensive characteristics.

Our analysis also extends to style factors and risk-return profiles under different economic conditions, providing valuable insights for informed investment strategies. We also provide an exclusive assessment of the cyclical and defensive characteristics of infrastructure stocks within the S&P 500.

1. Introduction
2. The dynamics of the US macroeconomic cycle
3. Shifts in the Macroeconomic Responsiveness of the Utility stocks – the Losers
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1 Introduction

In today's rapidly evolving financial landscape, the intersection of macroeconomic trends and the stock market is more pronounced than ever. This report aims to provide a comprehensive analysis of how macroeconomic indicators specifically impact the stock market, with a focus on infrastructure companies. Known for its low volatility and stable cash flows, the infrastructure industry consists of high quality stocks with long-term stable return profiles.

2 The Dynamics of the US Macroeconomic Cycle

In our analysis, we synthesize a range of critical economic indicators to construct a comprehensive business cycle, with a particular focus on the utility sector.

These indicators work together because they capture different phases of the business cycle, offering a comprehensive view of economic trends. Some, like the composite leading indicator and credit spreads, serve as early warning signals, helping to anticipate shifts in economic activity. Others, such as the Purchasing Managers Index and earnings revisions, provide more immediate insights into current conditions. Meanwhile, inventories and consumer confidence help confirm broader trends, offering a clearer picture of the economy's trajectory.

Their strength lies in their broad coverage, spanning financial markets, business activity, and consumer sentiment. Bond spreads and earnings data reflect investor expectations and corporate health, while the PMI and inventory levels highlight business conditions and supply chain dynamics. Consumer confidence, in turn, sheds light on household spending behaviour, a key driver of economic growth.

Beyond their individual relevance, these indicators are widely recognized by investors and policymakers across the globe. Their use in tracking economic health makes them valuable tools for understanding and anticipating changes in the business cycle.

Table 1 provides a detailed list of the variables we use for the Digital Leader US Economic Cycle Indicator.

Table 1: Macroeconomic indicators used to proxy the economic cycle

Category	Name	Frequency
Aggregate	Composite leading indicator	monthly
Sentiment	Economic policy uncertainty index	daily
Bond Market	Difference BofA US high Yield index Yield to Maturity and treasury yield, credit spread	daily
Equity Market	American Association of Individual investors survey	weekly
	Earnings Revisions Ratio	monthly
Labour Market	Unemployment rate	monthly
Demand	Consumer Confidence Index OECD	monthly
	Consumer Confidence Index University of Michigan	monthly
Output	Business Confidence Index	monthly
	Purchasing Managers Index	monthly
Industry Activity	Capacity Utilization Index	monthly
	Inventories to Sales Ratio	monthly
Prices	Consumer Price Index	monthly

In our comprehensive analysis of the business cycle, particularly as it affects the utility sector, we divide the cycle into four distinct phases: recovery, boom, slowdown, and recession. The **recovery** phase marks the period of economic rebound following a downturn, characterized by rising economic activity and improving investor confidence. During this stage, utility stocks tend to remain stable, as demand for essential services remains consistent, though interest rate trends may start influencing valuations.

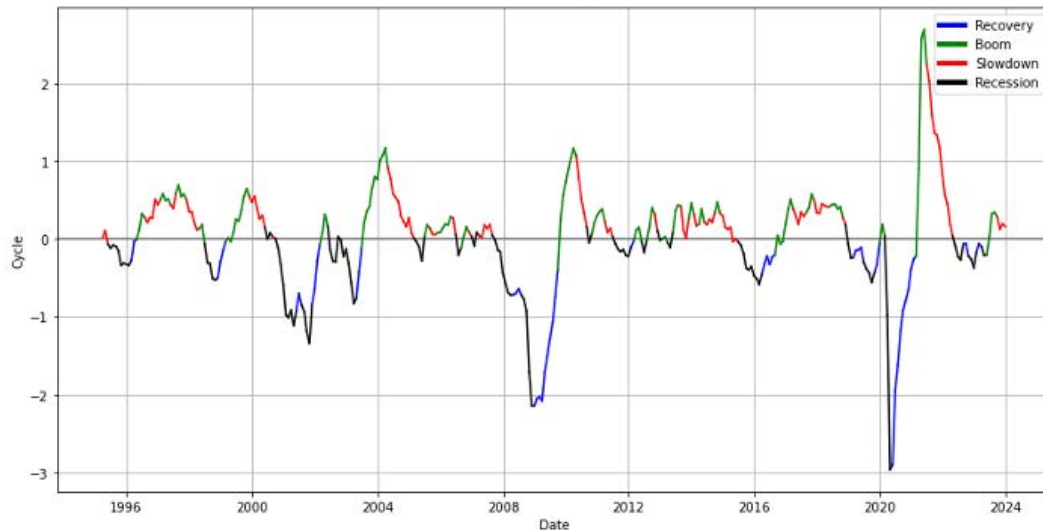
The **boom** phase sees peak economic performance, increased industrial output, and higher energy consumption, which can benefit utility companies, particularly those involved in electricity generation and transmission. However, rising interest rates during this period can weigh on valuations, as investors may shift toward more cyclical sectors.

The **slowdown** phase signals a deceleration in economic growth, often prompting shifts in investor sentiment. Utilities, being defensive stocks, tend to outperform the broader market in this stage as investors seek stability and reliable dividends.

Finally, the **recession** phase represents a significant decline in economic activity, marked by lower consumer spending, reduced business investment, and often a decline in stock prices. Utility stocks, however, tend to be more resilient than cyclical sectors, as their essential nature ensures continued demand, and their regulated revenue structures provide earnings stability.

By understanding these phases, we can better interpret the current economic landscape and anticipate future market movements, particularly in the more stable and income-focused context of the utility industry.

Figure 1. US Macro Cycle



In our exploration of the phases of the economic cycle and their impact on the stock market, we look at the effectiveness of different investment styles in these different economic environments. Our analysis shows that certain types of stocks tend to outperform during robust economic periods when activity is on the rise. In this phase, small-cap, high-beta and low-profitability stocks tend to outperform, benefiting from general market optimism and growth. Conversely, during periods of economic slowdown, investor preference shifts significantly. During these periods, there is a noticeable gravitation towards large-cap stocks, which tend to be more stable and established. In addition, stocks characterised by high profitability and low risk become more favoured. This shift reflects a more cautious approach to investing, where stability and reliability are valued amid economic uncertainty.

