The Sizemore Income Letter

June 2022

Time for a Portfolio Reshuffle

By Charles Lewis Sizemore, CFA

It's safe to say that I was early last month when I said we might be due for a bear market rally. The S&P 500 rolled over and died in the first half of June, bringing the total year-to-date loss in the S&P 500 to 23% at one point.

Stocks have rebounded… slightly. Or perhaps more accurately, I should say they've stopped dropping for the time being.

Does this mean that the bear market rally I wrote about in the last monthly issue might be starting now?

As I write this, it's too early to say. The selling does appear to be somewhat exhausted, though buyers have been slow to jump into the fray.

We'll see. The bear market will end when it ends. But we don't necessarily have to wait for that to start putting cash to work. And about that, I'll be taking advantage of the market turmoil to add seven new stocks to the Forever Portfolio as well as one new fat-yielder to the main portfolio.

We'll get to that in a minute. But first, I have a little housekeeping to attend to.

The swoon in the market last week claimed two new victims. We hit our stops in **Ares Capital Corporation (Nasdaq: ARCC)** and in our newest addition, **Prospect Capital Corporation (Nasdaq: PSEC)**.

It's a bitter pill to get stopped out of a stock less than a month after recommending it, but we're in a bear market. This is the world we live in at the moment. I still like Prospect Capital and Ares Capital, but we have stop losses for a reason. So, please take the following actions.

When Will the Bleeding Stop?

Figure 1

Action to take: Sell your shares of Ares Capital Corporation (Nasdaq: ARCC) at market.

Action to take: Sell your shares of Prospect Capital Corporation (Nasdaq: PSEC) at market.

We're getting out of PSEC at an 11% loss. I don't like it. But it's a tolerable loss that we can easily recover from.

Ares, however, is a solid win for us. We're exiting this position with an 87% gain.

I have more news before we jump into this month's recommendations. **LyondellBasell (NYSEL LYB)** just paid a monster $5.20 special dividend on top of the regular $1.19 quarterly dividend for a total of $6.39. The $1.19 represented a 5% increase.

I'm a big fan of special dividends because they show two things. To start, management takes the shareholders seriously and likes to reward them.

But beyond this, a special dividend shows discipline. When it comes to dividends, you <u>can</u> get too much of a good thing. Companies can get high on their success and raise the dividend to unsustainably high levels… levels that then have to be cut later. By making a one-time special dividend, the company returns excess cash to investors but also keeps the regular dividend at a safe and sustainable level for the future.

At current prices, LyondellBasell yields well over 5% and remains one of my very favorite positions. So, if you don't own shares already, please take the following action:

Action to take: Buy shares of LyondellBasell (NYSE: LYB) at market.

Finally, one last comment before we jump into the recommendations.

2022 Bear Market 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

Let's very briefly review our bear market playbook here. I hope you've been doing the first two bullet points of keeping a little cash on hand and keeping your position sizes a little smaller than usual. These are the most important things we can do from the onset to make sure we keep our losses minimal.

So, if you take nothing else away from this issue, please keep those two bullet points in mind.

The third bullet point is important too. Despite my chosen career of recommending and buying stocks, I am a big believer in having a large chunk of your assets <u>outside</u> of the stock market. I have colleagues that own Subway franchises. I have colleagues that own laundromats. I myself own a rental house and know plenty of other investors that do too. Any of these investments can sink or swim. But the key is that their risk factors are outside of the market. The movement in the S&P 500 will not affect whether any of these sink or swim.

I manage of suite of funds dedicated to generating returns outside of the stock market, by the way. If you'd like to know more, please reach out and we can speak offline.

Moving on, we're covering the last two bullet points here in the *Sizemore Income Letter*. Because we fallow the first bullet point and keep cash on the sidelines, we now have it to deploy in quality dividend payers when they are on sale. And when things don't work out… we honor our stops and get out.

America's Biggest Banks on Sale

With no further ado, let's get into it.

You might remember me drawing parallels between today's bear market and the tech bust of 2000-2002. There are differences to be sure. But in both cases, we had a massive bubble in the shares of new tech companies, some of which had dodgy business models and no real path to profitability… or at least no profitability that would ever hope to justify prices.

High quality tech stocks eventually recovered. But it would be years until they really took market leadership again. The leaders in the 2002-2007 bull market were more traditional sectors like energy and banks.

And that brings me to this month's recommendation, **Citigroup (NYSE: C)**.

A more aggressive Federal Reserve was supposed to be good for banks, as it meant higher net interest margins. But it seems that rates moved a little too far too fast, and now investor concern has shifted to sustainability. It's great that the profitability of each loan may potentially improve, but this is negated

Citigroup trading at 2013 Prices

Figure 3

Bargain Pricing in Citigroup

Figure 4

if the volume of loans drops off or delinquencies rise.

