The Sizemore Income Letter

October 2021

And Just Like That…

By Charles Lewis Sizemore, CFA

It was just last month that I was explaining, point by point, why stocks had just spent the last month in freefall.

That may as well have been a lifetime ago. The S&P 500 recouped all of its September losses in October and then went on to claim new highs.

Why?

There's really no specific reason. There never is. Though I suppose if I had to pick one, it would be earnings. Figure 2 on the following page might be a little hard to read unless you zoom in a little, but this shows the "earnings surprises" of the companies of the S&P 500. This is the degree to which actual earnings came in higher than the consensus expectation of Wall Street analysts.

The specific absolute, numbers matter a lot less than the trend here. You can plainly see that throughout 2020 and 2021, earnings have come in significantly higher than expected.

Wall Street really feared the worst from the COVID pandemic, the lockdowns and the lingering aftermath. Yet corporate America has found a way to deliver.

That's great news, of course. But all of those risk factors I mentioned last month haven't exactly gone away.

China is still looking rickety. The Fed is still planning to normalize monetary policy sooner rather than later. Some of the big government spending plans we were expecting to

Figure 1

goose the economy probably won't happen now.

And speaking of the economy…

The Bureau of Economic Analysis just published its estimate of 3rd quarter GDP growth. It came in at 2%.

By itself, that's not an awful number. But the consensus estimate among economists was 2.6%, and the number from the second quarter was 6.7%.

So, while we're still *far* from showing signs of a recession – the economy is still growing, after all – that growth is definitely slowing down.

That's not all bad for the market, as weaker growth may persuade the Fed to slow walk any monetary tightening. But in a market that continues to defy gravity in no small part due to earnings surprises, slowing growth is a potential landmine.

More on Inflation…

I would be remiss if I didn't address the elephant in the room: inflation.

If you've noticed prices rising lately… well, it's not your imagination. Prices are indeed rising (see Figure 4), and that's assuming you can get what you want at all. I was prepared to buy the PlayStation my son wanted for Christmas from a dodgy guy in a trench coat… or from the internet equivalent of the guy in a trench coat. I managed to get one online at a price that was *almost* reasonable. But that was after a month of looking.

Cars are more expensive (if you can get one at all). Food is more expensive. Gas is more expensive. *Everything* is more expensive.

