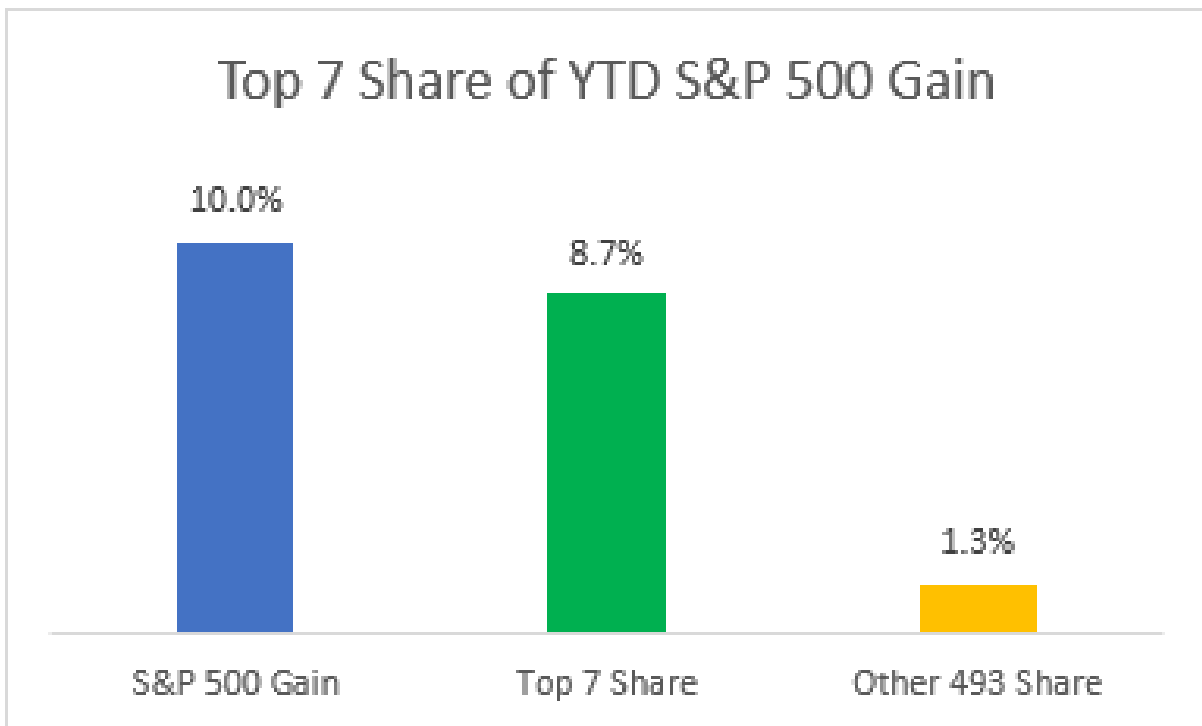


3 Compelling Reasons to Forget About the ‘Magnificent 7’ and Consider Buying the ‘Electric 5’

You have no doubt heard all about the “Magnificent 7.” These are the seven mega-cap technology-related stocks that have driven nearly all of the S&P 500’s year-to-date gains because of their huge weighting in the index. In fact, the score is not even close.



If you put all S&P 500 stocks on equal footing, cutting the Magnificent 7 down to equal size, then the index has actually gone nowhere this year.

Investors are enchanted with these seven mega-cap stocks – **Apple (AAPL)**, **Microsoft (MSFT)**, **Alphabet (GOOGL)**, **Amazon.com (AMZN)**, **Nvidia (NVDA)**, **Tesla (TSLA)**, and **Meta Platforms (META)** – thanks to their performance.

But I spy what may well be a better buying opportunity at the opposite end of the stock market spectrum. Instead of studying the seven biggest stock market winners, which everyone and their brother already knows all about, today I want to focus on “the losers.”

Specifically, I’m talking about the stock market’s worst-performing sector: the lowly utility sector. Because that’s where you’ll find the “Fantastic 5.” Better yet let’s call ’em the “Electric 5.” (I should trademark that.)