Those are valid concerns, of course. But as often happens, it seems the market has overreacted. At a price/book ratio of 0.5, Citigroup is trading just a hair above the panic levels of the 2020 COVID crash. Citigroup has only gotten this cheap a handful of times in the past decade, and every time it did, it's shares rallied hard not too long thereafter.

Of course, this is an income letter. So, let's talk dividends.

At current prices, Citi's shares yield about 4.4%. That's high for a "normal" common stock these days. We generally have to look in specialty sectors such as REITs or BDCs to find yields at that level.

The dividend yield can rise in one of two ways. Either the stock price can drop… or the dividend payment can rise. In the case of Citigroup, it's a combination of the two. The shares have really gotten hammered this year, but Citi has also been aggressively raising its dividend over the past 10 years.

Citi hasn't raised the dividend since the onset of the pandemic, which was a reasonable move given the uncertainty at the time. But given that the payout ratio is extremely low at just 24%, Citi has ample room to start raising the dividend again, come what may in the economy. (In plain English, the dividend payout ratio is the percentage of earnings being paid out as dividends. The lower the number, the more room the company has to raise the dividend.)

I like Citigroup for multiple reasons. To start, the stock is cheap and extremely out of favor. It trades for 5 times earnings, for crying out loud. That appeals to me as a value investor.

It pays a fat dividend, and there is plenty of room for additional dividend growth. That appeals to me as an income investor.

But there's also a portfolio management angle here. Our portfolio is really heavily weighted to energy and real estate right now. That's not a bad thing during a time of high inflation, of course. But it's good to get some diversification too, and Citi does that for us.

Dividend Yield Near Decade High

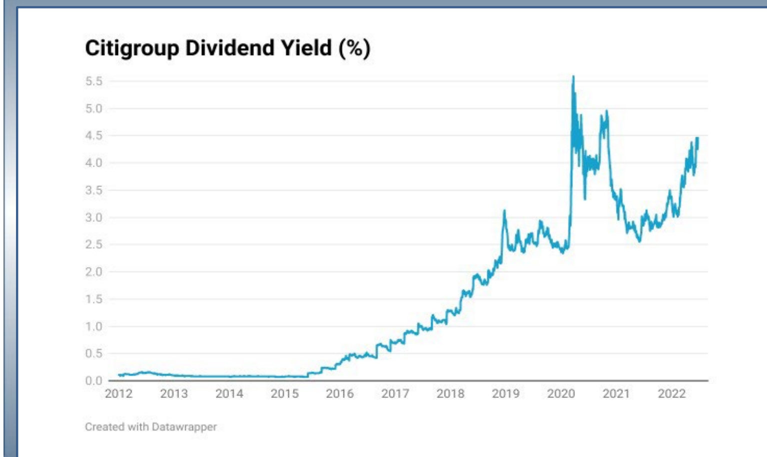

Figure 5

Solid Dividend Growth

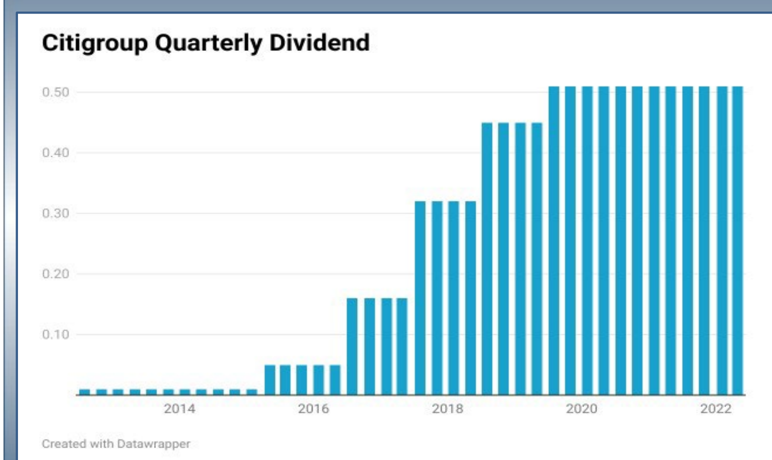

Figure 6

So, what kind of returns should we expect here?

Citi wasn't particularly expensive even before the recent drop. Simply returning to its old highs would give us a return of 63%, plus the dividends. If Citi simply avoids any major hiccups, returns of 100% or more within two years are completely reasonable.

So, with no further ado…

Action to take: Buy shares of Citigroup (NYSE: C) at market. Set an

initial stop loss at $32.57 based on closing prices.

The Forever Portfolio

We're just getting started.

If you're reading the newsletter, I think it's safe to make a few assumptions.

