The Sizemore Income Letter

April 2021

It Starts as an Anecdote

By Charles Lewis Sizemore, CFA

"All economic information of any importance is initially anecdotal."

--Dennis Gartman

No truer words have ever been spoken. I hate that Mr. Gartman retired from the financial newsletter business because he was the master of finding that little tidbit of seemingly random and unimportant information that somehow explains everything.

I bring this up because I'm looking to have some renovations done in my house in Dallas. We've been spending a lot more time in it over the past year, and so all of its little imperfections are starting to drive us crazy. It's an older house in an old, tree-lined neighborhood, and it's in need of a little tender loving care from a good contractor.

Well…

One painter offered to repaint the interior of my house for $16,000. Not including the paint. Now, keep in mind, this is not a large structure. It's only 2,000 square feet. A high-end painter might normally charge around $7,000 for a job like that in Dallas, and you can get it done for less than half of that if you're willing to speak directly to the painters and bypass the middlemen.

Suffice it to say I didn't call him back.

I got a quote to remodel our guest bathroom. We're not looking at making major structural changes. I simply wanted someone to rip out all the existing tile and then repaint and retile.

He wanted $10,000 for that, plus the cost of the materials. A year ago, I would have paid $3,000 to $4,000 for a job that small. I considered doing the job myself with my kids as a creative outlet. $10,000 for two days' worth of work is insulting.

The thing is, someone out there is paying these prices. Otherwise, they wouldn't be asking for them.

There are plenty of explanations here. To start, I live in Texas, the state that got obliterated by the ice storm a few months ago. There's a backlog of work still to be done, and if you want something done now, you essentially have to pay to get to the front of the queue.

There's also the stimulus payments. Most Americans weren't really all that affected by the pandemic. Yet most American families have received a couple thousand dollars from the government that they are now blowing on things like home remodeling.

Supply chain problems are a factor too. Apart from the painting and bathroom remodeling, I looked at getting my fence redone. I had a contractor point blank tell me to wait a year. Due to supply chain issues dating back to the pandemic, lumber and wood products are now scarce.

And on the subject of supply chains… My 11-year-old son, I am very proud to say, is developing into quite the little computer geek. He wants to build a gaming PC from scratch, and I'm really looking forward to helping him do it.

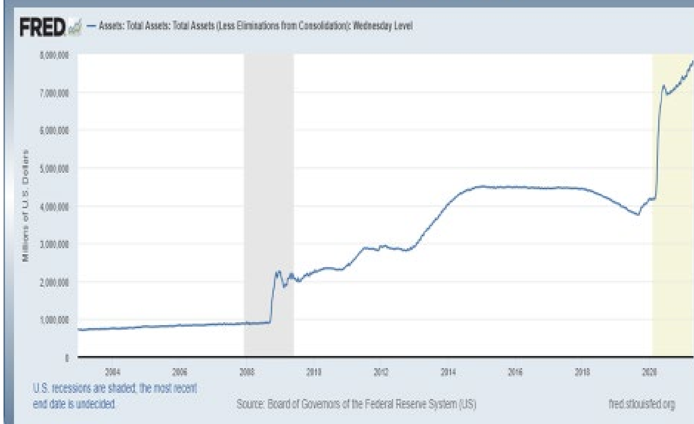
But good luck finding the parts. Due to a combination of demand being high from Bitcoin miners and supply being low due to supply chain issues, the price of video cards has gone through the roof. If we want to get the computer built any time soon, I may need to buy a video card off of some guy in a trench coat in a dark alley.

At the root of all of this is the Federal Reserve's easy money regime.

You know me. I like to be balanced and level-headed, and I don't like to get political. I'm not ideologically opposed to the Fed, and I accept that the chairman has a really tough job. It's not a responsibility that I'd want to take on.

But look at the expansion of the Fed's balance sheet.

Fed Balance Sheet



Source: St. Louis Fed *Figure 1*

The axis on the chart might be a little difficult to read, but I can sum it up pretty succinctly. In late 2019, the Fed held a little less than $4 trillion in assets. Today, that number is just shy of $8 trillion.

When the Fed grows its balance sheet, it creates new dollars to buy bonds and other assets. That means we added $4 trillion in new money to the financial system in a little over a year.

