The Sizemore Income Letter

May 2021

Is it Too Late for Sell in May?

By Charles Lewis Sizemore, CFA

Wall Street is the undisputed financial capital of the world, where the masters of the universe routinely shuffle trillions of dollars.

And yet… it seems to be governed by nursery rhymes and fortune cookie sayings.

“The trend is your friend!”

“Don’t frown, average down!”

And of course, “sell in May and go away.”

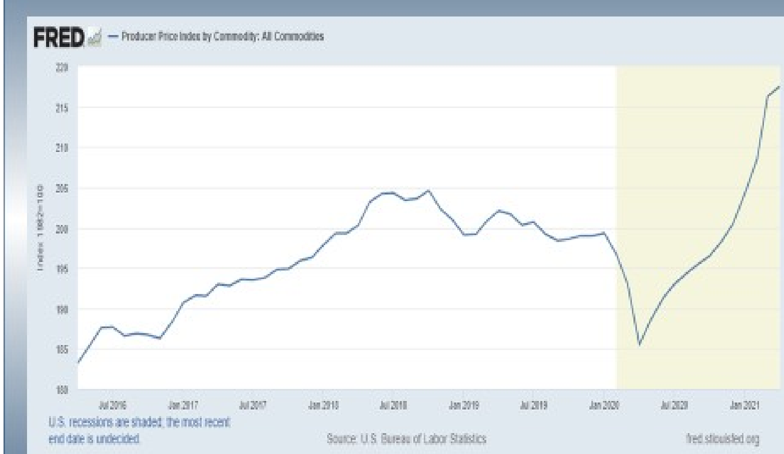
I tend to ignore calendar effects. The way I look at it, if a stock meets all of my investment criteria, why would I sell it just because it’s marginally less likely to enjoy a strong advance between the months of May and October?

That said, I do wonder if this is one of those years where it really does pay to sell in May, or at the very least, get a little more defensive. I still see some solid buys out there, and I’m adding two new picks this month. But the pickings are definitely getting slimmer. Rather than focus on raw yield, I’m having to focus more on total return, including expected capital gains. Because frankly, a lot of the high-yield options still available are things I’d rather avoid.

I’m not going to recommend you sell anything today. But you will notice that I’ve tightened most of our stop losses and moved some of our appreciated positions from “buys” to “holds.”

We’ll dig into those details later, but I can summarize my thinking like this: I still see upside in this market. But I don’t want to overstay my welcome. Stocks have traded mostly sideways for the past two months as Mr. Market handicaps the Fed’s next move. As I’ve been writing for months, inflation is back on investors’ radars for the first time in decades

Inflation is Back



Source: St. Louis Fed *Figure 1*

The Federal Reserve insists it's "transitory," and they might end up being mostly right. But then again, they might not. We run the real risk that the Fed creates an inflation problem that it then has to squash.

The market almost always moves *before* the economic data comes out. So, long before the Fed hikes rates or otherwise tightens, I would expect the market to have anticipated the move.

Again, we'll see. This may all be much ado about nothing, and the market may simply be taking a brief pause before moving higher. But I do think it makes sense to be careful here. This market lives or dies based on the Fed's next move.

Two New Picks

I'm wary about the broader market. But as I said a minute ago, I do believe there are pockets of real value still left out there.

I'll start with energy. In the *Sizemore Income Letter's* short life as a publication, we've gotten burned a few times in energy stocks. It seems that whenever the sector finally looked to be bottoming, it would reverse and head even lower. It seemed to be a classic value trap: cheap stocks that perpetually got cheaper as the world around them crumbled.

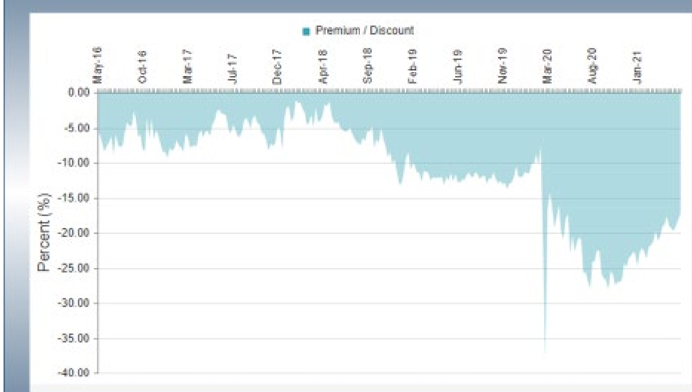
Well, it seems like that cycle has finally been broken. Energy stocks – and particularly energy midstream stocks – have been ripping higher since the 4th quarter of last year.