S&P 500 Earnings Surprise

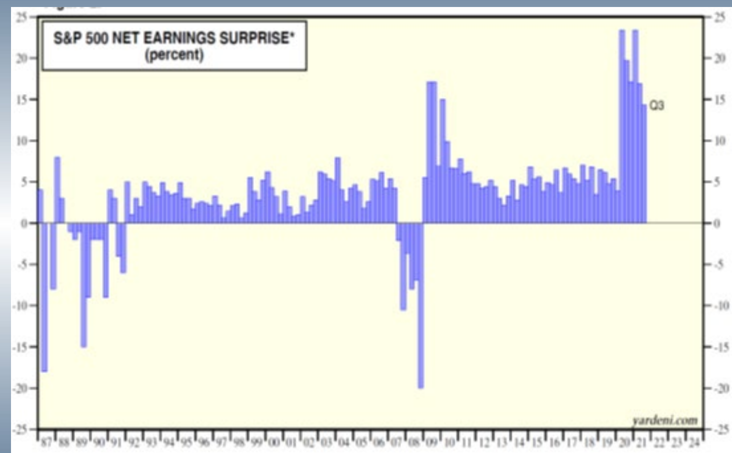


Figure 2

US Real GDP

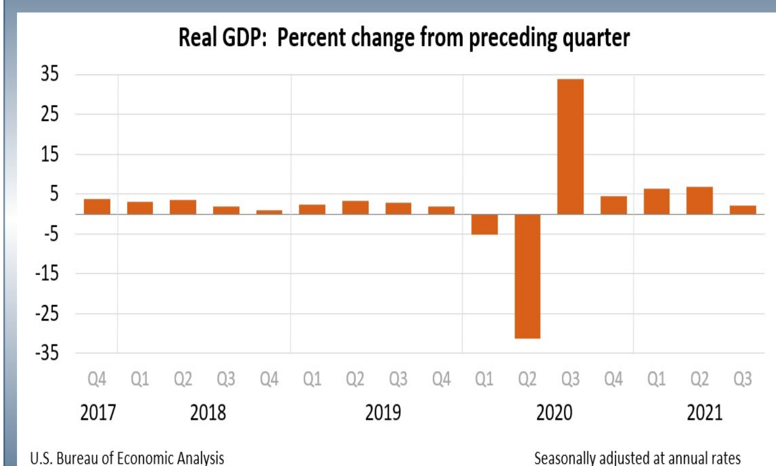


Figure 3

Core Inflation

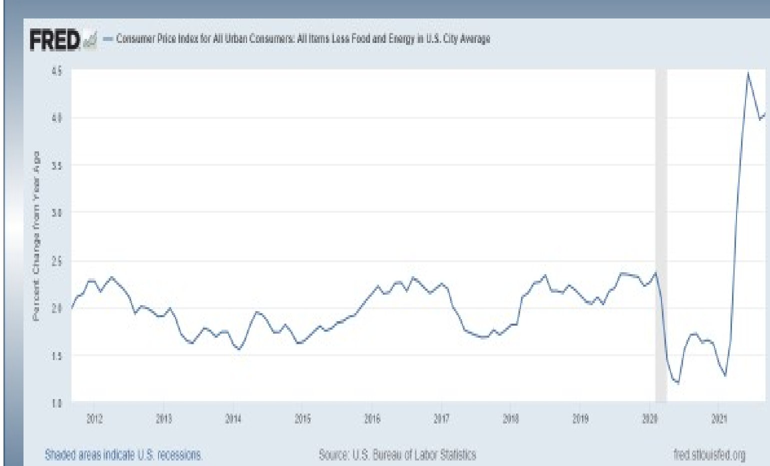


Figure 4

The Fed insists the inflation is transitory, and while the Fed routinely gets it wrong, I'm inclined to agree here.

I've mentioned this before, but it's worth repeating. Inflation essentially has two parts. There is "demand-pull" inflation and "cost-push" inflation.

If there were such a thing as "good inflation," it would be demand-pull. This is what you get when the economy grows too fast and starts to overheat. Fed policy tends to affect this; when the Fed makes credit available and cheap, it encourages borrowing and spending. But this can just as easily be reversed by simply raising rates and allowing the demand to drain off.

When demand-pull inflation gets a little out of control, no one really minds because that generally means the economy is booming and everyone has a job.

But then there is cost-push inflation… This is what happens when prices rise because input costs are higher. Think back to the 1970s and the oil embargoes. Oil supply was kept off the market, which created scarcity and sharply rising prices. This is the dreaded "stagflation." It's inflation but without the growth that makes inflation almost tolerable.

Today, we have a mix of these two. Low interest rates and pent-up demand after the pandemic have created demand-pull inflation. After being turned upside down by the virus, lockdowns and everything else, many businesses are having to start over with new, untrained staff at a time when demand is exploding.

S&P 500 Price / Sales Ratio

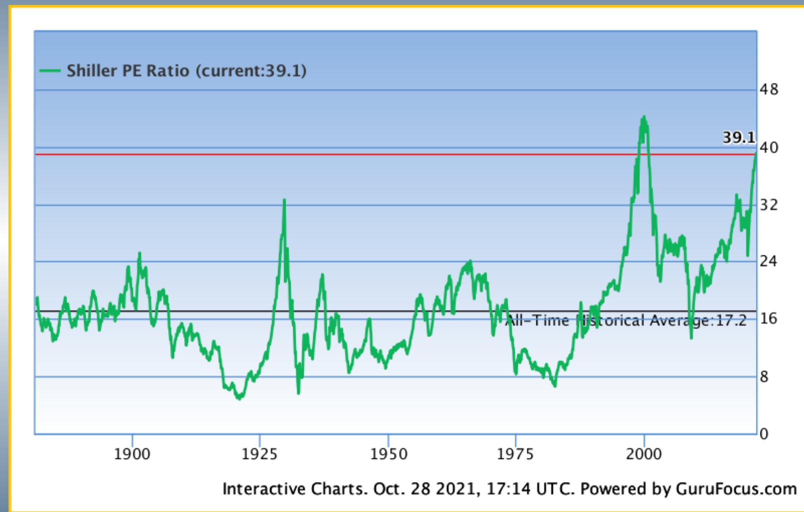
Source: https://www.multpl.com/sp-500-price-to-sales *Figure 5*