U.S. ISM Manufacturing Purchasing Managers Index (PMI)

Source: Investing.com *Figure 2*

The Fed is pumping money into the system to keep the economy growing.

Well, I can't say it's not working. The ISM Manufacturing Purchasing Managers Index – which is a composite measuring new orders, production, employment, supplier deliveries, and inventories – is now sitting at its highest levels since 1984.

Meanwhile, GDP estimates are coming in strongly. Economists see GDP growth coming in north of 5% once first quarter data is released, and the Atlanta Fed sees the number coming in at over 8%.

Granted, we're coming off a low base, but that's still quite good.

Unemployment claims are still elevated, but this is where Gartman's quote on anecdotes comes into play. I went to a restaurant with some friends last weekend, and the place was lively. We had to fight for a table.

The restaurant owner was a friend, and we asked him how business was going. He said things were really picking up, but…

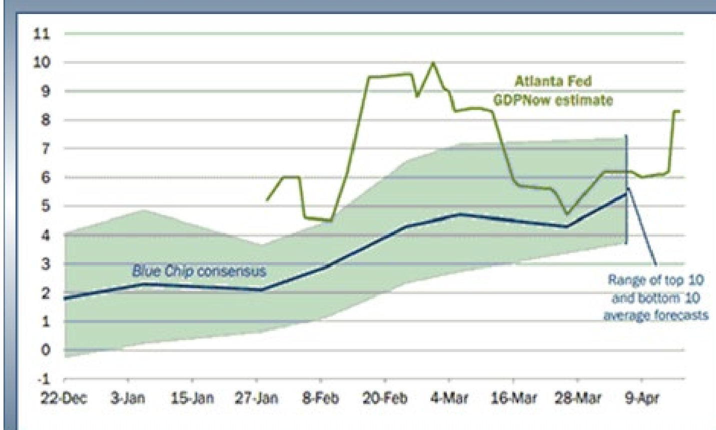
"I'm screwed if my head cook leaves. It's impossible to find labor, and restaurants have been poaching employees from each other. I can't afford to get into a bidding war."

I take the experience of a single Dallas restaurant owner with a major grain of salt. But if he's having a hard time keeping his restaurant staffed, then the high unemployment claims don't quite make sense.

It's not hard to see what is happening here. When you can collect $300 per week in COVID-related unemployment claims <u>in addition to</u> normal state unemployment benefits, a lot of would-be workers are finding that they make more money *not* working than they do actually earning a paycheck.

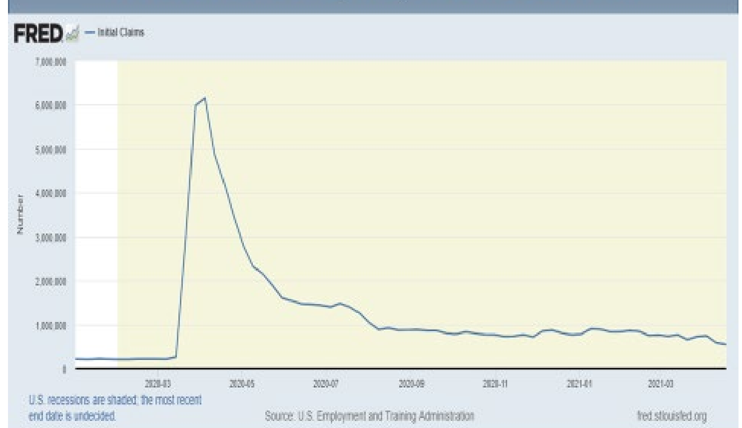
Clearly that is idiotic, but it's not likely to change any time soon. Benefits are scheduled to continue through at least September 6.

First Quarter 2021 GDP Estimates



Source: Atlanta Fed *Figure 3*

Initial Unemployment Claims



Source: St. Louis Fed *Figure 4*

There are a couple takeaways here.

To start, the economy is likely to be running hot for a while. Inflationary pressures are going to be seen.

As benefits run out and unemployed Americans find themselves hustling for work again, we'll see some of these labor pressures subside. But again, that will be in September at the earliest. And with a midterm election coming up, Congress might not be ready to tell Americans to sober up and get jobs.

So, the bottom line is that inflation-sensitive sectors should continue to do well for the foreseeable future.

