The Sizemore Income Letter

February 2022

Now What?

By Charles Lewis Sizemore, CFA

We have to start this month with Russia. The war in Ukraine is the only thing that matters at the moment. We can't have a conversation about investing and *not* mention the war.

You know my views here. Ultimately, the factors that will determine our returns are the Fed's actions, company earnings and – on a longer timeframe – valuations. We shouldn't take our eye off of the ball. These are the things that ultimately matter far more than war.

But in the short-term, developments in Ukraine are going to continue to play an outsized role. We're going to see large market swings both to the upside and the downside as new information comes in.

I have to say, I'm really rooting for Ukraine. This is the proverbial David fighting Goliath. Russia absolutely dwarfs Ukraine in terms of manpower, firepower and technology. Once the tanks started rolling in, I figured this would be over in 24 hours. Russia would have installed a puppet dictator, the West would have wagged a disapproving finger and then we might still be talking about those poor Ukrainians but life would have quickly moved on.

But then a funny thing happened. The Ukrainians actually stood their ground and fought back. Their situation is still bleak, and it's entirely possible that by the time this issue goes to print, the country will have fallen. But they're making the Russian pay for it in blood. They're not going down without a fight.

The question, of course, is what happens next?

I think it's pretty obvious that Russian President Vladimir

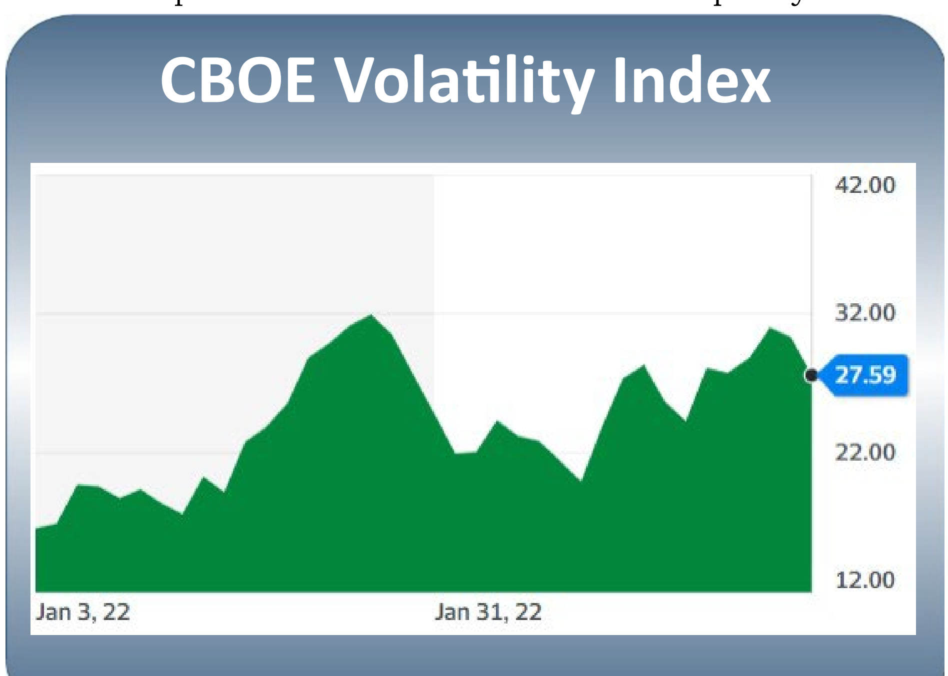

Figure 1

Putin thought more or less the same thing I did. He expected the war to be over before it started. The fact that it has dragged on like this is already an embarrassment for him. But now that he is in this mess, there is no easy or obvious way out.

He can't quit.

If he retreats, he looks weak and his legacy as the man that made Russia relevant again goes up in smoke. Furthermore, Putin isn't stupid. He knows his history, and he knows that dictators that gamble big and lose generally end up on trial at the Hague or hanged by their own people. (Russia being Russia, he'd be more likely to mysteriously die in his sleep than be hanged, but you get my point.)