But there is also a major component of cost-push inflation here. That restaurant down the street is having to pay up for a cook who is likely less productive (i.e., grills fewer steaks per hour) than the last guy.

And then there are the bottlenecks in the supply chain. The items we needed during the pandemic – masks, medicines, gloves, basic household items, packaged food, etc. – were not the items we needed pre-pandemic or today. So, the world's distribution system – planes, trains, trucks, boats, donkey carts… you name it – had to be reorganized. Boats that might normally move PlayStations from a factory in China to the port in Los Angeles might instead have moved rubber gloves from Thailand to India. And the shipping containers used to hold those gloves are now sitting discarded in a shipping yard in Mumbai rather than being where we now need them, in China.

This is where a lot of our inflation is coming from: Shortages coming from the supply chain mess.

Cyclically-Adjusted P/E Ratio



Source: GuruFocus

Figure 6

But this is always why the inflation really will be transitory. There's money on the line here. Do you really believe that Amazon.com Chairman Jeff Bezos is going to sit idly, wringing his hands, that he can't get his goods delivered on time?

The logistics problem will resolve itself. It will probably take another year. But it will resolve itself. There's too much money to be made for it not to be.

So, bottom line, inflation will be with us for a while. But there is light at the end of the tunnel. 18 months from now, we may very have deflation… which is an entirely different kind of problem and not a particularly fun one to deal with.

Where to Invest Right Now

Adding new capital is tough right now.

Pick any metric and you see a wildly expensive market.

Price/earnings? The S&P 500 is sitting at a ratio of 27. That might as well be the moon. The long-term average is around 16.

Sure, we could argue those numbers are skewed by the pandemic. Fair enough. But the forward P/E, which looks at earnings estimates a year in the future, is also wildly elevated at 21.

Price/Sales? Look at Figure 5 on the preceding page. At a ratio of 3.2, we have surpassed even the extremes of the great dot-com mania of the late 1990s.

Looking at the cyclically-adjusted price earnings ratio, or "CAPE," in Figure 6, we can see that stock valuations are moderately cheaper than they were at the top in 2000. But not by much… and is that really a period we want to copy?

Expensive stocks can always get more expensive. We've seen that time and time again. But with stocks priced as aggressively as they are right now, the market would appear to be that proverbial bug in search of a windshield.

What will that windshield be? I have no idea. We never really know what that straw that breaks the camel's back will be.

The Plan for This Month

I'm not going to make a regular portfolio addition this month. Our model portfolio has rebounded nicely and I continue to like every position in the portfolio.

But I'd like to wait and see before adding any new exposure there. Instead, I'm going to do something I very rarely do. I'm going to add another couple names to our **Forever Portfolio**.

I created the Forever Portfolio during the pits of the COVID selloff in March of last year. I didn't know at the time how bad the bear market would get or how bad the damage from the lockdowns would ultimately be. But I knew I wanted a portfolio that could handle whatever came next. I wanted a collection of stocks that I'd be comfortable buying, dropping in a proverbial drawer, and holding, potentially for the rest of my life.

Needless to say, those are high standards. Few companies meet that threshold.

One that does, however is **Prologis (NYSE: PLD).**

Like many of the stocks in the Forever Portfolio, Prologis is a REIT. Companies come and go. They get bought out or they fall under incompetent management. Competition is their undoing. But real estate? It's a lot harder to screw that up.