Dividend-Paying Goldmine

That brings me to this month's recommendation, blue-chip goldminer **Newmont Corporation (NYSE: NEM)**.

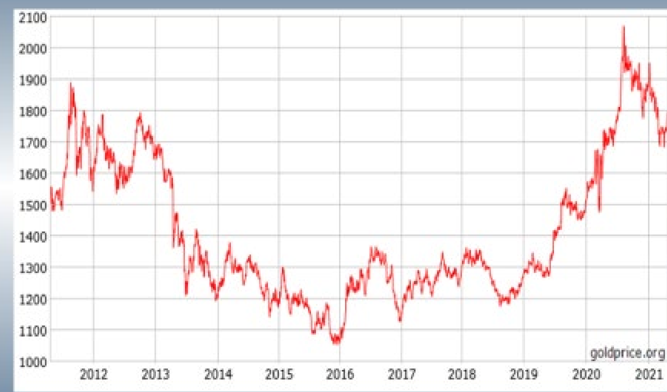
While Newmont mines copper, silver, zinc, and lead, among other metals, it is first and foremost a goldminer. The company has operations scattered across the globe, including the United States, Canada, Mexico, Dominican Republic, Peru, Suriname, Argentina, Chile, Australia, and Ghana.

As of the end of last year, it had proven and probable gold reserves of 94.2 million ounces.

I've been getting more focused on commodities in recent months, though my emphasis has up until now been industrial commodities. I recommended industrial metals miners **BHP Group (NYSE: BHP)** and **Vale SA (NYSE: VALE)** back in February in the belief that a major infratructure bill was likely to keep demand high for the foreseeable future.

Well, that's still the case. Nothing has changed on that front. But in the months that have passed since that issue, the price of gold appears to have finally reversed the nasty downtrend it's been in since August.

Spot Gold Price Per Ounce

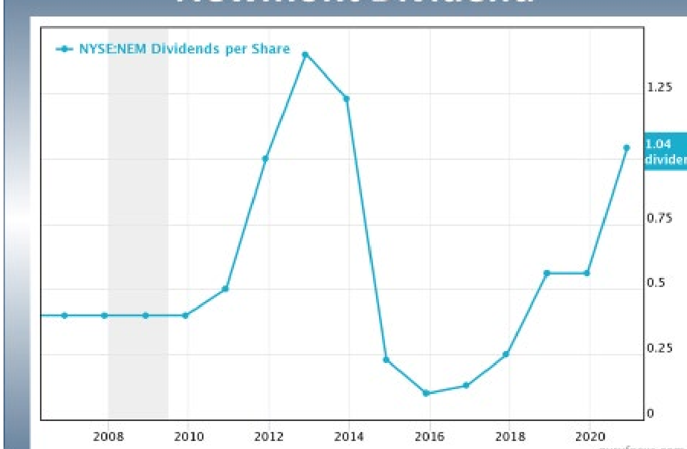


Source: Goldprice.org Figure 5

Newmont Corporation

Source: GuruFocus.com Figure 6

Newmont Dividend



Source: GuruFocus.com Figure 7

It may be too early to say whether the recent pop in the price of gold is truly the start of a new trend. But it's telling that Newmont's stock price has held up considerably better than the price of the gold it mines.

Let's talk dividends. At current prices, Newmont yields 3.3%. That makes it a relatively low yielder by the standards of the *Sizemore Income Letter.* But if things go the way I expect, the payout should be a good deal better than that.

It comes down to Newmont's payout policy which is… shall we say… a little complicated. Newmont aims to pay out 40% to 60% of free cash flow attributable to the price of gold being higher than $1,200 per ounce.

It's a messy formula, but you get the idea. A higher gold price means a higher dividend.

Looking at Newmont's dividend history, you can see this in action (Figure 7). Newmont cut its dividend in the mid 2010s because the price of gold suffered a nasty bear market. But as the price of gold has recovered, so has the dividend.

So, an investment in Newmont is essentially a question of how likely it is that gold prices keep rising.

Well, we have budget deficits that are at peacetime record highs and a central bank determined to pump as much liquidity as possible into the financial system. So, you tell me: Is it likely that gold goes higher from here?

