The Sizemore Income Letter

December 2021

Where to Invest in 2022

By Charles Lewis Sizemore, CFA

"It's difficult to make predictions, especially about the future."

That quote, or variations of it, has been attributed to everyone from Mark Twain to Yogi Berra. But as it turns out, the quote originated in Denmark, and no one really knows who said it first.

So, there you go. I really wanted it to be Yoga Berra.

At any rate, forecasting is notoriously difficult, and I try to be humble to the extent I attempt it at all. But as we're about to start a new year, this is certainly as good of a time as any to offer a few.

I always try to invest in such a way that forecasting isn't critically important. I try to employ strategies that will perform reasonably well regardless of whether I'm "right" or not. But there comes a point in which forecasting is necessary. Because the investments that work well in one regime might not work at all in another.

Take inflation. There are plenty of investments that can perform reasonably well when prices are rising or falling. Many stocks would fit the bill here. Demand for their products doesn't change all that much, and they're able to pass on rising input costs to their customers. Think Google, Microsoft or Apple… or even some of our "Forever" stocks like **Realty Income (NYSE: O)**.

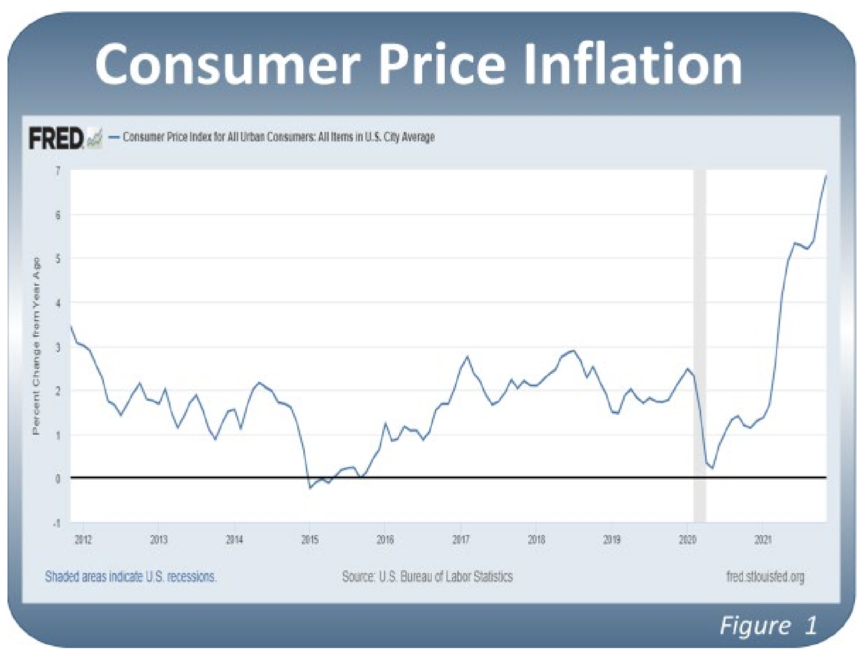

Figure 1

Most investments, however, are wildly sensitive to price changes. Inflation is *death* to long-term bonds, whereas deflation is a nightmare for many commodities. So, with all of that as background, let's get into my predictions for 2022.

Inflation Will Finally Crack

Every investor imagines themselves to be a contrarian willing to go against the grain.

Clearly that's impossible. If everyone is a contrarian, then no one is a contrarian.

This brings me back to inflation. The Fed has been saying for months that inflation will be transitory. I don't know anyone that believes that. It seems that "everyone" expects inflation to just keep creeping higher.

Well, I'm taking the other side of this bet. It looks horrendously awful right now, and on the surface, it would seem that all the pieces are in place for a wage/price inflationary spiral. But this inflationary regime is a lot more fragile that it looks.

Let's start with the supply chain. As has been the case for months, we remain in a shortage economy. The factories in Asia are hopelessly behind, particularly in the production of semiconductors, and getting caught up has been a challenge. Delays there have a ripple effect. When the production of intermediate goods like chips is delayed, then the production of finished goods also gets delayed.

And then there's transport. The pandemic changed what we needed, where we needed it, and the sense of urgency of when we needed it. But do you really think this is a permanent situation?

We live in a competitive capitalist economy. There is money to be made in fixing the supply chain, and the savviest business minds across the globe are working on it. They will throw money at it until it's fixed because their profits depend on it. It really is that simple.