Figure 2. Cycle Performance

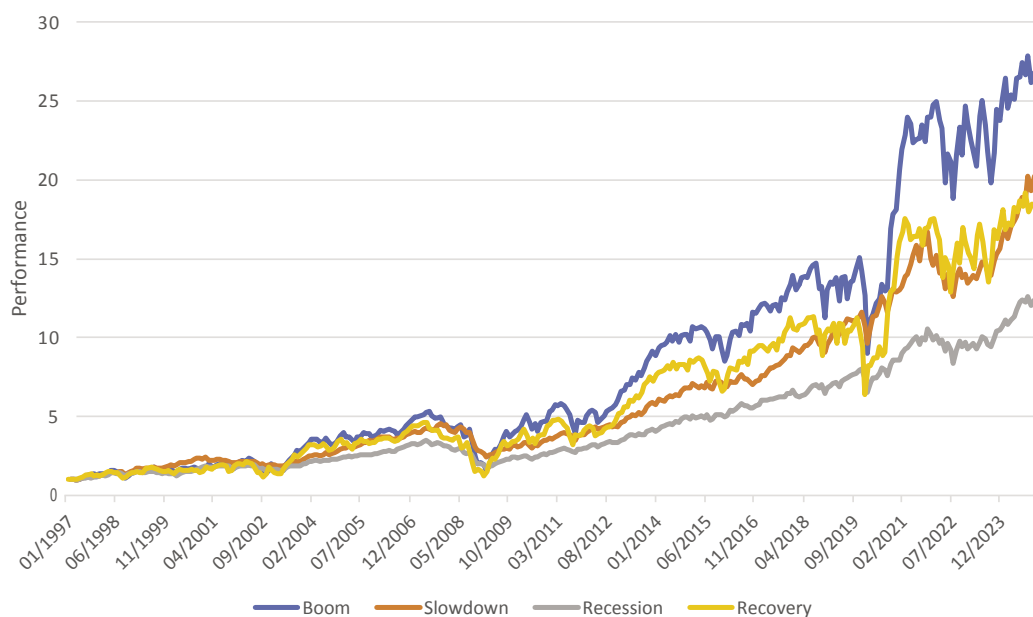


Figure 2 illustrates the long-term performance of groups of stocks that do well in one particular phase of the business cycle. The boom stocks perform also on average well over the other three phases of the cycle and display the highest performance over the complete business cycle. During this phase, the market typically rewards investors with high annual returns, but these lucrative returns are accompanied by considerable volatility with a high standard deviation, reflecting the inherent risks of a rapidly expanding economy. Despite these risks, the Sharpe ratio of 0.45 suggests that the returns, while not fully mitigating the volatility, still offer reasonable compensation for the risks taken.

Stocks that perform well during the economic slowdown show a marked reduction in both returns and volatility. Annual returns fall slightly to 11.3%, reflecting the market's muted enthusiasm. This is reflected in a lower annual standard deviation, indicating a more cautious approach by investors. The Sharpe ratio rises to 0.8 in this phase, indicating more favourable risk-adjusted returns compared to the boom phase.

Recession cycle stocks continue to show lower returns, which, although lower, are still indicative of resilience in the face of economic contraction. Volatility remains somewhat subdued with a standard deviation of 12.7%, underlining the ongoing uncertainty of this period. However, the Sharpe ratio remains relatively high at 0.7, suggesting that investors are still able to find good risk-adjusted opportunities even in the midst of economic downturns.

In the recovery phase, the market regains momentum and annual returns rise to 11%. However, this rebound is accompanied by the highest volatility of all phases, with a standard deviation of 29.1%, reflecting the market's search for a new equilibrium. The Sharpe ratio is the lowest of the phases, indicating that the higher volatility somewhat overshadows the improved returns.

Table 2

	Boom	Slowdown	Recession	Recovery
Ann. Ret.	12.46%	11.34%	9.41%	10.98%
Ann. StdDev	27.47%	13.47%	12.69%	29.09%
Ann. Sharpe (Rf=0%)	0.45	0.84	0.74	0.38
MaxDrawDown	69.72%	46.33%	50.06%	73.48%

3 Shifts in the Macroeconomic Responsiveness of the Utility stocks – The Losers

- **PPL Corporation:** Shifting Strategies and Increased Market Sensitivity
- **FirstEnergy:** From Stability to Volatility
- **Dominion Energy:** Regulatory Challenges and Performance Pressures
- **Eversource Energy:** Balancing Growth Ambitions with Defensive Strength
- **Entergy:** Navigating Regulatory Shifts and Market Cyclicalities

Shifts in the Macroeconomic Responsiveness of the Utility stocks

Utility stocks are considered defensive because they provide essential services such as electricity, water, and natural gas—necessities that individuals and businesses rely on regardless of economic conditions. Their defensive nature stems from several key factors.

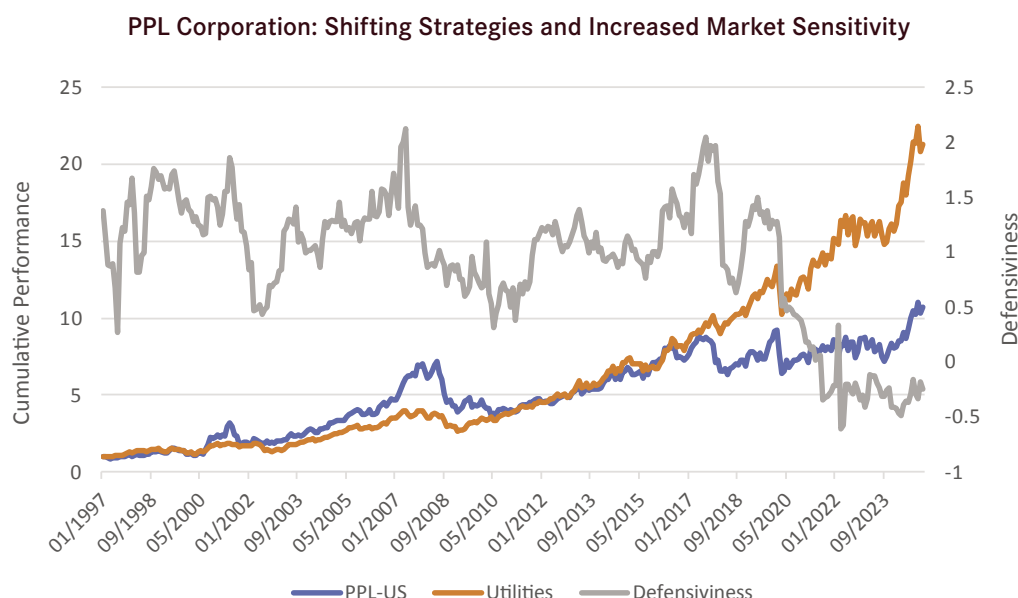
First, utilities benefit from stable demand, as their services are indispensable, ensuring relatively predictable and consistent revenue even during economic downturns. This stability is further reinforced by regulated revenue streams, where government oversight sets rates, securing steady cash flows and reducing pricing volatility. Even in deregulated markets, long-term contracts and monopoly-like market positions provide a strong foundation for financial stability.