We already have a little exposure to midstream energy infrastructure via **Magellan Midstream (NYSE: MMP)** and

ClearBridge Energy Midstream Opportunity Fund (NYSE: EMO)

Source: BigCharts *Figure 2*

An 83-Cent Dollar



Source: CEFConnect *Figure 3*

EMO Top Holdings

Top Holdings

As of 3/31/2021 reported by Fund Sponsor

MPLX LP Partnership Units	$37.20M	8.59%
Enterprise Products Partners LP	$33.04M	7.63%
Targa Resources Corp	$27.19M	6.28%
Western Midstream Partners LP	$26.83M	6.20%
Williams Companies Inc	$21.55M	4.98%
DCP Midstream LP	$21.25M	4.91%
Magellan Midstream Partners LP	$20.30M	4.69%
Energy Transfer LP	$18.77M	4.34%
Enbridge Inc	$17.57M	4.06%
ONEOK Inc	$15.69M	3.62%

Source: CEFConnect *Figure 4*

the **Tortoise Essential Assets Income Term fund (NYSE: TEAF)**. Well, today we're adding one more in the **ClearBridge Energy Midstream Opportunity Fund (NYSE: EMO).**

EMO is an attractive value play on multiple counts. To start, the sector as a whole is cheap. Pipeline stocks were suffering long before anyone had ever heard of COVID-19, and the disruptions to the energy market last year were the final blow. Even the blue chips in the space, such as **Enterprise Products Partners (NYSE: EPD)** – which is a proud member of our "Forever" Portfolio – saw their share prices cut in half.

But then, something funny happened. Just as it seemed that things would never get better… they got better. There was no particular event. The shares simply got so cheap that the bad news was finally priced in, and they had nowhere to go but up.

Pipeline shares have been rallying ever since.

But here's where EMO gets fun. EMO is not simply an ETF or mutual fund. It's a closed-end fund (CEF).

That might sound like a distinction without a difference, but remember that CEFs have a unique quirk. Unlike ETFs and mutual funds, which have redemption mechanisms that ensure the funds always trade at or near their net asset values, CEFs generally have no such thing. The price of a CEF can move completely independently of the stocks in its portfolio.

Well, today, EMO trades at a 17% discount to its net asset value (Figure 3 on previous page). In plain English, that means that we're getting a dollar's worth of assets for just 83 cents.

Unlike TEAF, EMO doesn't have a mechanism to close the gap. TEAF will cease to trade in the year 2030, and its investors will be paid out at NAV. Any discount will be closed on liquidation. EMO, in contrast, is designed to be perpetual.

That means that the discount doesn't "have to" close. But over the fund's history, it generally has. The fund normally trades at either a small discount or small premium. The discount started to widen in late 2018, and then the bottom fell out in 2020.

If history is any guide, that gap should close by at least 10% over the next year. So, apart from whatever gains we see in the underlying pipeline stocks – which should be substantial – we should also get the additional kicker of the discount shrinking.

Let's talk dividends. This is an *income* letter, after all.

At current prices, EMO yields 6.9%. That's not bad at all. But I believe it's likely we see a payout a good deal larger than that.

EMO slashed its dividend by 72% last year as the COVID bear market took a wrecking ball to its portfolio. But as conditions have improved, so has EMO's ability to pay. EMO raised its dividend by 17% last quarter, and I expect additional hikes to come.

So, in EMO, we have…

- A beaten-down value sector that appears to have finally bottomed out.

- A massive discount to net asset value that should significantly narrow from here.
- A high dividend that's likely to grow in the coming quarters.

Oh, and I should also mention that EMO, unlike a lot of its underlying holdings, is absolutely IRA friendly and won't create any tax headaches if held in a retirement account.

It's hard to see anything not to like here.

Barring any major blow-ups in the market, I believe we could easily double our money in this stock within 2-3 years and collect a steady stream of dividends while doing it.

So, please take the following action…

Action to take: Buy shares of ClearBridge Energy Midstream Opportunity Fund (NYSE: EMO) at market. Set an initial stop loss at $14.94 based on closing prices.

Looking Overseas

I've argued for a while now that U.S. stocks were looking "fully valued," which is Wall Street code for stupidly expensive.

I'll spare you a full recap, but the summary goes like this. Following the 2008 meltdown, investors shied away from value sectors and from pretty much anything overseas. Yes, the United States had its problems. But it was also home to some of the largest and best-known new-economy growth stocks. The Apples, Amazons and Microsofts of the world were all headquartered in America, and that's where investors wanted to be.