The labor shortage might take longer to fix. You can't replace people that died in the pandemic, and convincing Boomers that took early retirement to come back to work will be a challenge. But as they say, the cure for higher prices is higher prices. The shortage of labor will simply accelerate the trend that has been in place for decades: the replacement of humans with automation.

There's been a lot of handwringing over labor conditions in Amazon.com distribution facilities. But the most remarkable thing about them is the *lack* of workers due to Amazon's deployment of labor-saving tech. Amazon does $352,824 in sales per employee. That's 46% higher productivity than Walmart, which squeezes $242,351 in sales out of each employee. And Walmart is well known for being brutally competitive.

You think the rest of corporate America isn't furiously trying to catch up with Amazon's productivity?

We will hit a tipping point in which the labor shortage quickly turns into a labor surplus. That might be a little further out than 2022. The timing remains to be seen. But it will happen. And you read it here first.

Naturally, there's also the Fed. Ultra-loose monetary policy has been a major contributor to inflation. You can't dump $120 billion *per month* into the capital markets for nearly two years *while also keeping interest rates at zero* and not have it show up in prices.

Well, the Fed is already scaling back its purchases and plans to eliminate them altogether by March. Maybe they hit that goal, maybe they don't. But that's the general direction they're going. The Fed isn't exactly going into uberhawk mode. But it's getting less dovish by the day.

And finally, you have COVID-era stimulus payments, debt moratoriums, etc. Unemployment benefits have already been largely cut back, and the moratoriums on student debt payments will, at least in theory, be eliminated in the spring. And rent / mortgage moratoriums have expired in most of the country by this point.

You know as well as I do that there was a lot of abuse there. The number is impossible to calculate, but I'm betting a large chunk of the money that was supposed to be spent on rent or student loan payments instead got spent on "stuff" ordered on Amazon and elsewhere. As we get closer to a world in which people actually have to meet their obligations again, that excess demand will evaporate, further dampening inflation.

I know, I know. "Everyone" says inflation is going higher. But that virtual uniformity of opinion tells me that it's exactly the opposite we should expect.

The Market Will Have a Correction

I generally leave the market forecasting to my friend Harry Dent. But since we're making predictions for the year, I might as well give it a go here.

I expect a deep correction in 2022 and possibly a bear market.

Stock prices stopped making sense a long time ago. The Shiller P/E (Figure 2) is closing in on the all-time highs hit during the 1990s dot-com mania, and the price/sales ratio (Figure 3) is more than 50% higher than its 1990s highs. We're in uncharted territory here.

S&P 500 Cyclically-Adjusted P/E

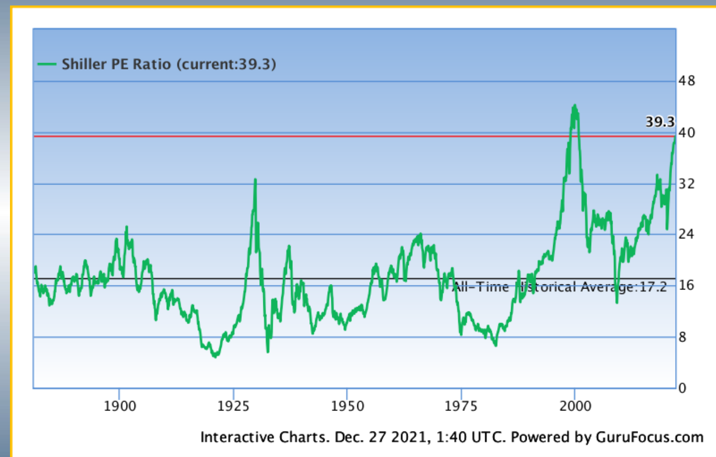

Figure 2

S&P 500 Price / Sales Ratio

Source: https://www.multpl.com/sp-500-price-to-sales *Figure 3*

Stocks don't correct because they're expensive, however. They correct because supply outstrips demand and the sellers overpower the buyers.

This is not to say valuation doesn't matter, of course. High prices tend to scare away prudent investors, and – when the bottom finally falls out – the fall tends to be a lot more severe.

Well, in today's market, buying pressure has been dominated by retail traders… the same retail traders that have been flush with cash due to government checks they didn't really need.

I won't hazard to guess when exactly the market tops out. I have no crystal ball and no unique insight as to the timing. But I do expect it to happen sometime in 2022.

For months now I've been recommending you take more of a short-term approach to investing. This is what I've been doing for my own money and for my private clients. I prefer to eke out a percent or two per month in low-risk, short-term trading that to swing for the fences for a major gain. This just isn't the time for that, or at least not with the bulk of your portfolio.