Another defining characteristic of utility stocks is their ability to generate consistent dividends. Thanks to steady cash flows, utilities return a significant portion of their earnings to shareholders in the form of high, reliable dividends, making them particularly attractive to income-focused investors. These dividend yields are often higher than those of the broader market, providing an additional layer of resilience during periods of financial uncertainty.

Unlike cyclical stocks, utilities are less sensitive to economic fluctuations because consumers prioritize paying utility bills over discretionary spending. Additionally, many utilities operate in geographically protected areas with little competition, ensuring a stable customer base and further contributing to their reliability as an investment.

Utility stocks also tend to exhibit lower market volatility compared to growth or technology stocks. Their stable earnings and dividends make them a favored choice for investors seeking shelter during market uncertainty or economic slowdowns, reinforcing their role as a defensive asset class.

We have examined how utility stocks perform when they lose their defensive nature and become more sensitive to the business cycle. Historically, stocks that once demonstrated strong performance tend to underperform both their sector and the broader market in such scenarios. Here, we present examples from the S&P 500 to illustrate this trend and explore the strategic decisions or regulatory challenges that have contributed to their declining performance.



The blue line in the charts above illustrates PPL Corporation's cumulative performance relative to the equal-weighted average performance of utility stocks in the S&P 500. The grey line, plotted on the right axis, indicates PPL Corporation's defensive nature in terms of standard deviations compared to all other S&P 500 stocks. A higher value signifies stronger defensive characteristics, while a negative value suggests a more cyclical stock behaviour.

PPL Corporation's underperformance in recent years can largely be attributed to its strategic shift, financial challenges, and weaker growth prospects compared to other utilities. One of the most critical factors was its decision to sell its UK business, Western Power Distribution (WPD), in 2021 for \$10.8 billion. WPD was a highly profitable, well-regulated asset that provided steady cash flow, and its sale left PPL more reliant on its U.S. operations, which come with lower growth potential and higher regulatory risks. Following this divestment, PPL acquired Narragansett Electric in Rhode Island, a move that many investors viewed as overpriced, further weakening the company's financial profile. The restructuring created uncertainty around PPL's future growth strategy, contributing to prolonged stock underperformance.

In addition to strategic missteps, PPL's earnings growth has lagged behind other utilities, with a below-average return on invested capital (ROIC) making it less attractive to investors. While some utilities have expanded into high-growth areas like data center-driven electricity demand and renewable energy, PPL has remained concentrated in slower-growth regions such as Pennsylvania, Kentucky, and Rhode Island, limiting its ability to capitalize on broader industry trends.

The company's high debt levels and aggressive capital spending plans have also been a concern. Unlike utilities with high earnings growth that can offset such spending, PPL's modest revenue growth has raised questions about financial sustainability. The rise in interest rates has only made matters worse, as higher borrowing costs have further strained the company's balance sheet. With approximately \$15-16 billion in debt, PPL has committed to over \$14 billion in capital expenditures between 2025 and 2028, further increasing its leverage.

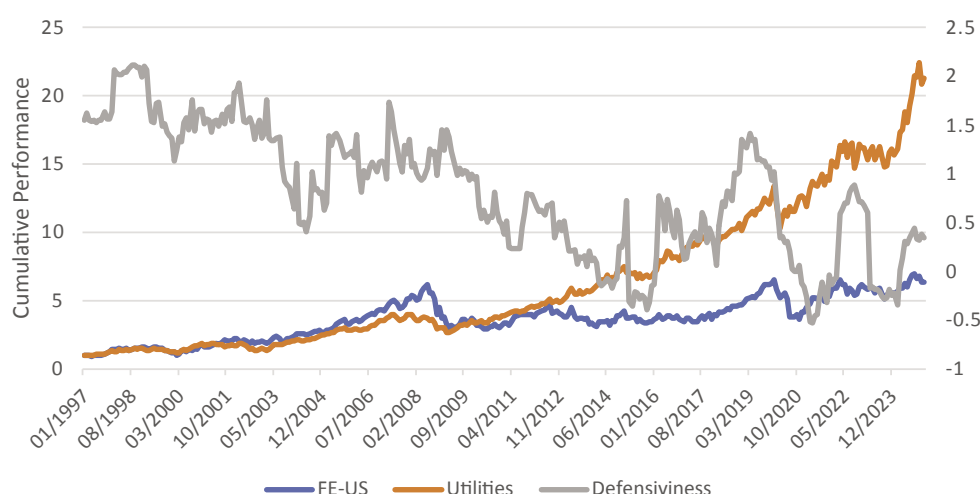
Another major factor that hurt investor sentiment was PPL's dividend cut in 2022. Previously, PPL had been a popular choice among income-focused utility investors, but the dividend reduction led many long-term shareholders to sell their holdings, adding downward pressure on the stock. While other utilities maintained or even increased their dividend payouts, PPL's reduced yield made it a less compelling option for income investors.

Despite its weaker stock performance, some analysts argue that PPL is still trading at a relatively high valuation compared to its fundamentals. The stock has been valued at around 20 times earnings in 2020 and significantly increasing thereafter, a level higher than some peers with stronger growth prospects. Additionally, PPL's dividend yield of approximately 3.5% is lower than many other utilities, making it less attractive in a sector where yield is a key draw for investors.