Europe Still On Sale

Source: BigCharts.com — Figure 5

FDEU Discount / Premium to NAV

Source: GuruFocus.com — Figure 6

FDEU Country Breakdown

Top Countries (as of 4/30/2021)[6]

Country	Percent
United Kingdom	36.67%
Switzerland	17.28%
France	12.96%
Netherlands	8.32%
Germany	6.33%
Spain	5.26%
Sweden	4.54%
Italy	2.33%
Austria	1.94%
Norway	1.82%
Finland	1.29%
Denmark	0.99%
Bermuda	0.27%

Source: Company Filings — Figure 7

After our housing and banking crisis had passed, Europe had a second round of crises starting with the Greek sovereign bond mess. Rather than try to buy the dip in that mess, investors bought their American growth stocks and called it a day.

Well, that trade got crowded, and during the COVID pandemic it got more crowded. Capital flowed into American growth and fled out of virtually everything else.

That's changing now. Valuations finally got extreme enough to push investors out of their comfort zones. They're rediscovering value stocks and, by proxy, overseas stocks.

For our second pick this month, I'm going to recommend the **First Trust Dynamic Europe Equity Income Fund (NYSE: FDEU)**.

This is another closed-end fund, and it's one with income as its primary objective. But apart from the attractive 5.3% dividend yield, I expect us to enjoy some serious capital gains in the year ahead.

European stocks haven't had a great run. FDEU started trading in 2015 and proceeded to spend most of the next four years trending lower. Then the pandemic hit in 2020, and the bottom fell out. The shares cratered.

But it seems Europe finally got cheap enough. The shares have been trending sharply higher since last March.

And here's the fun part. The stocks that FDEU owns have risen a lot faster than the shares of FDEU itself. This has kept its discount to NAV (Figure 6 on previous page) far wider than normal, which is exactly what we like to see. I'm really only interested in closed-end funds when they're on sale. And FEDU's shares are currently selling at about 90 cents on the dollar of net asset value.

FDEU Top Holdings

Top 10 Holdings (as of 4/30/2021)[6]

Holding	Percent
Nestle SA (CHF)	2.93%
Anglo American PLC (GBP)	2.75%
National Grid PLC (GBP)	2.63%
British Land Co PLC (GBP)	2.54%
Vodafone Group PLC (GBP)	2.45%
Novartis AG (CHF)	2.38%
SSE PLC (GBP)	2.24%
Allianz SE (EUR)	2.18%
TOTAL SE (EUR)	2.14%
GlaxoSmithKline PLC (GBP)	2.11%

Source: Company Filings *Figure 8*

FDEU Sector Holdings

Sector	Percent
Financials	21.37%
Industrials	15.16%
Health Care	10.65%
Consumer Staples	10.41%
Energy	7.41%
Utilities	7.32%
Communication Services	7.31%
Materials	6.97%
Consumer Discretionary	5.99%
Real Estate	3.87%
Information Technology	3.54%

Source: Company Filings *Figure 9*

FDEU isn't a wildly speculative fund by any stretch of the imagination. It owns a diversified portfolio of European blue chips, and its largest single holding is the stodgy candy and packaged foods company Nestle.

The fund is a little heavy in financials with a 21% weighting. That's not ideal given the low rate environment we're in, but it's certainly no deal breaker. Bank stocks are cheap and should have decent upside from here.

Overall, FDEU is a pretty conservative fund, and I'm good with that. We don't need to get aggressive here. We're buying a cheap fund within a cheap sector that's now trending higher. All we need to do is hitch our buggy to this horse and let it run and collect a nice 5.3% dividend while we do it.

So, with no further ado…

Action to take: Buy shares of First Trust Dynamic Europe Equity Income Fund (NYSE: FDEU) at market. Set an initial stop loss at $11.50 based on closing prices.

Portfolio Update

I mentioned that I was getting a little more conservative, and you'll see that in our stop losses. I raised the stop losses at least marginally in every single stock in the portfolio.

We're in no real danger of hitting these revised stops any time soon, and in any event I will alert you if one of our stops gets tripped. So, you don't really have any action to take today. But note that I plan to keep tightening our stops as this market goes higher. The melt-up in asset prices continues, and we want to participate in that. But we also want to make sure that we protect ourselves as we go. It doesn't do us any good to see massive paper gains only to let them evaporate because we didn't have a plan to sell.

Also note that I moved several of our positions (see page 8) to "hold" from "buy." Let me be clear that this does not mean sell. Remember, we're income investors, and the whole purpose of this enterprise is to generate dividend income. I want to hold on to my positions as long as possible to squeeze every last dividend payout out, so long as I don't put my capital at risk in the process.