I do, of course, have a portfolio of core dividend stocks that I'm comfortable holding whether the market goes up, down or sideways. These are our "Forever Portfolio" stocks. And I'm also comfortable adding new positions to our core *Sizemore Income Letter* portfolio. **Let me be clear that I'm <u>not</u> selling all of my stocks and digging a bunker in Idaho to hide in.**

I am, however, recommending you keep your position sizes a little smaller than usual and keep your stops a little tighter. And I recommend that you dedicate a little more of your portfolio than usual to shorter term strategies that aren't tied directly to the market. It only makes sense.

Value and Dividend Investing Will Come Back in Style

This may be hope springing eternal, but I also believe that value and income stocks will outperform this new year.

When the tech boom finally went bust in 2000, money rotated into value and income stocks. Even while the Nasdaq was in freefall, value and income stocks enjoyed nearly two more solid years of gains before the September 11, 2001 terror attacks and aftermath finally halted their advance.

History never repeats itself exactly, of course. But I think it is reasonable to believe that the most speculative stocks will lose momentum as the Fed drains liquidity out of the market and that the stodgy dividend payers will assume market leadership.

COVID-19 Will Stop Mattering by Spring

Most people are numb to the pandemic at this point. Yes, we're willing to wear masks on planes, and most of us are generally willing to get vaccinated and get regular boosters. But we're long past the point of worrying about it and there's no political will to impose new lockdowns.

The good news is that if what we think we know about omicron is correct, none of that will be necessary anyway. Omicron's symptoms appear to be much milder, and this variant is aggressively crowding out the more dangerous delta and other variants.

One estimate I read – and take this with a large grain of salt, though it was from a medical journal – showed more than 60% of Americans infected with omicron by March.

If infection is all but inevitable and the result is generally not all that severe anyway, then life should be able to get back to normal in a hurry.

I don't want to be dismissive, and please, for the love of God, do not take any of this as medical advice. Listen to your doctor and to the public health professionals. This is what they do. But no set of forecasts for 2022 would be complete without at least a mention of the pandemic, so here's mine: The omicron variant will effectively end the pandemic by late spring.

I may get all of these predictions right… or I might be wide of the mark on every single one of them. But either way, we have portfolios to run. So, with no further ado, let's get to my last stock recommendation of 2021.

Revisiting an Old Friend

If you've been reading the *Sizemore Income Letter* for any time, you know I'm a fan of master limited partnerships (MLPs), particularly in the midstream pipeline space. One of our original "Forever Portfolio" stocks, **Enterprise Products Partners (NYSE: EPD)** is an MLP, as is our Income Letter portfolio holding **Magellan Midstream Partners (NYSE: MMP)**. And we have additional exposure via the **Clear Bridge Energy Midstream Opportunity Fund (NYSE: EMO)** and the **Ecofin Sustainable and Social Impact Term Fund (NYSE: TEAF)**.

Midstream pipeline operators generally operate under long-term contracts and – if they're running their business right – will base their revenue streams on the volume of oil and gas transported rather than the price, which can be wildly volatile.

The industry came under stress during the energy bear market that started in 2015 and was forced into a painful deleveraging and de-risking. It wasn't fun to live through, but the collapse in energy prices at the onset of the

Energy Transfer Partners (NYSE: ET)