The pandemic sped up several trends that were already in place, such as internet commerce and working from home. Yes, there will always be offices where people go to collaborate, and there will always be retail stores of some kind or another. But you're not going to see me buying office or mall REITs any time soon. Or if I did, it would only be as a short-term trade. The longer term trends here just aren't all that great.

Rather than fight the trends, I prefer to embrace them.

We all know that Amazon.com is taking over the world. This is a foregone conclusion. But rather than whine about it, why not profit from it by being Amazon's landlord?

Enter Prologis, the industry leader in logistical real estate and a major landlord to Amazon and other e-tailers.

Prologis owns the gritty underbelly of the e-commerce world, the warehouses and distribution facilities that make it all work. There would be no internet commerce without the real-world assets that actually support it. There would be no Amazon without Prologis and its peers.

To put some real numbers to it, a shocking 2.5% of the world's GDP already flows through Prologis properties. World GDP was estimated at

The Forever Portfolio

Stock	Ticker	Entry Date	Buy Price	Recent Price	Stop Loss	Yield	Cumulative Dividends	Total Return	IRA Friendly?
Prologis	PLD	10/29/2021	$ 146.67	$ 146.67	None	1.75%	$ -	0.00%	Yes
Crown Castle International	CCI	12/29/2021	$ 181.90	$ 181.90	None	3.27%	$ -	0.00%	Yes
Philip Morris International	PM	3/30/2021	$ 89.35	$ 95.20	None	5.27%	$ 1.20	7.88%	Yes
Altria Group	MO	3/19/2020	$ 37.10	$ 45.04	None	7.58%	$ 5.12	35.19%	Yes
Realty Income	O	3/19/2020	$ 48.08	$ 73.30	None	3.86%	$ 3.75	60.25%	Yes
AT&T	T	3/19/2020	$ 31.15	$ 25.57	None	8.30%	$ 3.64	-6.24%	Yes
Enterprise Products Partners	EPD	3/19/2020	$ 14.52	$ 23.18	None	7.42%	$ 2.24	75.00%	No
Kinder Morgan	KMI	3/19/2020	$ 11.20	$ 17.30	None	6.24%	$ 1.32	66.25%	Yes
Ventas	VTR	3/19/2020	$ 19.98	$ 54.79	None	3.28%	$ 3.04	189.45%	Yes
Public Storage	PSA	3/19/2020	$ 187.60	$ 331.29	None	2.48%	$ 10.00	81.92%	Yes
International Paper	IP	3/19/2020	$ 30.13	$ 50.08	None	3.69%	$ 2.57	74.71%	Yes
STAG Industrial	STAG	3/19/2020	$ 21.71	$ 44.30	None	3.32%	$ 1.93	112.92%	Yes
Retail Opportunity Investments	ROIC	3/19/2020	$ 7.25	$ 17.92	None	2.47%	$ 0.42	152.90%	Yes
Average						**4.53%**		**77.29%**	

$85 trillion last year. That means more than $2 trillion in inventory passes through the company's properties every year, and that number is growing.

The company owns nearly a billion square feet spread in properties spread across 19 countries with an occupancy rate of 97.1%.

Now, you tell me. Five years from now, do you see yourself buying more things online or less?

We both know the answer to that question. And whatever you buy, there is a good chance that somewhere along the supply chain, it will pass through a Prologis property.

At 1.75%, Prologis isn't the highest yielding stock in our portfolio by any stretch of the imagination. This is a stock that rarely goes on sale.

That's ok. This is the Forever Portfolio. I'm good holding this for decades. My children may continue to hold it long after I'm dead.

And while the yield may not be exceptional, Prologis is a healthy dividend grower and hikes its dividend nearly every year. The REIT has raised its dividend by nearly 20% since the onset of the pandemic and has more than doubled it since the end of 2013.

Will the Fed hike rates next year? I have no idea. Will China finally have a hard landing? You tell me!