But "winning" will give him a pyrrhic victory at best. Yes, he will have prevented Ukraine from drifting into the European Union or NATO. But it's hard to see that being worth the economic damage of the sanctions or the cost of being an international pariah on par with Iran or Venezuela.

So, it seems that Putin has worked himself into an uncomfortable stalemate where he can neither win nor lose.

This is a very long way of saying that I have no idea what happens next, and neither does anyone else. This situation will *probably* be contained to Ukraine. But if Putin feels trapped and has nothing to lose, does he go for broke and invade the Baltic states or Poland?

Probably not. But let's look at other scenarios. What if he decides to retaliate against the West with a cyber attack? Does that "count" as an act of war that would drag NATO and Russia into open combat?

Again, I have no idea. But until there is more clarity here, we should expect volatility to remain high (see Figure 1 on previous page).

What to Do About It

Let's take a step back and revisit our 2022 Correction Plan. Entering this year, I had no idea that war in Ukraine would roil the market. But I did view the market as that proverbial bug in search of a windshield. Valuations were stretched, and investors weren't taking the risk of aggressive Fed hikes seriously. You had a new generation of extremely cocky retail investors that had never experienced a bear market *wildly* speculating on anything that moved. And you had the kooky weird stuff that you generally see at market tops, like "meme stocks," dog-themed cryptocurrencies and a host of others.

Something was going to blow that market up. If it wasn't Russia, it would have been something else.

2022 Correction Plan

- Keep a little more cash on hand.
- Keep your position sizes a little smaller than usual.
- Keep a good percentage of your portfolio in non-market alternatives.
- To the extent you buy and hold stocks, focus on quality dividend payers.
- Be willing to make short-term trades, and be sure you have an exit plan.

Figure 2

I don't think we necessarily need to sell everything and move to a bunker in Idaho. That's generally a poor course of action. But I do think it makes sense to keep more cash on hand than usual and to keep your position sizes a little smaller for now. It also makes sense to focus on shorter-term trading and on non-market alternatives.

And about that…

Let's talk.

Over the past several years, I've been putting together a suite of alternatives designed to survive and thrive in a bear market. I not betting *against* the market, as that's a tricky game to play and one that few investors win. But I've put together investments that move independently. Whether the market goes up, down or sideways, I expect these to keep chugging along.

If you'd like to discuss, please contact me office.

Buying What's On Sale

We still won't know for weeks or even months if this correction we're in today is actually just the first act of a broader bear market. And I should be VERY clear that the S&P 500 is far from cheap. Prices would need to fall another 20-30% to create what I could consider a great buying opportunity for the broader market. But already, bargains are starting to pop up in corners of the market. The Nasdaq is already in bear market territory, and around 40% of the stocks in the index are down by more than half. This is an income letter, so I'm not going to make a list of tech stocks to buy. But I do think it's fair to say that with that kind of carnage, there's likely some really attractive deals.

Well, I'm also seeing some pretty decent bargains in the world of fixed income, and particularly in closed-end funds (CEFs). While most CEFs have been trading at or even above net asset value (NAV) for months, recent surge in bond yields has pushed a lot of CEF investors to sell first and ask questions later. And as a result, I'm starting to see some of the widest discounts in well over a year.

A Quick Review of CEFs

CEFs are a type of mutual fund, and in fact, they are older than what you might think of as the "traditional" open-ended mutual funds you might find in your 401k plan. The very first closed-end fund was launched in 1893 – more than 30 years before the first open-ended mutual funds were created.

As with their mutual fund cousins, CEFs are pooled investment vehicles that hold portfolios of stocks, bonds or other assets. But that's where the similarities stop.

Mutual funds are open-ended. When you want to invest, you or your broker sends cash to the fund, and the manager takes that fresh cash and uses it to buy assets. When you want to sell, the manager will sell a small amount of assets to cash you out. Money is always coming and going, and there's no hypothetical limit to the amount of new money a popular fund can take in and invest.