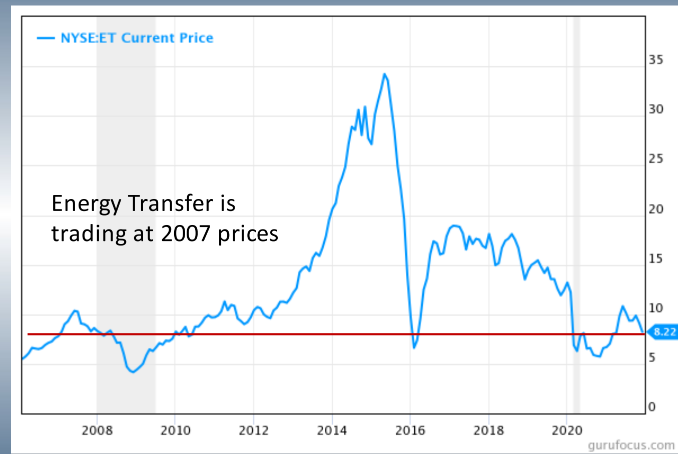

Figure 4

Energy Transfer Price/Sales

Figure 5

Energy Transfer Distribution

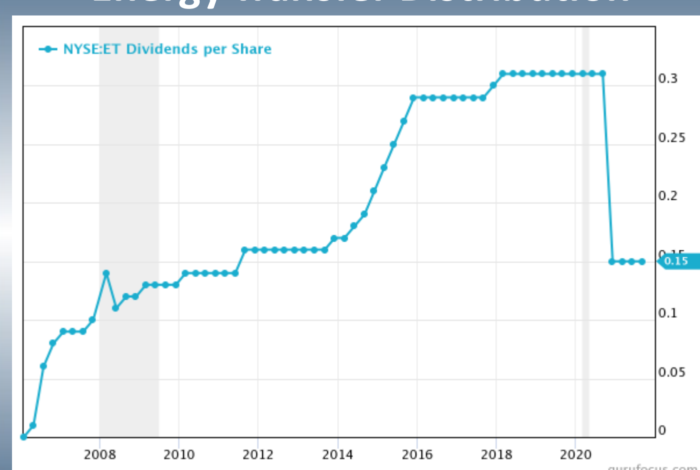

Figure 6

pandemic had the effect of wiping the slate clean, and the MLPs that survived emerged from the ordeal lean and mean.

With all of that as introduction, let me introduce **Energy Transfer Partners (NYSE: ET)**.

Founded by Dallas billionaire Kelcy Warren, Energy Transfer has been building its energy infrastructure empire for 25 years. Today, the company operates an astounding 114,000 miles of pipelines. That's enough to wrap around the world nearly five times and enough to build a pipeline halfway to the moon. About 30% of all American oil and gas flows through Energy Transfer pipelines.

Energy Transfer has been a growth dynamo over its quarter century of existence. Yet its shares today trade at 2007 prices.

You read that right. This is a $25 billion energy infrastructure company that has massively expanded its presence over the past decade and a half… and yet its stock price has effectively gone nowhere, even while the S&P 500 has tripled in value. This is a cheap stock in a market where cheap stocks aren't particularly easy to come by.

The company's "problem," if we want to call it that, is that it's grown a little too fast over the years, and investors would prefer that it slow down its growth ambitions and focus more on debt reduction and lowering its risk profile.

That may or may not happen while Kelcy Warren is still calling the shots, as Mr. Warren has consistently put an emphasis on growth. But at these prices, I'm fine with it.

Let's talk income.

Energy Transfer cut its distribution last year, which also dampened investor enthusiasm for the stock. Again, I'm ok with that. The threat of a cut had hung over the company's head for years, and reducing the payout massively lowered the company's risk profile. And post cut, the yield is still an extremely competitive 7.42%.

I fully expect ET to be a wild ride. This is a volatile stock, and that's just a fact. But the upside here is fantastic. Simply returning to pre-COVID levels would get us a 50% price return, plus distributions. Getting back to 2018 levels would be a 100% price gain, plus distributions. And if the stock reached its old all-time highs, we'd make four times our money… plus distributions.

I don't necessarily see the stock retesting its old highs soon. But I do consider returns of 100% or more to be doable and likely in the next 1-2 years.

So, for one final pick for 2021…

Action to take: Buy shares of Energy Transfer (NYSE: ET) at market. Set an initial stop loss at $7.30.

Note that Energy Transfer should not be held in an IRA or other tax deferred account, as it can produce unrelated business taxable income (UBTI).

Other Portfolio Moves

Alas, we hit our stop loss in the **Morgan Stanley Emerging Markets Domestic Debt Fund (NYSE: EDD)**, putting us down about 8% on the position.

You know the rules. We hit our stops, and we're out. So with no further ado…

Action to take: Sell your shares of the Morgan Stanley Emerging Markets

Domestic Debt Fund (NYSE: EDD) at market.

Emerging markets, both stocks and bonds, have been a frustrating place to invest over the past several years. Every time it seems the sector is awakening from its long slumber, it disappoints yet again.

Emerging markets will have their day again… someday. But now, with the Fed tightening (or at least loosening less), they face potential headwinds. We'll see what the new year brings, but for now we're steering clear of emerging markets.

Before I wrap this up, I had a reader write in with an excellent question that I thought I'd share:

I read in your recent article about retirement funds. I have a 401(k) that I will max out at 67,000 next year. What other options do I have to put funds in retirement accounts? I'm 73 years old. I am a real estate attorney and carry malpractice insurance but after I retire I want to make sure my investments are safe from possible claims.

What do you suggest?

Thanks

John

To start, John raises a great point about asset protection. Apart from the tax benefits, IRAs and 401(k) plans are generally just about bulletproof in the event you get sued. The courts consider them just about untouchable.