Will the debt ceiling ever get resolved and will America ever have a stable government again? Who knows.

But I can say with absolute certainty that no matter what 2022 throws at us,

Prologis Dividends Per Share

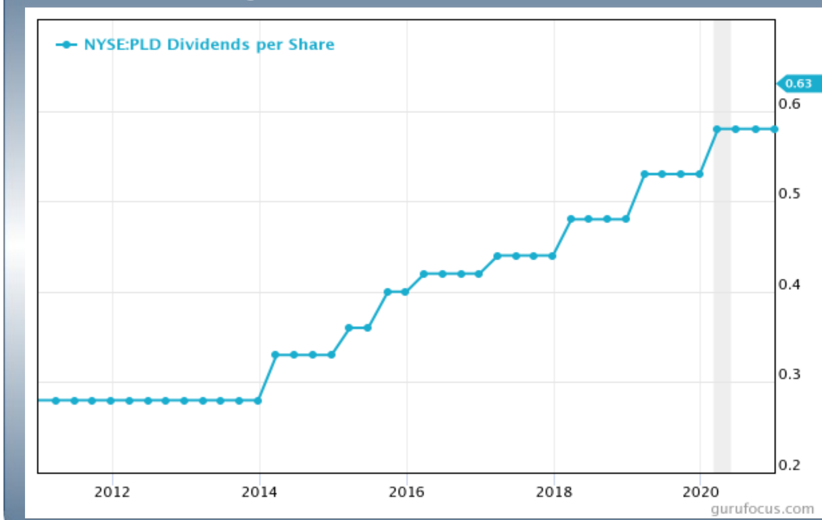


Figure 7

Crown Castle Dividends Per Share

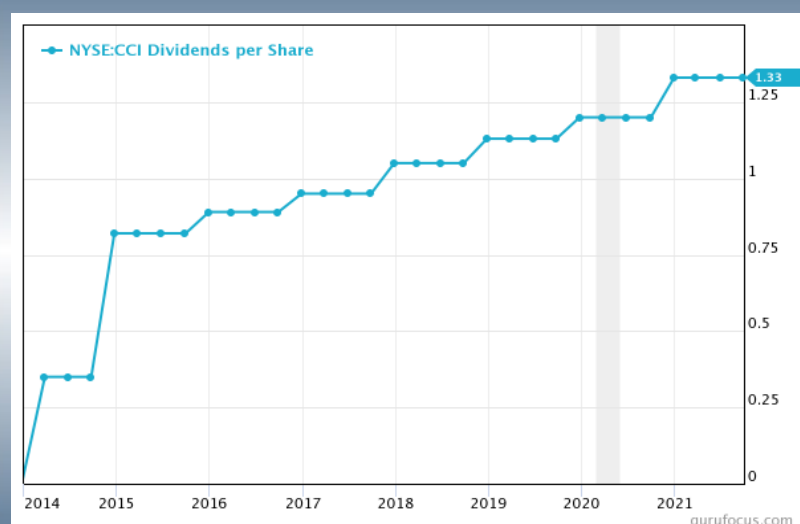


Figure 8

Prologis will still be in the business of moving the goods. This is a stock we want to own forever.

Action to take: Buy shares of Prologis (NYSE: PLD). No stop loss. Plan to hold forever.

Our second addition is also a stock that would seem to be pretty close to future proof.

Let me ask you another rhetorical question. Do you use more or less cellular data than you did five years ago? And five years from now… do you think you'll be using more or less?

As I write this, one of my sons is streaming Netflix on a phone while the other is playing an online videogame. I think you know my answer.

This brings me to **Crown Castle International (NYSE: CCI)**.

Crown Castle is also a REIT, but unlike Prologis it doesn't own a lot of square footage. Instead it owns a network of more than 40,000 cell towers and 80,000 route miles of fiber cable.

Could we live to see a day in which we no longer use cell towers?

I suppose it's possible. At the rate tech is advancing, there may be some entirely new standard on the horizon that makes our current communications infrastructure obsolete.