Beyond financial concerns, PPL faces geographic and regulatory disadvantages. Its primary markets—Pennsylvania, Kentucky, and Rhode Island—have slower population growth and less dynamic energy demand compared to high-growth regions like Texas or the Southeast. Regulatory challenges have also made it harder for PPL to secure rate hikes and recover infrastructure costs, limiting its earnings upside.

Investor sentiment has further weighed on PPL's stock, as market trends have favoured utilities with strong growth catalysts, such as companies investing in renewables, transmission networks, and data center power demand. In contrast, PPL has lacked a clear driver of future growth, prompting investors to allocate capital elsewhere. Rising interest rates have pressured utility stocks across the board, but companies with higher growth potential have fared better than PPL, exacerbating its underperformance.

FirstEnergy: From Stability to Volatility



FirstEnergy's significant underperformance relative to other utility stocks since 2008 can be attributed to several key factors, including financial struggles, regulatory issues, and strategic missteps.

FirstEnergy was highly leveraged going into the financial crisis, and its exposure to wholesale power markets left it vulnerable to declining electricity demand and falling power prices. While other utilities with regulated businesses fared better, FirstEnergy's earnings were hit hard, leading to long-term underperformance.

Unlike many regulated utilities that benefit from stable, predictable earnings, FirstEnergy had a significant exposure to unregulated power generation. Wholesale electricity prices declined sharply after 2008 due to lower natural gas prices (driven by the shale boom) and stagnant demand growth. This pressured FirstEnergy's margins and led to earnings volatility. The company eventually decided to exit competitive generation, but the transition took years and was costly.

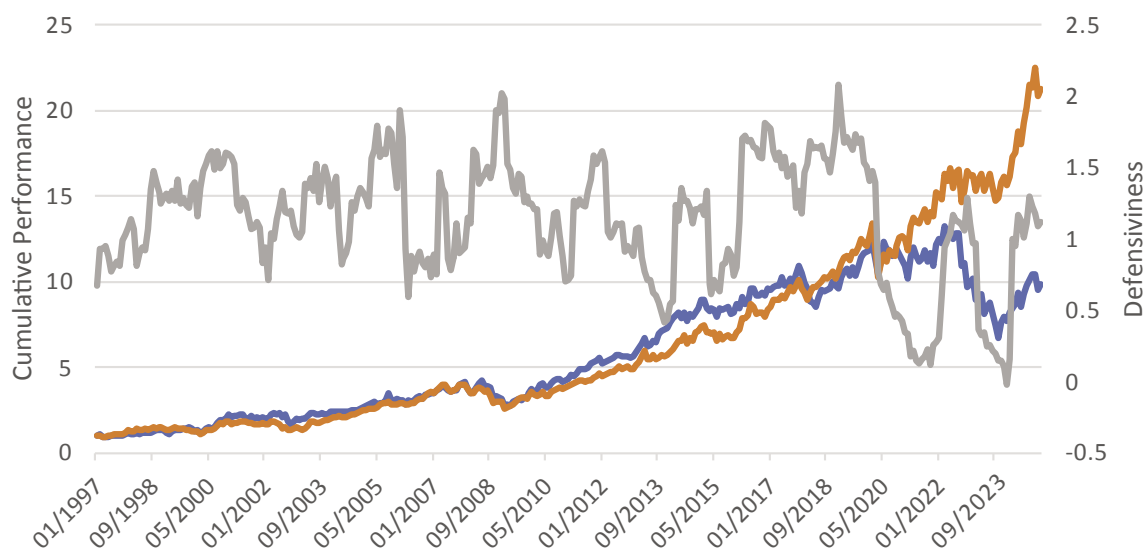
FirstEnergy struggled with high debt levels and weak cash flows, which forced it to cut dividends in 2014—a major red flag for income-focused utility investors. Many other utilities, in contrast, maintained or grew their dividends, making FirstEnergy less attractive as an investment.

One of the biggest blows to FirstEnergy's stock performance came in 2020, when the company became embroiled in a massive bribery scandal in Ohio. FirstEnergy admitted to paying \$60 million in bribes to secure a bailout for its nuclear plants, leading to legal penalties, executive firings, and reputational damage. This scandal not only hurt the stock price but also led to increased regulatory scrutiny, adding uncertainty for investors.

While other utilities focused on growing regulated assets and expanding into renewables, FirstEnergy spent years trying to fix its struggling competitive generation business. The company ultimately transitioned to a fully regulated model, but it lagged behind peers that had already made similar moves. The delays in restructuring weighed on its financials and stock price.

Even after shifting to a regulated model, FirstEnergy's earnings growth has remained sluggish compared to other utilities. Many peers have benefited from strong capital investment programs, electrification trends, and rate base growth, while FirstEnergy has faced lingering financial and regulatory headwinds.

Dominion Energy: Regulatory Challenges and Performance Pressures



Dominion Energy's underperformance relative to other utility stocks since 2018 can be attributed to a combination of strategic missteps, asset sales, regulatory challenges, and financial concerns. While many utility stocks have benefited from strong capital investment programs and stable earnings, Dominion has faced several headwinds that have weighed on its stock price.

In 2018 alone, Dominion's stock dropped nearly 16%, driven by investor concerns over its acquisition of SCANA Corporation and related legal and regulatory risks.

One of the biggest factors behind Dominion's underperformance has been its decision to sell off major assets, significantly altering its business model. In 2020, Dominion sold its natural gas transmission and storage assets to Berkshire Hathaway for approximately \$9.7 billion, including debt. This was part of a strategic shift to focus on regulated electric and gas utilities. While the move reduced debt, it also weakened Dominion's earnings growth potential, as these assets provided steady cash flow. Investors were disappointed with the deal because it reduced Dominion's diversification and long-term earnings power.