Closed-end funds are different. CEFs have initial public offerings (IPOs) like stocks, and there is a fixed number of shares that then trade on the stock market. If you want to buy shares, you buy them the same way you'd buy a stock.

And here's where the fun starts. CEF prices are set by the market the same way a share of Apple (Nasdaq: AAPL) or Amazon.com (Nasdaq: AMZN) would be, but that price can vary wildly from the value of the assets the fund holds. It's not uncommon to see CEFs trading at a premium to the value of the assets they own. But just as you'd never pay $1.10 for a dollar, you're generally better off avoiding CEFs trading a premium.

Discounts, however, are another story. Closed-end funds often sell at massive discounts to net asset value (NAV). In these cases, they're effectively worth more dead than alive!

Another nice aspect of CEFs is that, unlike mutual funds, they can use debt leverage to juice their returns. You have to be careful here, of course, as leverage can be a two-edged sword. But leverage also allows closed-end funds to sport some of the highest yields you're likely to find.

Last month, I recommended shares of the **Vertical Capital Income Fund (NYSE: VCIF),** and we're up a modest one half of one percent. (Given that the market has been mostly down this month, even a half percent gain is looking pretty good!)

This month, I'm going back to the origins of the *Sizemore Income Letter*, and I'm going to recommend the shares of a conservative municipal bond fund. I'm not quite ready to dip my toes into the stock market, but I'm ready to snap up the shares of a tax-free income machine when they're on sale.

And this brings me to my recommendation for the month, the **MFS Municipal Income Trust (NYSE: MFM).**

MFS Municipal Income Trust

Figure 3

MFM Portfolio Breakdown

COLORADO HEALTH FACS AUTH REV 4%	$5.76M	1.41%
MASSACHUSETTS ST DEV FIN AGY REV 4%	$5.21M	1.28%
BUCKEYE OHIO TOB SETTLEMENT FING AUTH 5%	$3.64M	0.89%
CHICAGO ILL 5%	$3.59M	0.88%
DOWNEY CALIF UNI SCH DIST 4%	$3.57M	0.87%
NEW YORK N Y CITY HSG DEV CORP MULTIFAMILY MTG REV 4.5%	$3.10M	0.76%
CALIFORNIA HEALTH FACS FING AUTH REV 4%	$3.04M	0.75%
PUBLIC FIN AUTH WIS ARPT FACS REV 5%	$2.62M	0.64%
PUERTO RICO SALES TAX FING CORP SALES TAX REV 5%	$2.60M	0.64%
CHICAGO ILL BRD ED DEDICATED CAP IMPT 6%	$2.27M	0.56%

Figure 4

MFM Portfolio by State

Illinois	10.14%
Pennsylvania	7.67%
California	6.17%
New York	6.01%
Puerto Rico	5.02%
Florida	4.77%
Texas	4.61%
Wisonsin	4.52%
Ohio	3.71%
New Jersey	3.37%

Figure 5

MFM has seen its shares absolutely pummeled over the past few months, dropping about 14% from its recent highs. That might not sound like an extreme figure in a world where Netflix misses an earnings estimate and sees its shares drop by 40%. But in the sleepy world of bond CEFs, that's a big move.

I also think it's likely to be over… or awfully close to over. The shares have been trading in a relatively tight range for the past month and appear to be forming a base.

Digging deeper into the portfolio, a few things jump immediately off the page. To start, the fund is exceptionally well diversified. Its largest position makes up only 1.4% of the portfolio.

The portfolio is also well diversified by state. It's largest state allocation is to Illinois, and remember that this allocation is spread across dozens of cities, counties, school districts and other entities.

As I mentioned earlier, the beauty of CEFs is the ability to buy at a discount. Well, for most of February, the shares have been trading at a discount to NAV of 8% to 10%.