But while I'm not in a hurry to sell any of these positions, I don't recommend adding to all of them at current prices. We're just not getting the juice I want at current prices.

Action to take: Continue to hold the following stocks, collecting the dividend as you go, but do not buy any additional shares:

- **Invesco Adv. Municipal Income Trust II (NYSE: VKI)**
- **Iron Mountain (NYSE: IRM)**
- **AllianceBernstein Holding, LP (NYSE: AB)**

Note that these three have something in common. They are closer to "pure income" plays than most of the rest of the stocks in the portfolio. They offer capital gains potential if bought at the right price, as our record here proves. I'd be willing to buy all three again at the right prices. But these are not growth companies by any stretch of the imagination.

Contrast this with, say, **LyondellBasell Industries (NYSE: LYB)**. The juicy dividend was my primary reason for wanting this stock a year ago, but I also knew that the company had strong and growing plastics and petrochemicals business that was poised to rebound once the economy started to open up again.

And that's exactly what happened. We're up over 83% in LyondellBasell, and I still expect more gains to come. The stock is still dirt cheap, trading at just 8 times forward earnings.

I'm also still wildly bullish about our mining stocks **Newmont Corporation (NYSE: NEM), BHP Group (NYSE: BHP)** and **Vale SA (NYSE: VALE)**. We're already sitting on decent profits in two of the three, and I expect all three to ultimately pay off handsomely for us.

That's going to wrap it up for this month. If you want a laugh at my expense, know that I'll be in Orlando over the holiday weekend, pushing a stroller around Universal Studios and quietly sobbing behind my sunglasses as all of my hard-earned dividends are squandered on overpriced food and souvenirs.

Sigh…

Oh well. This is, ultimately, why we invest for income. If you can't spend some of the cash on an impromptu trio to Orlando with your family… well… what's the point of earning it?

We'll pick this up net month.

Until then, keep cashing those dividend checks!

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?	Action
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$ 21.94	$14.94	6.86%	$ -	0.00%	Yes	Buy
First Trust Dynamic Europe Equity Income	FDEU	5/26/2021	$13.68	$ 13.68	$11.50	5.26%	$ -	0.00%	Yes	Buy
Newmont Corporation	NEM	4/27/2021	$65.72	$ 73.16	$55.43	2.97%	$ -	11.32%	Yes	Buy
BHP Group	BHP	2/25/2021	$78.04	$ 71.91	$61.50	4.27%	$ -	-7.85%	Yes	Buy
Vale SA	VALE	2/25/2021	$17.40	$ 20.14	$15.04	5.75%	$ 0.77	20.16%	Yes	Buy
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$ 48.52	$38.96	8.27%	$ 1.03	11.57%	No	Buy
WisdomTree Emerging Markets High Dividend Fund	DEM	12/31/2020	$41.22	$ 45.89	$39.60	4.13%	$ 0.18	11.75%	Yes	Buy
Healthcare Trust of America	HTA	11/20/2020	$26.80	$ 28.17	$23.45	4.61%	$ 0.32	6.31%	Yes	Buy
Physicians Realty Trust	DOC	11/20/2020	$17.80	$ 18.36	$15.19	5.00%	$ 0.23	4.44%	Yes	Buy
AllianceBernstein Holding, LP	AB	11/6/2020	$30.85	$ 43.69	$33.04	6.95%	$ 0.97	44.76%	No	Hold
Main Street Capital	MAIN	9/25/2020	$29.74	$ 40.99	$32.96	5.96%	$ 0.82	40.59%	Yes	Buy
Iron Mountain	IRM	8/25/2020	$30.22	$ 43.22	$33.48	5.66%	$ 1.24	47.11%	Yes	Hold
Starwood Property Trust	STWD	8/25/2020	$15.70	$ 24.75	$17.56	7.66%	$ 0.96	63.76%	Yes	Buy
Dow Inc.	DOW	6/24/2020	$38.45	$ 69.00	$45.91	4.07%	$ 0.70	81.27%	Yes	Buy
Tortoise Essential Assets Income Term Fund	TEAF	6/24/2020	$10.73	$ 14.53	$11.94	6.18%	$ 0.60	41.01%	Yes	Buy
LyondellBasell Industries	LYB	5/22/2020	$60.39	$ 109.89	$78.49	3.76%	$ 1.05	83.71%	Yes	Buy
Invesco Adv. Municipal Income Trust II	VKI	4/23/2020	$10.12	$ 12.19	$11.32	4.78%	$ 0.51	25.44%	No	Hold
Ares Capital Corporation	ARCC	4/23/2020	$11.35	$ 19.08	$15.92	8.27%	$ 1.20	78.68%	Yes	Buy