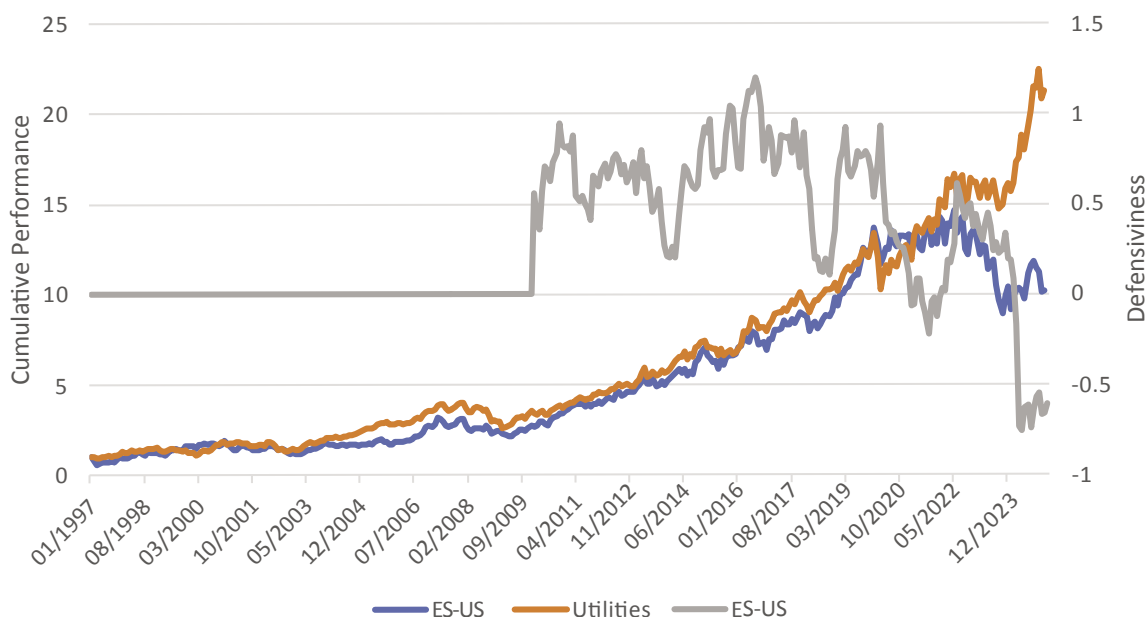
Dominion and Duke Energy had planned to build the Atlantic Coast Pipeline, a major natural gas infrastructure project. However, due to legal and regulatory challenges, the project was canceled in 2020, resulting in a \$2.8 billion write-off. The failure of this project raised concerns about Dominion's ability to execute large infrastructure developments, damaging investor confidence.

As part of its asset sales and strategic shift, Dominion cut its dividend by 33% in 2020, a move that significantly hurt investor sentiment. Utility stocks are typically favoured by income-focused investors, and a dividend cut is seen as a red flag. Many investors rotated out of Dominion in favour of other utilities with more stable and growing dividends.

Even after shifting to a fully regulated utility model, Dominion has struggled with slower earnings growth compared to peers. The company's return on equity (ROE) has been lower than many other utilities, raising concerns about its long-term profitability. Its valuation has suffered as investors have favoured utilities with stronger capital investment programs and higher earnings growth.

Dominion operates primarily in Virginia, where regulatory uncertainty has been an ongoing issue. The company has faced increased political and regulatory scrutiny, particularly over rate structures and grid investments. Delays or pushback on rate adjustments have created uncertainty about future earnings growth.

Eversource Energy: Balancing Growth Ambitions with Defensive Strength



One of the biggest reasons for Eversource's underperformance since 2020 has been its large investment in offshore wind projects, which have faced significant delays, cost overruns, and financial pressures.

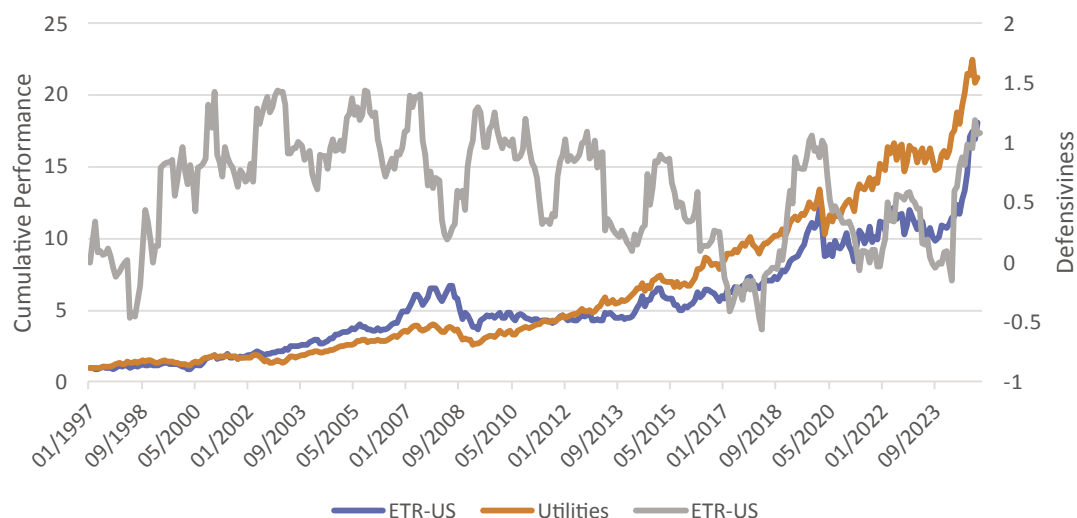
Eversource initially positioned itself as a major player in offshore wind, partnering with Ørsted to develop projects along the East Coast. However, rising inflation, supply chain disruptions, and higher financing costs have dramatically increased the cost of these projects, reducing expected returns. In 2023, Eversource announced it was selling its offshore wind assets, signaling a retreat from its ambitious expansion plans. The uncertainty surrounding the wind business and the financial strain from these projects have hurt investor confidence.

Eversource operates primarily in Connecticut, Massachusetts, and New Hampshire, areas with complex regulatory environments and high electricity costs. The company has faced regulatory pressure regarding rate increases and cost recovery for infrastructure investments. New England has also seen pushback against utility rate hikes, which has limited the company's ability to pass rising costs onto customers.

Compared to other utilities, Eversource's earnings growth has been relatively weak, partly due to its regulatory hurdles and offshore wind challenges. Some peers have benefited from data center expansion, grid modernization, and electrification trends, while Eversource has struggled to deliver strong earnings growth. The company's offshore wind exit strategy has also created uncertainty about its long-term growth plans.

While Eversource continues to pay a dividend, its payout ratio has risen, leading to concerns about whether dividend growth will slow. Many investors prefer utilities with strong dividend growth and stable cash flows, and Eversource's struggles have made it less attractive compared to peers. The uncertainty around offshore wind divestitures and future investment plans has led some investors to rotate into other utility stocks with clearer growth trajectories. Companies focused on regulated transmission, electrification, and data center power demand have outperformed, while Eversource's challenges have made it less appealing.