I think it's certainly worth a modest bet. In Newmont, we get a blue-chip goldminer that has survived some nasty booms and busts over the years. Its shares managed to hold up fairly well during a rough patch for the yellow metal over the past eight months and are now moving higher again along with the price of gold.

If I'm right, we could make two or three times our money on the share price in the coming years while also seeing our dividend income rise by a comparable amount.

And if I'm wrong?

No worries. We'll simply follow our stop losses, sell, and move on.

So, let's do this!

Action to take: Buy shares of Newmont Corporation (NYSE: NEM) at market. Set an initial stop loss at $53.74 based on closing prices.

The Elephant in the Room: Taxes

This letter is more than just a stock picking service. I like to more comprehensive advice because, at the end of the day, making fantastic investment returns is a fool's errand if you end up giving half the returns away due to bad tax planning.

So with that said, let's take a look at President Biden's recent tax proposals.

I'll start by pointing out the obvious. This is an opening shot. No one believes that what has been proposed will end up being the final bill. It will be debated and negotiated in congress… there will be backroom deals… and whatever ends up on Biden's desk for signature will end up looking very different.

But just for grins, let's give a good hard look at the proposal.

For most investors, the damage will be pretty minimal. People earning more than $1 million will be bumped from the 37% bracket to the 39.6% bracket.

The Forever Portfolio										
Stock	Ticker	Entry Date	Buy	Price	Recent Price	Stop Loss	Yield	Cumulative Dividends	Total Return	IRA Friendly?
Philip Morris International	PM	3/30/2021	$	89.35	$ 94.61	None	5.28%	$ -	5.89%	Yes
Altria Group	MO	3/19/2020	$	37.10	$ 47.39	None	6.55%	$ 4.26	39.22%	Yes
Realty Income	O	3/19/2020	$	48.08	$ 69.40	None	4.39%	$ 2.81	50.18%	Yes
AT&T	T	3/19/2020	$	31.15	$ 31.40	None	6.91%	$ 2.08	7.48%	Yes
Enterprise Products Partners	EPD	3/19/2020	$	14.52	$ 23.28	None	7.83%	$ 1.79	72.62%	No
Kinder Morgan	KMI	3/19/2020	$	11.20	$ 16.78	None	6.25%	$ 1.05	59.21%	Yes
Ventas	VTR	3/19/2020	$	19.98	$ 54.77	None	3.28%	$ 2.14	184.85%	Yes
Public Storage	PSA	3/19/2020	$	187.60	$ 276.77	None	3.27%	$ 8.00	51.80%	Yes
International Paper	IP	3/19/2020	$	30.13	$ 56.78	None	3.72%	$ 2.05	95.26%	Yes
STAG Industrial	STAG	3/19/2020	$	21.71	$ 36.27	None	4.24%	$ 1.44	73.71%	Yes
Retail Opportunity Investments	ROIC	3/19/2020	$	7.25	$ 17.58	None	1.88%	$ 0.31	146.76%	Yes
Average							**4.87%**		**78.11%**	

That 2.6% difference isn't going to kill them. But the proposed change in the capital gains tax rate might. Under the proposal, the capital gains rate would jump 43.4% from the current 23.8% (20% + the 3.8% Obamacare surcharge).

And believe it or not, this is not the biggest potential bomb. Biden has also proposed doing away with the step-up in basis on inherited shares and dramatically lowering the estate tax threshold from $11.7 million to $5 million.

These are, of course, high-quality problems. If you make more than $1 million per year, life is pretty good and paying more in taxes isn't exactly going to put you in the breadline.

But it's still a bitter pill to see your savings punished like that.

We'll see what comes of it. Again, we need to remember that this is the opening salvo. Biden may simply be starting extreme to give himself room to negotiate later.

But I'll say this. There will always be tax loopholes. I don't know what all of them will be ahead of time, but the best one I know of today is the 401(k) and defined-benefit plan combination. Depending on your age and income level, you can potential shield multiple hundreds of thousands of dollars from the tax man.

If this is something you'd like to discuss, please contact my office. I've set these up for some of my high-income clients and they've saved a bundle in taxes.

Update on the Forever Portfolio

I don't comment on the Forever Portfolio every month given that it's, by design, a low maintenance portfolio designed to be bought and held and largely forgotten about.

But since we added a new pick last month, I feel it's worth at least a quick mention.