Exploring the Electric 5

The **S&P 500 Utility Sector ETF (XLU)** is down 14.4% year-to-date. It has been in *TradeSmith's* Health Indicator Red Zone for over a year. The sector is also in a downtrend, and, according to our *Trade Cycles* timing indicators, it's approaching a peak (signaling a downturn).

So, why on earth would anyone want to prospect for buying opportunities in utilities right now?

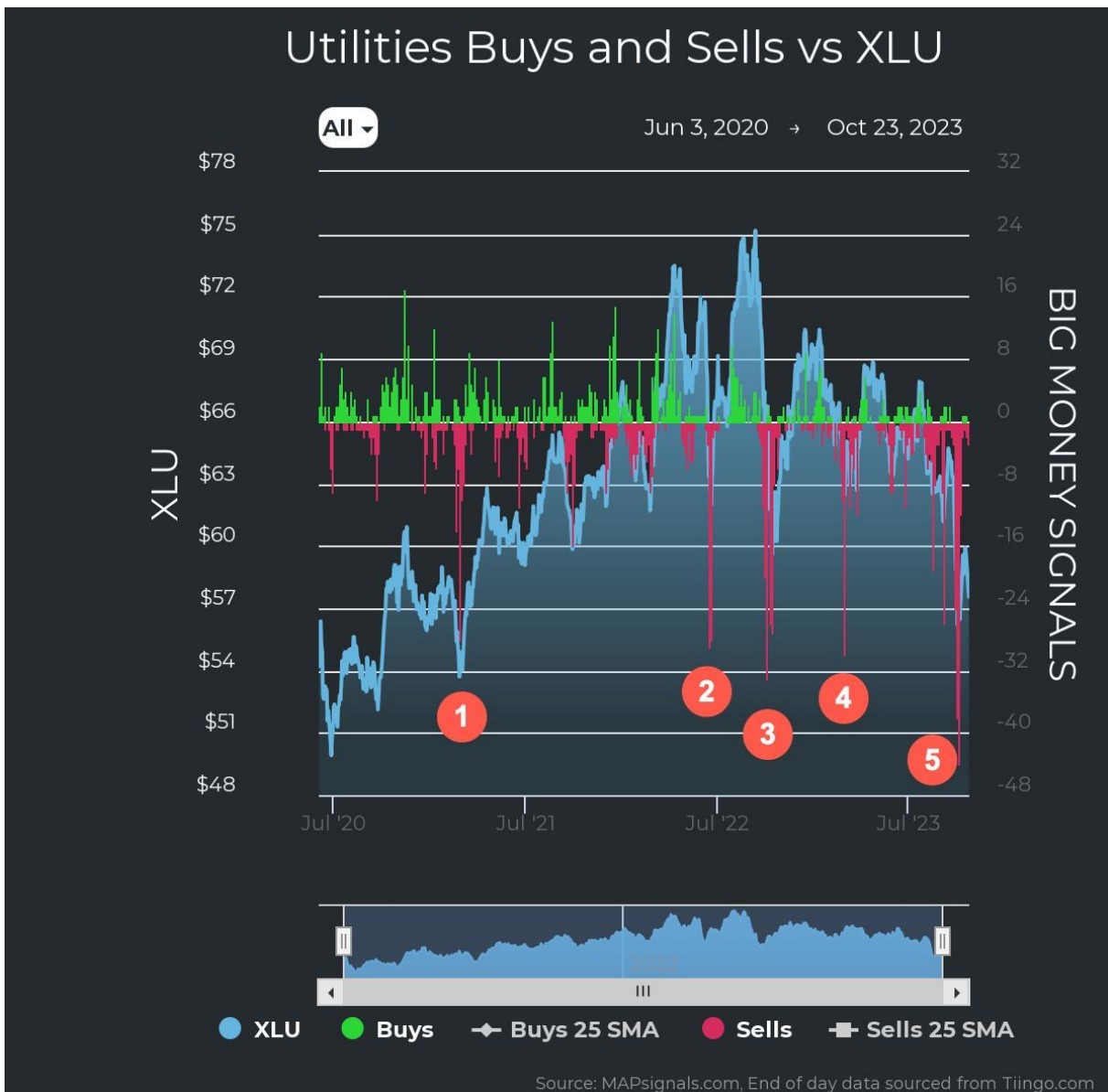
It's precisely because they are universally hated by investors, extremely oversold, and cheap in valuation.