1. You want income
2. You're concerned that income won't keep pace with inflation

I hear you, and I feel the same way. So, today, I'm making my biggest changes to the Forever Portfolio since the launch of the *Sizemore Income Letter*. I'm adding seven new picks to the portfolio, all of which have a few key attributes in common.

To start, all have dividend yield of at least 3%. That's not a screaming high yield, of course, but it's competitive with the 10-year Treasury note. At time of writing, the 10-year Treasury yields 3.08%. We can consider these our bond replacements.

Apart from the yield, every stock on this list has a solid history of dividend growth over the past 10 years, and most have reasonably high dividend growth over more recent time horizons too.

And finally, every stock on this list is less volatile than the S&P 500, and most by a wide margin.

Beta is a measure of a stock's volatility relative to the S&P 500. Without bogging you down in the math, we think of it like this. A stock with a beta of 1 essentially just moves with the market. A beta less than 1 means that the stock is less volatile than the market.

For example, **Conagra Brands (NYSE: CAG)** has a beta of 0.68. This means the stock only has about 68% of the volatility of the S&P 500. In the case of **Clorox Company (NYSE: CLX),** the stock has only 17% of the volatility of the market.

So, in all seven of these new additions, we're getting a reasonable high yield, respectable dividend growth that should keep pace with inflation over time, and generally lower volatility than the market. Call this the "low heartburn portfolio," if you will.

There are some other similarities between the stocks, of course. Conagra. **Campbell Soup Company (NYSE: CPB), Flowers Foods (NYSE: FLO), General Mills (NYSE: GIS)** and **J.M. Smucker**

Stock	Ticker	Recent Price	Yield	1-Year Dividend Growth	5-Year Dividend Growth	10-Year Dividend Growth	Beta
Conagra Brands	CAG	$ 32.47	3.87%	3.8%	10.0%	5.3%	0.68
The Clorox Company	CLX	$ 132.14	3.69%	4.5%	7.7%	6.8%	0.17
Campbell Soup Company	CPB	$ 46.97	3.15%	0.0%	1.1%	2.5%	0.39
Flowers Foods	FLO	$ 24.97	3.52%	4.8%	5.3%	7.5%	0.22
General Mills	GIS	$ 67.90	3.01%	0.0%	0.8%	5.3%	0.44
J.M. Smucker Company	SJM	$ 123.83	3.18%	10.0%	5.7%	7.5%	0.28
Target Corporation	TGT	$ 140.81	3.10%	20.0%	11.7%	11.6%	0.97

Company (NYSE: SJM) are all in the packaged foods business. Boom or bust, inflation or deflation, people still have to eat. And all of these companies own popular brands that have withstood the test of time. I might worry that a trendy tech stock is at risk of disruption from the *next* trendy tech stock. But is anyone really lining up to take on Campbell Soup in the war for chicken noodle soup dominance?

Yes, there is competition from white label generic brands. But management would have to really go out of its way to screw up business models this simple.

Clorox isn't in the food business, of course. They sell cleaning supplies. But the same principles apply. Clorox operates in a mature market that is largely immune from technological disruption. Even if we one day have robot housekeepers cleaning our homes, those robots will still need Clorox supplies to do their jobs.

Target Corporation (NYSE: TGT) is a little different from the rest. It's a mass market retailer and not a manufacturer of specific products. But Target sells basic necessities. And while 2022 has been a difficult year for the retailer, I would argue that the company's handling of its inflation and inventory issues is proof of just how durable the company is.

You might recall that Target's shares took a pounding after management announced they were writing down large swaths of inventory and cancelling orders. But this wasn't the sign of weakness that Wall Street feared. It was simply Target's realization that its customers' needs had changed post-COVID. The company did what good, proactive companies do. It pivoted and rearranged its inventory to better match its customers' needs.

Of all the stocks on this list, I'm probably most excited about Target and expect it to give us the strongest performance over the next year or two. But I consider all of these to be fantastic long-term holdings. And taken as a group, I believe they can be a viable substitute for a bond portfolio or can at least replace part of a bond portfolio.

I should be clear, these stocks are more volatile than a bond portfolio. And stocks are inherently riskier than bonds because they have lower priority in the capital structure. In the event of bankruptcy or liquidation, the bond holders always get paid first. And a company can cut its dividend before it cuts its bond coupon payment.

All of this is true. But we must also balance these risks against the risk of losing ground to inflation. I will take the *possibility* of stock market losses over the *guarantee* of inflation losses any day. Every stock on this list has a long history of dividend growth, and I expect that dividend growth to more than keep pace with inflation going forward.

So, please take the following actions:

Action to take: Buy shares of Conagra Brands (NYSE: CAG) at market. Plan to hold forever.