Entergy: Navigating Regulatory Shifts and Market Cyclicity



One of Entergy's biggest missteps was its heavy investment in merchant (unregulated) nuclear power plants, which turned into a major drag on performance. In the early 2000s, Entergy acquired several nuclear plants in the Northeast (e.g., Indian Point, Vermont Yankee, Pilgrim), hoping to benefit from high electricity prices. However, the shale gas boom after 2008 led to a collapse in wholesale electricity prices, making nuclear plants far less profitable. Entergy failed to exit these assets quickly, and they became a financial burden, forcing costly shutdowns, legal battles, and regulatory disputes. Many peers focused on regulated growth and renewable energy, while Entergy remained stuck with high-cost nuclear operations.

Due to the unprofitability of merchant nuclear plants, Entergy was forced to shut down several facilities, leading to significant financial losses and stock underperformance. Vermont Yankee closed in 2014, resulting in a \$1.7 billion write-off. Pilgrim (2019) and Indian Point (2021) closures added to restructuring costs and lost revenue. Regulatory battles with New York and Massachusetts over these plant closures created uncertainty and legal expenses, weighing on the stock price. While other utilities were investing in grid modernization and renewables, Entergy spent billions decommissioning nuclear plants, putting it at a disadvantage.

Entergy operates in the Southeastern U.S., particularly in Louisiana, Arkansas, Mississippi, and Texas, states with historically tougher regulatory conditions for utilities. Entergy has had ongoing disputes with regulators over rate hikes, cost recovery, and infrastructure investment. In Louisiana and Mississippi, Entergy has struggled to get full cost recovery for some of its major capital projects, limiting earnings growth. Legal battles over storm recovery costs and grid resiliency investments have slowed its ability to modernize infrastructure.

Compared to other utilities, Entergy has delivered below-average earnings growth and return on capital, making it a less attractive investment. Entergy's earnings per share (EPS) growth has consistently lagged behind utilities focused on transmission expansion, renewables, and data center-driven demand. The company's capital expenditures have exceeded earnings growth, leading to balance sheet concerns and a weaker financial profile. Some peers, such as NextEra Energy and Sempra, have outperformed due to better capital allocation and growth in high-return projects, while Entergy has struggled with low-return investments.

As a Southeastern utility, Entergy has been heavily exposed to hurricanes and extreme weather events, which have caused grid damage, higher expenses, and regulatory disputes over recovery costs. Hurricanes Katrina, Gustav, Isaac, Laura, and Ida all inflicted significant damage on Entergy's infrastructure, requiring billions in repairs. While other utilities have modernized their grids and improved reliability, Entergy has lagged in upgrading transmission lines and storm-hardening its network. The company has struggled to get regulatory approval for full cost recovery, limiting its ability to invest aggressively in infrastructure.

Entergy has shown notable improvement over the past 15 months, and its stock performance has recovered relative to other utilities. This turnaround can be attributed to a shift in strategy, improving regulatory relationships, better earnings growth, and a more favorable investment outlook. One of Entergy's biggest weaknesses over the past two decades was its exposure to merchant nuclear plants, which led to earnings volatility and financial struggles. However, the company has now fully exited the merchant power business and is focusing on its regulated utilities, providing more stable, predictable earnings. The closure of unprofitable nuclear plants (e.g., Indian Point, Pilgrim, and Vermont Yankee) eliminated a key source of financial drag. Entergy is now fully regulated, meaning its revenue is largely determined by state-approved rates, rather than volatile wholesale electricity prices. This shift has reduced risk and improved earnings visibility, making Entergy a more attractive investment in the utility sector.

Entergy's earnings growth has improved, with higher rate base expansion driving stronger financial performance. The company has been investing heavily in transmission and grid modernization, which regulators have been more willing to approve. Many of Entergy's service areas in the Southeast (Louisiana, Texas, Arkansas, Mississippi) are experiencing population and economic growth, leading to increased electricity demand.

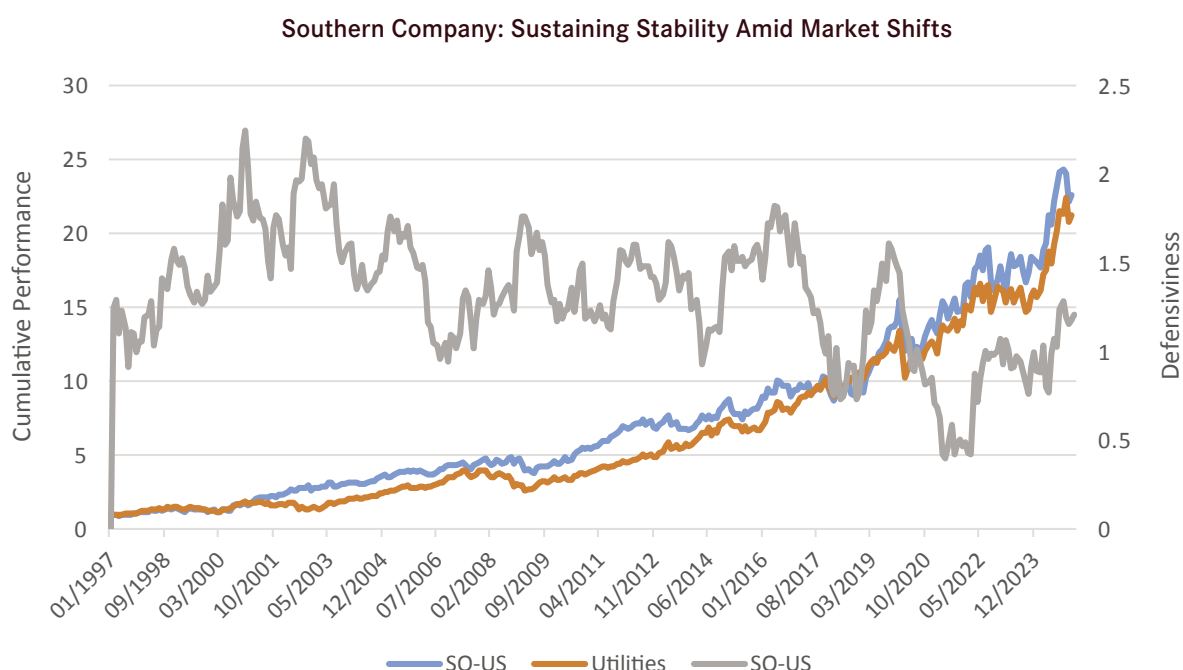
4 Shifts in the Macroeconomic Responsiveness of the Utility stocks – The Winners