Sometimes these are the exact kinds of beaten-down, dumpster-diving stocks that can make highly profitable, contrarian buying opportunities for you.

Here's why I think some utility stocks could be just such an opportunity right now, and how to carefully go about your research into this sector – the *TradeSmith* way.

The credit for this research goes to my colleague Jason Bodner. Jason's specialty is spotting Big Money flows into and out of the markets, ETFs, and individual stocks. He analyzes big spikes in both price and volume... these are the hallmarks of big institutional buying or selling. And when those money flows reach extremes, they most often result in big moves for stocks or ETFs.

Recently the XLU, which tracks utility stocks, experienced some extreme selling, as you can see below.



The long red bars in the chart above indicate times when high-volume selling is taking place. That's when large institutions are unloading XLU across the board. They're throwing in the towel and dumping the ETF.

Now, here's the interesting, contrarian part of this story.

Going back to mid-2020, just three years ago, we can see a total of five times with similar Big Money outflows from XLU. Each time is numbered above, with No. 5 being the most recent instance of heavy selling. This level is rare.

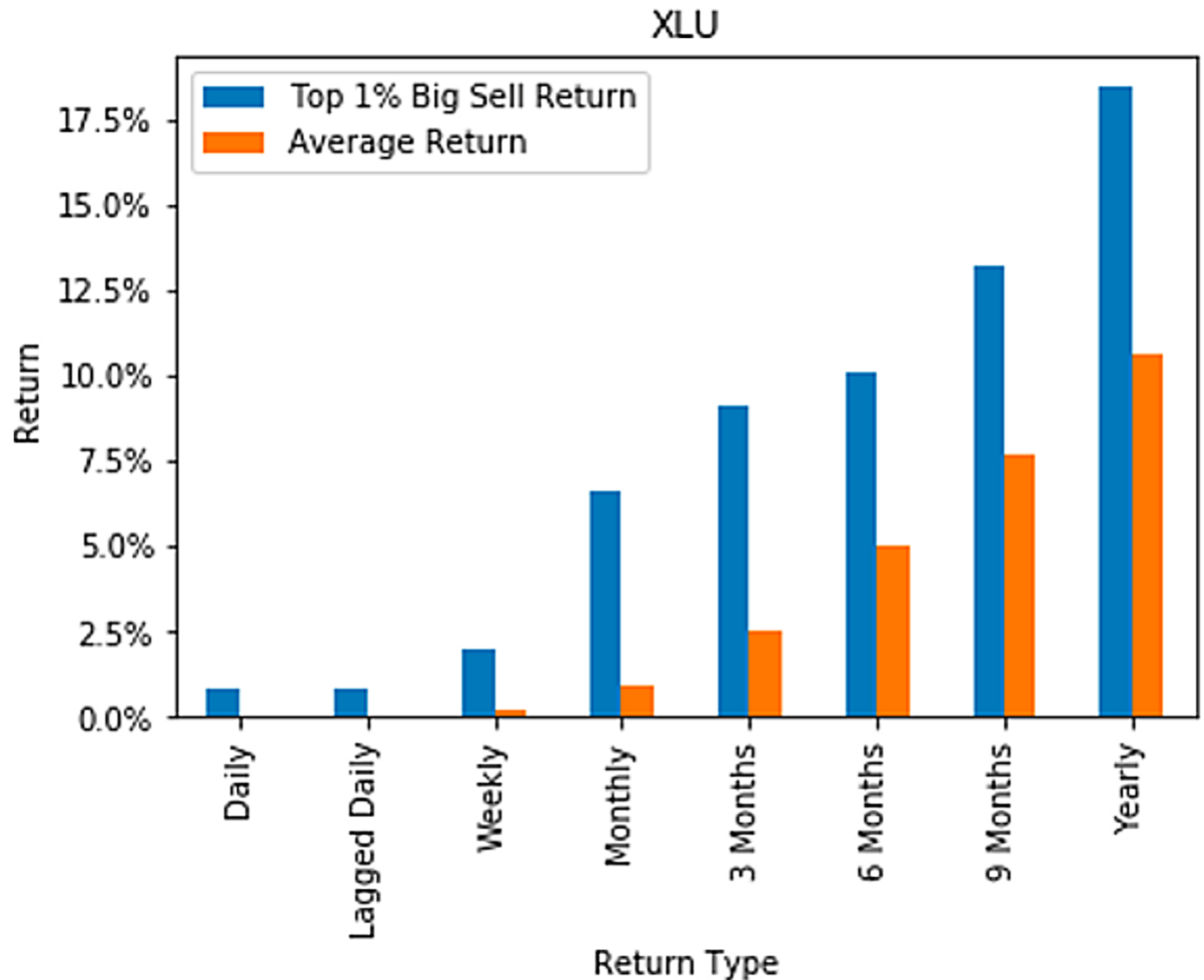
And guess what – it almost always marks a bottom in XLU.