But is that likely to happen over the horizon of your retirement?

Probably not. I think it's safe to say we'll be connecting via cell towers for the foreseeable future.

Crown Castle's dividend yield is competitive at 3.27%. That's not a massive yield by the standards of the stock we cover here in the *Sizemore Income Letter*. But in a world where the 30-year U.S. Treasury yields only 2.1%, and the 10-year is right behind it at around 1.6%, that's not too shabby.

Plus, Crown Castle will almost certainly raise its payout in the coming years. In December of last year, the company raised its dividend by 11%, and it raised it by 7% the year before. The company has raised its payout every year since initiating the dividend in 2014 and shows no sign of slowing down.

So, please take the following action:

Action to take: Buy shares of Crown Castle International (NYSE: CCI). No stop loss. Plan to hold forever.

That's all I have for today. I'm going to sign off and get an early start on a long weekend of trick-or-treating and Halloween costumes with the kids.

Until next time, 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
Chevron Corporation	CVX	9/30/2021	$103.33	$ 112.53	$76.24	5.19%	$ -	8.90%	Yes	Buy
AGNC Investment Corp.	AGNC	8/30/3031	$16.23	$ 15.85	$13.52	8.71%	$ -	-2.33%	Yes	Buy
Morgan Stanley Emerging Markets Domestic Debt	EDD	7/30/2021	$6.15	$ 5.84	$ 5.50	6.60%	$ -	-5.04%	Yes	Buy
Nuveen Real Estate Income	JRS	6/25/2021	$10.77	$ 11.56	$ 9.27	6.68%	$ -	7.34%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$ 24.59	$17.30	7.10%	$ 0.38	13.81%	Yes	Buy
First Trust Dynamic Europe Equity Income	FDEU	5/26/2021	$13.68	$ 13.27	$11.76	5.29%	$ 0.18	-1.69%	Yes	Buy
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$ 49.50	$41.78	8.65%	$ 2.06	16.09%	No	Buy
WisdomTree Emerging Markets High Dividend Fund	DEM	12/31/2020	$41.22	$ 43.77	$40.42	4.48%	$ 0.82	8.16%	Yes	Buy
Healthcare Trust of America	HTA	11/20/2020	$26.80	$ 33.40	$23.45	4.61%	$ 0.96	28.21%	Yes	Buy
Physicians Realty Trust	DOC	11/20/2020	$17.80	$ 19.06	$15.30	4.49%	$ 0.69	10.96%	Yes	Buy
AllianceBernstein Holding, LP	AB	11/6/2020	$30.85	$ 56.15	$36.20	6.77%	$ 1.78	87.78%	No	Hold
Main Street Capital	MAIN	9/25/2020	$29.74	$ 43.90	$32.96	5.93%	$ 1.85	53.82%	Yes	Buy
Iron Mountain	IRM	8/25/2020	$30.22	$ 46.14	$35.76	5.30%	$ 2.48	60.86%	Yes	Hold
Starwood Property Trust	STWD	8/25/2020	$15.70	$ 25.24	$18.15	7.38%	$ 1.92	72.96%	Yes	Buy
Dow Inc.	DOW	6/24/2020	$38.45	$ 56.36	$47.25	4.53%	$ 2.80	53.85%	Yes	Buy
Ecofin Sustainable and Social Impact Term Fund	TEAF	6/24/2020	$10.73	$ 14.49	$12.19	6.14%	$ 0.98	44.14%	Yes	Buy
LyondellBasell Industries	LYB	5/22/2020	$60.39	$ 96.18	$79.23	4.27%	$ 5.33	68.08%	Yes	Buy
Invesco Adv. Municipal Income Trust II	VKI	4/23/2020	$10.12	$ 11.80	$11.46	4.70%	$ 0.75	24.01%	No	Hold
Ares Capital Corporation	ARCC	4/23/2020	$11.35	$ 21.58	$16.45	8.20%	$ 2.00	107.71%	Yes	Buy