Once you've maxed out your 401(k) plan, you do have other options though. To start, if you are self-employed and have no full-time employees, you can create a one-person defined benefit plan. Depending on your age an income, you can potentially put back hundreds of thousands of dollars per year tax free. It's insane how much you can lower your tax bill with a strategy like this. (If you're a high-income earner looking to shelter more than your 401(k) will allow, contact me. Let's chat.)

But if a plan like this won't work for you, there are other options at your disposal as well, at least for asset protection. You can place your investments in an irrevocable trust. Also, limited partnerships and limited liability companies (LLCs) can add a layer of protection. Generally speaking, a creditor cannot seize your interests in an LP or LLC. They can get a charging order to seize any distributions, but if you never make a distribution, there's nothing to seize. As an added layer here, it's a good idea to have more than one partner or member. If you're the only owner, a court might be more likely to disregard the entity.

This is a longer discussion than I can cover in a newsletter, but if this is something that you'd want to discuss in more detail, please feel free to reach out.

That's all I have for 2021!

This was a mixed year for me. 2021 was a solid year of growth in my business, and I have a lot to be thankful for. But unfortunately, I lost a few friends this year to covid. That has a way of putting things into perspective.

In 2022, my new year's resolution will be to slow down and enjoy my life a little more. Because if the past two years have taught us anything, it is that things can change very quickly.

Until next year, 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
Energy Transfer Partners	ET	12/27/2021	$8.16	$8.16	$7.30	7.42%	$ -	0.00%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$47.52	$33.92	6.28%	$ -	-0.54%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$117.43	$88.14	4.62%	$ 1.34	14.94%	Yes	Buy
AGNC Investment Corp.	AGNC	8/30/3031	$16.23	$15.21	$14.93	8.71%	$ 0.24	-4.81%	Yes	Buy
Morgan Stanley Emerging Markets Domestic Debt	**EDD**	**7/30/2021**	**$6.15**	**$5.47**	**$5.50**	**6.60%**	**$ 0.19**	**-7.97%**	**Yes**	**Sell**
Nuveen Real Estate Income	JRS	6/25/2021	$10.77	$12.71	$9.69	6.68%	$ 0.19	19.78%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$21.55	$17.30	7.10%	$ 0.76	1.69%	Yes	Buy
First Trust Dynamic Europe Equity Income	FDEU	5/26/2021	$13.68	$13.27	$11.76	5.29%	$ 0.36	-0.37%	Yes	Buy
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$45.13	$41.78	8.65%	$ 4.12	10.90%	No	Buy
WisdomTree Emerging Markets High Dividend Fund	DEM	12/31/2020	$41.22	$43.31	$40.42	4.48%	$ 1.81	9.45%	Yes	Buy
Healthcare Trust of America	HTA	11/20/2020	$26.80	$33.76	$26.95	4.61%	$ 1.29	30.76%	Yes	Buy
Physicians Realty Trust	DOC	11/20/2020	$17.80	$18.90	$15.30	4.49%	$ 0.92	11.35%	Yes	Buy
AllianceBernstein Holding, LP	AB	11/6/2020	$30.85	$49.10	$40.98	6.77%	$ 3.58	70.76%	No	Hold
Main Street Capital	MAIN	9/25/2020	$29.74	$44.61	$35.50	5.93%	$ 2.88	59.68%	Yes	Buy
Iron Mountain	IRM	8/25/2020	$30.22	$52.54	$39.74	5.30%	$ 3.10	84.10%	Yes	Hold
Starwood Property Trust	STWD	8/25/2020	$15.70	$24.38	$18.15	7.38%	$ 2.40	70.57%	Yes	Buy
Dow Inc.	DOW	6/24/2020	$38.45	$56.78	$47.65	4.53%	$ 3.50	56.78%	Yes	Buy
Ecofin Sustainable and Social Impact Term Fund	TEAF	6/24/2020	$10.73	$14.47	$12.35	6.14%	$ 1.20	46.04%	Yes	Buy
LyondellBasell Industries	LYB	5/22/2020	$60.39	$92.19	$79.23	4.27%	$ 6.46	63.35%	Yes	Buy
Invesco Adv. Municipal Income Trust II	VKI	4/23/2020	$10.12	$12.26	$11.77	4.70%	$ 0.90	30.01%	No	Hold
Ares Capital Corporation	ARCC	4/23/2020	$11.35	$20.97	$17.55	8.20%	$ 2.41	105.99%	Yes	Buy