Cheap assets can always get cheaper, of course, and it's always possible that discount gets wider. But I can say that history is on our side here. MFM rarely trades at a deeper discount than today's levels. And when it does, those moments tend to be really brief.

And the Yield?

MFM currently yields 4.51%. That might not sound like a monster yield at first, but remember that it's **tax free**. If you happen to be in a high tax bracket, your tax equivalent yield will be much higher

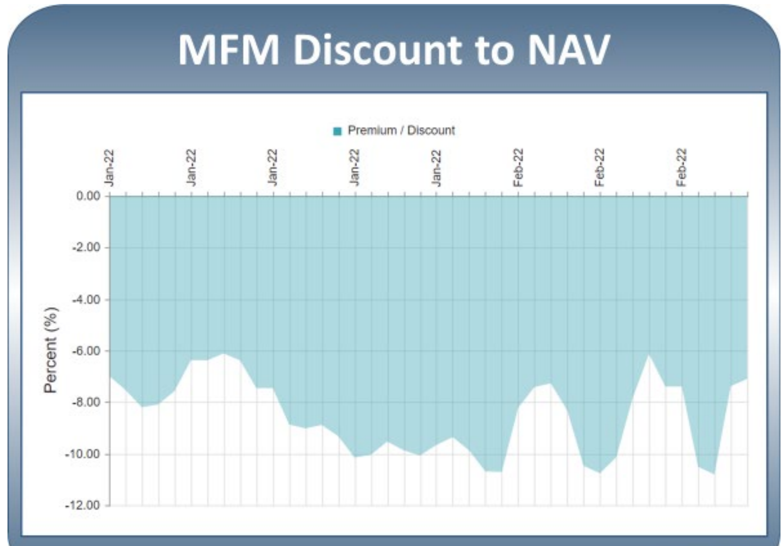

Figure 6

than that. As an example, that 4.51% tax-free yield is the equivalent of a 7.16% yield if you're in the 37% bracket.

What's the Risk?

I'm not too worried about default risk. These are the debts of states, cities and counties we're talking about.

But interest rate risk is something we'll need to watch. About 55% of the fund is invested in bonds with maturities of 20 years or more.

That means that the fund will be very sensitive to rising bond yields.

I'm good with that. I may be a lone voice in the wilderness when I say this, but I don't see bond yields marching inexorably higher from here. I continue to believe that inflation will really start to taper off by this summer, and when it does, bond yields will level off as well. My reasoning here is a much longer story that I'll save for another newsletter. But I can summarize by saying that bond yields have remained "impossibly" low in Japan for the better part of 30 years now. When you live in a world of aging demographics and ample liquidity, yields will remain low. And that's the world we see today.

So, what kinds of returns should we expect?

Between the current yield, a mild improvement in bond prices and a mild closing of the discount to NAV, 20% - 30% gains over the next year or two is reasonable. And remember, this is a conservative bond fund!

So, please take the following action…

Action to take: Buy shares of the MFS Municipal Income Trust (NYSE: MFM). Set an initial stop loss at $5.93 based on closing prices.

Note that MFM is not a fund you'd want to put in your IRA account. It's not going to cause you any accounting issues if you do, of course, but remember that one of the main selling points of the fund is its tax-free dividend. What's the point of getting a tax-free yield if you're just going to bury it in a tax-free account?

This is one you'll want to own in a regular, taxable brokerage account.

Portfolio Update

I was wildly bullish on energy long before the Russian invasion of Ukraine became a reality. And given the very real possibility that Russian oil and gas production and distribution gets curtailed due to sanctions, the bullish backdrop for energy only gets better.

We're already up nearly 20% in **Energy Transfer (NYSE: ET)** and 37% in **Chevron (NYSE: CVX)**. We're also up about 15% in the **ClearBridge Energy Midstream Opportunity Fund (NYSE: EMO)**.