Utility companies with strong defensive characteristics

Southern Company: Sustaining Stability Amid Market Shifts

Sempra: Resilient Growth Through Diversification

Public Service Enterprise Group: A Steady Performer in a Changing Landscape



Southern Company has outperformed other utility companies over the past 25 years. The company primarily operates in the Southeastern U.S., including Georgia, Alabama, and Mississippi—states known for strong population growth, economic expansion, and business-friendly regulatory environments. Unlike utilities with exposure to competitive wholesale markets, Southern Company has benefited from a heavily regulated model, providing steady returns and reducing earnings volatility. The Southeast has experienced above-average population growth, driving increased electricity demand and allowing for rate base expansion.

Southern Company has a long history of dividend stability and growth, making it an attractive stock for income-focused investors. The company has increased its dividend for over 20 consecutive years, reinforcing its reputation as a reliable income stock. Southern's dividend yield has consistently been competitive within the utility sector, helping to attract long-term investors. The regulated earnings model has provided the cash flow needed to sustain and grow dividends, unlike utilities that have had to cut payouts due to financial stress.

Southern Company has made strategic investments in both traditional and renewable energy infrastructure, balancing grid modernization, gas expansion, and renewables to position itself for long-term growth. The acquisition of AGL Resources in 2016 expanded its natural gas business, providing additional revenue diversification. While some peers struggled with renewables or unregulated power businesses, Southern maintained a steady investment strategy, ensuring growth without excessive risk. Investments in nuclear power (Plant Vogtle), despite delays, provide long-term baseload capacity, strengthening Southern's future earnings stability.

Unlike utilities in more volatile regulatory environments (e.g., California or the Northeast), Southern operates in business-friendly states with constructive regulators. Southern has been able to pass costs onto customers more effectively than utilities facing

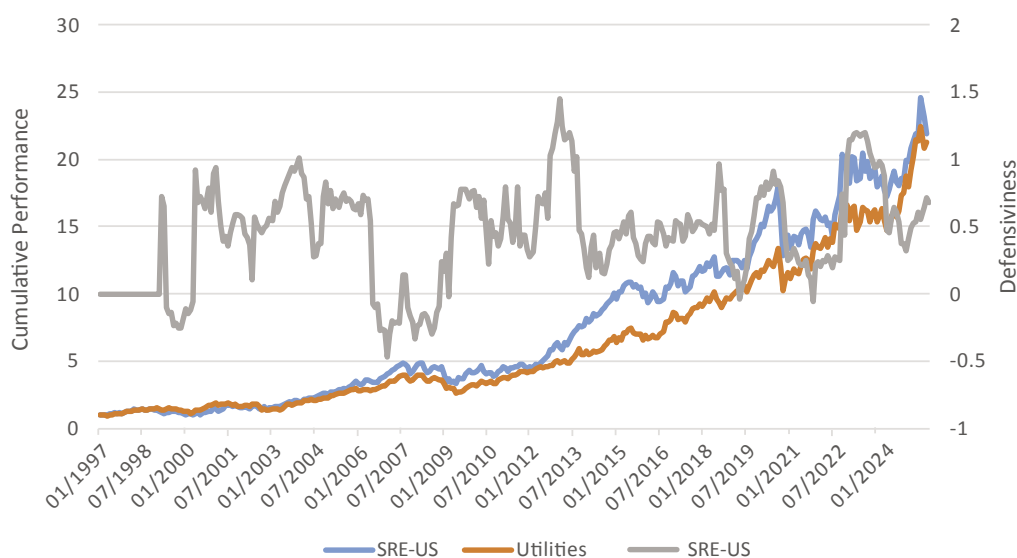
stricter rate regulations. The rate structures in Georgia, Alabama, and Mississippi allow for more predictable earnings and less regulatory risk compared to utilities in states with stricter energy mandates.

Utilities that relied on competitive power markets (e.g., FirstEnergy, Exelon) faced challenges when electricity prices fell after the shale gas boom. Southern Company's focus on regulated utility operations has shielded it from earnings volatility linked to wholesale power prices. While some peers faced earnings declines from exposure to deregulated energy markets, Southern maintained steady, regulated cash flows.

Several major utilities underperformed due to debt issues, dividend cuts, failed acquisitions, or regulatory scandals—problems that Southern largely avoided. FirstEnergy was hit by a bribery scandal and competitive generation struggles. Dominion Energy suffered from offshore wind struggles, asset sales, and a dividend cut. Eversource had costly offshore wind delays and regulatory headwinds in New England. Southern, while facing some nuclear project delays, did not overextend itself or make major missteps that hurt shareholder value.

Southern Company's long-term outperformance is the result of a strong regulated business model, favorable geography, resilient dividends, smart infrastructure investments, and constructive regulatory relationships. While other utilities have struggled with debt, regulatory uncertainty, or poorly executed strategic shifts, Southern has remained a well-managed, financially stable, and steadily growing utility stock—making it one of the best-performing utilities over the past 25 years.

Sempra: Resilient Growth Through Diversification



Sempra has outperformed other utility companies over the past 25 years due to a well-diversified business model, strategic investments in high-growth markets, international expansion, strong regulatory positioning, and exposure to energy infrastructure trends. Unlike many traditional utilities that rely primarily on regulated electricity distribution, Sempra has successfully capitalized on natural gas infrastructure, renewable energy, and global energy demand, positioning itself as a leader in the sector.

Sempra is unique among U.S. utilities because it operates a highly diversified portfolio that extends beyond just electricity distribution. It owns regulated utilities in California (San Diego Gas & Electric) and Texas (Oncor), which provide steady, predictable earnings. Unlike most traditional utilities, Sempra has significant exposure to natural gas infrastructure, including pipelines, liquefied natural gas (LNG) export terminals, and energy storage facilities. This combination of regulated stability and growth-driven energy infrastructure has allowed it to outperform utilities focused solely on electricity transmission and distribution.