In the past, whenever utility stocks see heavy selling like this, value hunters swoop in and buy the fire sale. This is the epitome of the Wall Street wisdom to “buy low, sell high.” Historically, these lows offer a compelling opportunity to do just that.

In fact, going back to 2013, Jason's system shows that extreme selling in utility stocks happened 33 times.

The average return for XLU just six months later was a gain of 10.1%.

And one year after an extreme signal like this, XLU was up 95.2% of the time, posting average gains of 19.4%. See for yourself:



The recent high-volume selling in XLU is signaling a bottom in this ETF.

Valuation is another good reason to consider the Electric 5 over the Magnificent 7. The stellar performance of the seven this year means their valuations have swelled, with the Magnificent 7 now trading at an average forward price-to-earnings ratio of 33.5x, compared with the S&P 500's P/E of 18.3.

How about utilities valuation? Glad you asked.

After the sector's 14% slide, XLU looks pretty cheap, trading at just 16x expected earnings. That's less than half the valuation of the Magnificent 7.

How to Find the Best Utility Stocks – the *TradeSmith* Way

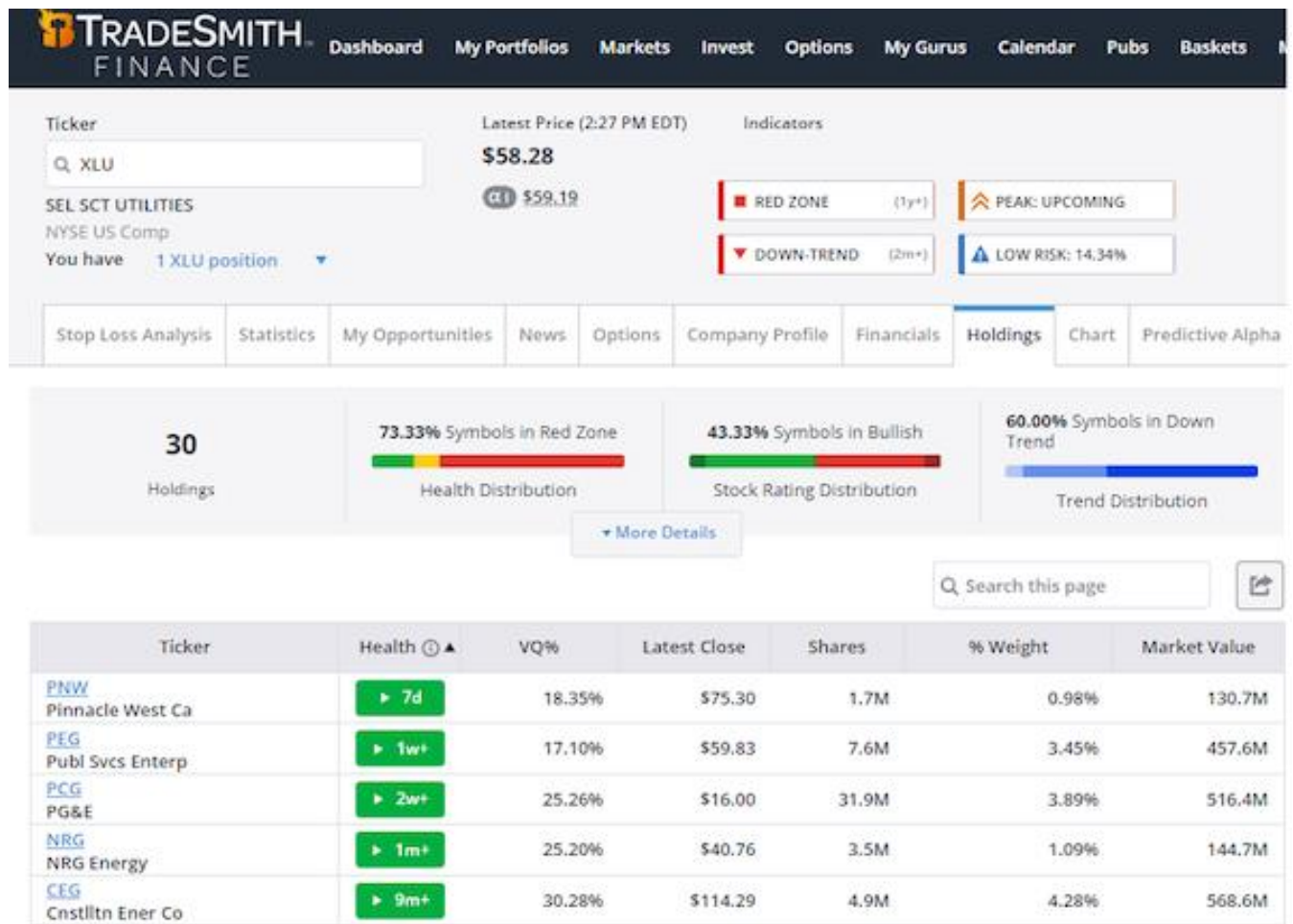
It's no surprise that most stocks in the utility sector have followed suit with the poor performance of XLU itself, as is often the case. So, it's best to stick with the best stocks in an otherwise bad sector. Here's a quick way to find them using *TradeSmith's* Market Outlook.

(Members with *Ideas by TradeSmith*, *Trade360*, *TradeSmith Essentials*, and *TradeSmith* Platinum subscriptions can access this tool.)

- Be sure you're logged in to *TradeSmith Finance*, then click on **Markets** in the top menu.