Let's talk about that…

Like MFM, EMO is a closed-end fund, meaning it has the ability to trade at a discount to NAV. And let me tell you, it most certainly does. EMO trades at an absurd 22% discount.

Yes, you read that right. The shares trade for 78 cents on the dollar.

The discount has been extremely high in this fund since the onset of the pandemic. At some point, it will narrow to something closer to normal. And when it does, investors should enjoy a nice windfall.

If you don't already own shares of EMO, I recommend you add some.

Rounding out our energy positions, we're up about 15% in **Magellan Midstream Partners (NYSE: MMP)** and just shy of 48% in the **Ecofin Sustainable and Social Impact Fund (NYSE: TEAF)**.

If you don't already own shares of any of these, it's not too late. I see a lot more upside in all of our energy picks, though I do expect a little volatility as well. If the Ukraine situation gets resolved soon – which, of course, is by no means certain – energy prices might recede a little. But the longer-term bullish thesis is still intact. After years of underperformance, the economics of the oil patch are a lot stronger today, and stock prices are still ridiculously cheap. In a market where nearly everything is still expensive, energy stocks are a buy.

That's all I have for now.

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
MFS Municipal Income Trust	MFM	2/28/2022	$6.54	$6.54	$5.93	4.51%	$ -	0.00%	No	Buy
Vertical Capital Income Fund	VCIF	1/27/2022	$9.99	$10.04	$8.95	9.23%	$ -	0.50%	Yes	Buy
Energy Transfer Partners	ET	12/27/2021	$8.16	$9.79	$7.30	7.42%	$ -	19.98%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$50.12	$33.92	6.28%	$ -	4.90%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$140.45	$88.14	4.62%	$ 1.34	37.22%	Yes	Buy
Nuveen Real Estate Income	JRS	6/25/2021	$10.77	$11.37	$9.69	6.68%	$ 0.19	7.34%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$24.49	$17.30	7.10%	$ 0.76	15.09%	Yes	Buy
First Trust Dynamic Europe Equity Income	FDEU	5/26/2021	$13.68	$12.97	$11.76	5.29%	$ 0.36	-2.56%	Yes	Buy
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$46.78	$41.78	8.65%	$ 4.12	14.62%	No	Buy
WisdomTree Emerging Markets High Dividend Fund	DEM	12/31/2020	$41.22	$45.46	$40.42	4.48%	$ 1.81	14.67%	Yes	Buy
Healthcare Trust of America	HTA	11/20/2020	$26.80	$31.04	$26.95	4.61%	$ 1.29	20.62%	Yes	Buy
Physicians Realty Trust	DOC	11/20/2020	$17.80	$16.95	$15.30	4.49%	$ 0.92	0.39%	Yes	Buy
AllianceBernstein Holding, LP	AB	11/6/2020	$30.85	$45.64	$40.98	6.77%	$ 3.58	59.55%	No	Hold
Main Street Capital	MAIN	9/25/2020	$29.74	$43.07	$35.50	5.93%	$ 2.88	54.51%	Yes	Buy
Iron Mountain	IRM	8/25/2020	$30.22	$48.65	$39.74	5.30%	$ 3.10	71.23%	Yes	Hold
Starwood Property Trust	STWD	8/25/2020	$15.70	$23.95	$18.15	7.38%	$ 2.40	67.83%	Yes	Buy
Dow Inc.	DOW	6/24/2020	$38.45	$59.65	$47.65	4.53%	$ 3.50	64.24%	Yes	Buy
Ecofin Sustainable and Social Impact Term Fund	TEAF	6/24/2020	$10.73	$14.64	$12.35	6.14%	$ 1.20	47.62%	Yes	Buy
LyondellBasell Industries	LYB	5/22/2020	$60.39	$98.00	$79.23	4.27%	$ 6.46	72.98%	Yes	Buy
Ares Capital Corporation	ARCC	4/23/2020	$11.35	$21.77	$17.55	8.20%	$ 2.41	113.04%	Yes	Buy