We're up a quick 5.9% in **Philip Morris International (NYSE: PM)**. If you haven't bought shares yet, you still have time. Emerging markets got hit a lot harder by the pandemic than the United States did, and these markets consequently have a much more aggressive rebound to look forward to.

Philip Morris International is not an "emerging market," per se, as the company is American. But its clientele is exclusively overseas, and emerging markets are a big part of that story. If you want access to an emerging market rebound without the heartburn that comes with investing in emerging market stocks directly, PM is a solid bet.

I also still really like **Realty Income (NYSE: O)**. To start, it's a nice reopening play given its exposure to retail properties. But remember, real estate is also a natural inflation hedge. So, if inflation really does become a problem down the line, Realty Income should benefit from higher rents and from property appreciation.

The same goes for **STAG Industrial (NYSE: STAG)**. And STAG has the added benefit of being one of Amazon.com's landlords. If you like the idea of a gritty inflation hedge with indirect exposure to the ongoing growth in e-commerce, then STAG belongs in your portfolio.

That's going to wrap it up for this month. We'll pick this up in May. Until then, keep cashing those dividend checks!

Charles Sizemore

P.S.: Apart from writing this newsletter, I run a full-service wealth management firm along with my colleagues. At **Sizemore Capital Management**, we build income portfolios like those I write about in the *Sizemore Income Letter*. But we also do a lot more than that. We manage a suite of low-volatility strategies offering low correlation to the S&P 500. If you think your portfolio is a little too exposed to the stock market right now, let's talk. I may have some alternatives that can offer competitive returns without the heartburn.

If you'd like for me to take a look at your portfolio and offer some recommendations, contact me at info@sizemorecapital.com.

The Sizemore Income Letter Portfolio

Stock	Ticker	Entry Date	Buy Price	Recent Price	Stop Loss	Yield	Cumulative Dividends	Total Return	IRA Friendly?
Newmont Corporation	NEM	4/27/2021	$65.72	$ 65.72	$53.74	3.35%	$ -	0.00%	Yes
BHP Group	BHP	2/25/2021	$78.04	$ 74.68	$60.94	4.10%	$ -	-4.31%	Yes
Vale SA	VALE	2/25/2021	$17.40	$ 19.66	$12.06	3.00%	$ -	12.99%	Yes
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$ 46.40	$34.74	9.10%	$ 1.03	6.80%	No
WisdomTree Emerging Markets High Dividend Fund	DEM	12/31/2020	$41.22	$ 45.44	$37.02	4.70%	$ -	10.24%	Yes
Healthcare Trust of America	HTA	11/20/2020	$26.80	$ 28.85	$23.14	4.75%	$ 0.32	8.84%	Yes
Physicians Realty Trust	DOC	11/20/2020	$17.80	$ 18.81	$14.53	5.12%	$ 0.23	6.97%	Yes
AllianceBernstein Holding, LP	AB	11/6/2020	$30.85	$ 42.21	$28.16	9.12%	$ 0.97	39.97%	No
Main Street Capital	MAIN	9/25/2020	$29.74	$ 42.82	$24.36	8.46%	$ 0.82	46.74%	Yes
Iron Mountain	IRM	8/25/2020	$30.22	$ 40.32	$23.53	8.15%	$ 1.24	37.52%	Yes
Starwood Property Trust	STWD	8/25/2020	$15.70	$ 25.53	$15.87	12.05%	$ 0.96	68.73%	Yes
Dow Inc.	DOW	6/24/2020	$38.45	$ 62.05	$41.05	6.62%	$ 0.70	63.20%	Yes
Tortoise Essential Assets Income Term Fund	TEAF	6/24/2020	$10.73	$ 14.71	$11.07	8.19%	$ 0.60	42.68%	Yes
LyondellBasell Industries	LYB	5/22/2020	$60.39	$ 104.41	$73.29	6.17%	$ 1.05	74.63%	Yes
Invesco Adv. Municipal Income Trust II	VKI	4/23/2020	$10.12	$ 12.10	$10.87	4.76%	$ 0.51	24.56%	No
Ares Capital Corporation	ARCC	4/23/2020	$11.35	$ 19.56	$15.02	11.44%	$ 1.20	82.91%	Yes