- Select the **S&P Sectors** tab, scroll down the page, and click the blue **Utilities (XLU)** link.
- Next you'll see the Stock Analyzer page for the Utilities sector ETF (as seen below). It will open showing the **Holdings** tab. There you'll find the complete list of 30 utility stocks included in XLU.
- And with just one click to the **Health** column (see green arrow in the image below), the best stocks rise to the top.

As of last Friday, 73% of XLU holdings were in the Red Zone. *Spoiler Alert:* There were *ONLY* five ... count 'em, just five ... utility stocks still holding on in the Green Zone.

Here are the few, the proud, the Electric 5, for your consideration.



Digging deeper into the individual stocks, **Constellation Energy (CEG)** looked most promising to me after a quick review. The stock is one of only two Electric 5 stocks still in an uptrend and above its Smart Moving Average; the other is **NRG Energy (NRG)**. Plus, CEG has an above-average **Business Quality Score (BQS)** of 64, and its next valley area (signaling an upturn) starts in just a few weeks (on Nov 3).

Mike Burnick's Bottom Line: This simple analysis doesn't make CEG, or any of the stocks listed above, automatic buys. You've got to do your own homework first and take a closer look at the financials one by one. Still, when an entire sector gets smashed – is universally hated by investors, deeply oversold, and cheap in valuation – it's compelling enough to get my attention. I'll be adding the Electric 5 to my watchlist to keep tabs on them.

Good investing,

Mike Burnick

Senior Analyst, TradeSmith

P.S. If you have any questions or concerns, please reach out to me at emailmikeburnick@tradesmith.com and include "Inside TradeSmith" in the subject line.