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TIP SHEET: Miller Sticks To Slow And Steady In This Race

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NEW YORK -- If the world were divided into tortoises and hares, Miller/Howard Investments' **Lowell Miller** would prefer to be counted among the reptiles.

With Nasdaq poised to report its worst year ever, and the S&P 500 in negative territory, Miller's Flex-Funds Total Return Utilities fund has once again proven Aesop's adage, "slow and steady wins the race," by posting double-digit returns.

For the hares of the world, who hunt for quick profits rather than low-risk, steady gains, Miller's strategy screams dull. But the strategy has paid off with a gain of 14.4% so far this year, according to Morningstar.

When Miller launched the fund, the goal was to provide conservative investors with a equity option to fixed income.

Miller's fund picks strictly utility stocks, and the sector has been the market's best performer this year. He looks for strong dividends, good regulatory environments and sound management. Most of his picks are mid-capitalization stocks.

Within the utility category, Miller shifts between subsectors depending on market conditions. Currently, the fund's heaviest concentration, about 40%, is in natural gas transportation companies.

Rounding out its other investments, Miller puts about 20% to 30% of its $21 million in assets in telecommunications stocks, 20% to 30% in electricity and 5% to 6% in water utility stocks.

Miller favors natural gas-weighted stocks because he sees gas as "the fuel of the future." Demand for the commodity, which has traditionally been used to heat homes and power manufacturing plants, is on the rise as power generation plants switch to the cleaner burning fuel from coal.

The companies that transport gas are one beneficiary of this trend, Miller said. And, as an added bonus, some gas transportation companies also operate units that explore for and produce natural gas, the portfolio manager said. With gas prices quadruple their year-ago levels, the E&P units have turned into cash cows.

One stock in this category is Questar Corp. (STR), a Salt Lake City gas distributor with customers in Utah, Wyoming and Idaho. Over the past year, the stock has doubled because of Wall Street's attention to the company's interest in a western Wyoming natural gas discovery.

Miller expects Questar to earn back its investment in developing the gas discovery within four months.

Miller also likes NiSource Inc. (NI), Merrillville, Ind., a gas and water distributor that recently acquired Columbia Energy Group. The acquisition, which Miller calls a "wonderful deal," gives the combined company pipeline operations in 16 states. NiSource shares, which closed Tuesday at $31.50, have gained 76% in the past 12 months.

Keyspan Energy Corp. (KSE), Brooklyn, N.Y., also has been a consolidator in the distribution business. Although the stock has gotten "a little pricey," Miller thinks the company has an excellent service territory. Keyspan closed Tuesday at $42.06, up 81% over the past 12 months.

Although Miller prefers large electricity utilities, he is steering clear of California because of its uncertain regulatory environment.

California's two largest utilities, which are owned by Edison International (EIX) and PG&E Corp. (PCG), have been struggling with skyrocketing energy costs in the state's deregulated market. The companies are now appealing to the state's regulators for a rate hike the companies say is needed to avert bankruptcy.

Whatever the outcome of those discussions, Miller doesn't expect to see a backlash of re-regulation. "You can't put the toothpaste back in the tube," he said.

"California made it difficult to build new generation," he said, explaining that there are a lot of reasons that make the California power crisis unique. Aided and abetted by the existing utilities, the state didn't keep up with its growing power needs, he said.

Miller also doesn't invest in the merchant energy providers that are reaping the benefits of California's volatile power market. These companies include AES Corp. (AES) and Calpine Corp. (CPN).

While the group's earnings have been strong, the political situation in the state has elevated the sector's risk profile, according to Miller, so he is sitting on the sidelines for now.

Among the merchant power players he favors are the more diversified companies: Duke Energy Corp. (DUK), Reliant Energy Energy Inc. (REI), and Exelon Corp. (EXC).

Duke shares closed Tuesday at $87.13, up almost 74% in the past 12 months.

Reliant shares closed Tuesday at $44.13, up more than 90% in the past year. Exelon, which was formed by the merger of Unicom and PECO Energy, closed Tuesday at $70.50, after setting an all-time high of $70.98.

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Briefing Book for: AES | CADAY | CPN | DJDAY | DUK | EIX | EXC | KSE | NI | PCG | REI | STR