One of Sempra's biggest growth drivers has been its early investment in liquefied natural gas (LNG) infrastructure, which has paid off tremendously. Sempra LNG exports from the U.S. have benefited from growing global energy demand, particularly in Europe and Asia. The company's Cameron LNG facility in Louisiana and other projects have positioned Sempra as a major player in the global natural gas market. As natural gas remains a critical energy source in the transition to renewables, Sempra's LNG exports have outperformed traditional utility revenue streams.

Sempra operates in two of the largest and fastest-growing states in the U.S.—California and Texas, giving it a distinct advantage. California has led the way in renewable energy adoption, electrification, and infrastructure investments, creating strong rate base growth opportunities for Sempra. Texas has seen rapid population and industrial growth, which has driven increased electricity and

energy demand. Oncor, Sempra's Texas utility subsidiary, has been a major growth asset, benefiting from the state's expanding energy grid and continued business-friendly policies.

While many utilities have struggled with challenging regulatory environments, Sempra has navigated regulatory frameworks effectively to ensure long-term stability. San Diego Gas & Electric (SDG&E) operates in California, a state that supports aggressive energy transition policies, leading to increased infrastructure investments in renewables, grid modernization, and electrification. Oncor (Texas) benefits from a growing customer base and business-friendly regulatory conditions, enabling steady earnings growth. Sempra's ability to work within regulatory constraints while still maintaining profitability has set it apart from peers struggling with rate hikes and cost recovery.

Sempra has delivered consistent dividend growth while maintaining a competitive total return for shareholders. The company has increased its dividend for nearly two decades, reinforcing its reputation as a strong income investment. Unlike some utilities that have had to cut dividends due to debt or restructuring (e.g., Dominion Energy), Sempra has maintained financial discipline and steady payout growth. Investors looking for a combination of yield and capital appreciation have favored Sempra over lower-growth utilities.

Sempra has positioned itself to benefit from long-term structural trends in the energy sector. Electrification and grid modernization in California have driven investment in infrastructure. LNG exports and global energy demand have made its natural gas operations more valuable. Renewable energy investments and transmission expansion have positioned it for future growth. The growing need for reliable energy in Texas has ensured continued revenue growth through Oncor.

Unlike many utilities that rely solely on regulated electricity businesses, Sempra has capitalized on global energy demand, LNG exports, and infrastructure expansion, giving it a distinct growth advantage over traditional utilities. Its ability to balance stability with innovation has made it one of the best-performing utility stocks in the long run.

Public Service Enterprise Group: A Steady Performer in a Changing Landscape



Public Service Enterprise Group (PSEG) has outperformed most utilities over the past 25 years due to its strategic focus on regulated operations, investments in clean energy, operational excellence, financial strength, and resilience in the face of challenges. Despite a brief period of underperformance in 2022, the company has successfully positioned itself as a leader in the industry.

A key factor behind PSEG's success has been its shift toward regulated utility operations, which provide stable and predictable cash flows. By exiting the merchant fossil generation business in 2022 and selling stakes in offshore wind projects, the company simplified its operations and concentrated on its core subsidiary, Public Service Electric & Gas (PSE&G), which generates the majority of its earnings. This strategic pivot has allowed PSEG to focus on long-term, regulated growth rather than the volatility of competitive energy markets.

The company has also consistently invested in clean energy and infrastructure upgrades, aligning with regulatory priorities and increasing customer demand for decarbonization. Initiatives such as Clean Energy Future and various energy efficiency programs have reinforced its commitment to sustainability. Looking ahead, PSEG plans to invest between \$21 billion and \$24 billion from 2025 to 2029 in regulated capital projects, ensuring continued growth and modernization.

Operational excellence has been another key driver of performance. PSE&G has been recognized for reliability and customer satisfaction, winning the ReliabilityOne Award for 23 consecutive years. The company also operates one of the most efficient nuclear fleets in the U.S., providing a reliable source of carbon-free energy and benefiting from Production Tax Credits (PTCs), which help stabilize revenues. These achievements have bolstered investor confidence and reinforced PSEG's reputation as a high-performing utility.

Financial discipline has further strengthened PSEG's position. The company has maintained a solid balance sheet, allowing it to fund major capital programs without issuing new equity or selling assets. This approach has supported consistent dividend growth, making it attractive to income-focused investors. Additionally, PSEG has delivered earnings within or above its guidance for 20 consecutive years, demonstrating financial stability and reliability.

Although 2022 was a challenging year due to inflation, supply chain disruptions, and energy price volatility, PSEG quickly rebounded through strategic divestitures and regulatory approvals. Improved valuation metrics and earnings visibility have since driven significant stock price gains, with PSEG's stock increasing by approximately 40% since the end of fiscal 2022.

The company's strong regulatory relationships have played a critical role in its success, ensuring cost recovery for major investments in energy efficiency programs and infrastructure upgrades. This regulatory support has allowed PSEG to maintain long-term earnings growth while keeping customer costs reasonable.

Finally, PSEG's commitment to sustainability has positioned it as a leader in the clean energy transition. With a goal of achieving net-zero greenhouse gas emissions by 2030, the company aligns well with market trends and regulatory goals, further strengthening its reputation and investor appeal.

Overall, PSEG's strategic focus on regulated operations, clean energy investments, operational excellence, financial strength, and regulatory support have enabled it to outperform most utilities over the past 25 years. Even during short-term challenges like those faced in 2022, PSEG has demonstrated resilience and adaptability, reinforcing its position as one of the strongest players in the utility sector.

Summary

In this report, we present a framework for defining a business cycle approach and classifying utility stocks based on their sensitivity to different economic phases. Through historical analysis, we examine how the defensive characteristics of selected utility stocks have evolved over time. Our findings reveal a clear pattern: utility stocks that lose their defensive qualities tend to underperform both their sector and the broader market, often struggling until they regain their defensive attributes. Conversely, utilities that maintain their defensive nature consistently outperform the average utility stock, demonstrating resilience across market cycles. This analysis provides valuable insights into how investors can navigate shifts in utility stock performance by understanding their changing sensitivities to the business cycle.

Find out more

For more information, please contact your local Fidante Partners Business Development Manager, call the Fidante Partners Adviser Services team on 1800 195 853 or visit us at www.patrizia.ag/en

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