Action to take: Buy shares of Clorox Company (NYSE: CLX) at market. Plan to hold forever.

Action to take: Buy shares of Campbell Soup Company (NYSE: CPB) at market. Plan to hold forever.

The Forever Portfolio

Stock	Ticker	Entry Date	Buy Price	Recent Price	Stop Loss	Yield	Cumulative Dividends	Total Return	IRA Friendly?
Conagra Brands	CAG	6/23/2022	$ 32.46	$ 32.46	None	3.87%	$ -	0.00%	Yes
The Clorox Company	CLX	6/23/2022	$ 132.14	$ 132.14	None	3.69%	$ -	0.00%	Yes
Campbell Soup Company	CPB	6/23/2022	$ 46.97	$ 46.97	None	3.15%	$ -	0.00%	Yes
Flowers Foods	FLO	6/23/2022	$ 24.97	$ 24.97	None	3.52%	$ -	0.00%	Yes
General Mills	GIS	6/23/2022	$ 67.90	$ 67.90	None	3.01%	$ -	0.00%	Yes
J.M. Smucker Company	SJM	6/23/2022	$ 123.80	$ 123.80	None	3.18%	$ -	0.00%	Yes
Target Corporation	TGT	6/23/2022	$ 140.64	$ 140.64	None	3.10%	$ -	0.00%	Yes
Coca-Cola Company	KO	4/27/2022	$ 65.56	$ 61.15	None	2.96%	$ 0.44	-6.06%	Yes
Prologis	PLD	10/29/2021	$ 146.67	$ 115.46	None	2.86%	$ 2.21	-19.77%	Yes
Crown Castle International	CCI	10/29/2021	$ 181.90	$ 168.07	None	3.63%	$ 4.41	-5.18%	Yes
Philip Morris International	PM	3/30/2021	$ 89.35	$ 99.17	None	5.10%	$ 4.95	16.53%	Yes
Altria Group	MO	3/19/2020	$ 37.10	$ 41.49	None	7.95%	$ 8.72	35.34%	Yes
Realty Income	O	3/19/2020	$ 48.08	$ 66.39	None	4.58%	$ 6.41	51.42%	Yes
AT&T	T	3/19/2020	$ 31.15	$ 20.30	None	5.56%	$ 4.96	-18.91%	Yes
Enterprise Products Partners	EPD	3/19/2020	$ 14.52	$ 24.09	None	7.61%	$ 4.07	93.90%	No
Kinder Morgan	KMI	3/19/2020	$ 11.20	$ 16.34	None	6.92%	$ 2.41	67.41%	Yes
Ventas	VTR	3/19/2020	$ 19.98	$ 49.75	None	3.71%	$ 4.39	170.99%	Yes
Public Storage	PSA	3/19/2020	$ 187.60	$ 306.23	None	2.65%	$ 18.00	72.83%	Yes
International Paper	IP	3/19/2020	$ 30.13	$ 41.24	None	4.42%	$ 4.30	51.16%	Yes
STAG Industrial	STAG	3/19/2020	$ 21.71	$ 30.41	None	4.78%	$ 3.26	55.08%	Yes
Investments	ROIC	3/19/2020	$ 7.25	$ 15.71	None	3.34%	$ 0.97	130.07%	Yes

Action to take: Buy shares of Flowers Foods (NYSE: FLO) at market. Plan to hold forever.

Action to take: Buy shares of General Mills (NYSE: GIS) at market. Plan to hold forever.

Action to take: Buy shares of J.M. Smucker Company (NYSE: SJM) at market. Plan to hold forever.

Action to take: Buy shares of Target Corporation (NYSE: TGT) at market. Plan to hold forever.

That's all I have for now. Have a good weekend, and 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
Citigroup Inc	C	6/23/2022	$47.16	$47.16	$32.57	4.39%	$ -	0.00%	Yes	Buy
Prospect Capital	**PSEC**	**5/31/2022**	**$7.78**	**$6.89**	**$6.80**	**9.25%**	**$ -**	**-11.44%**	**Yes**	**Sell**
ONEOK, Inc.	OKE	4/28/222	$65.50	$53.64	$47.91	5.73%	$ 0.94	-16.68%	Yes	Buy
Digital Realty Trust	DLR	3/24/2022	$136.79	$132.29	$118.15	3.57%	$ 1.22	-2.40%	Yes	Buy
Vertical Capital Income Fund	VCIF	1/27/2022	$9.99	$9.19	$8.95	9.23%	$ 0.37	-4.30%	Yes	Buy
Energy Transfer Partners	ET	12/27/2021	$8.16	$10.00	$7.79	7.42%	$ 0.38	27.14%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$45.42	$33.92	6.28%	$ 1.83	-1.12%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$147.87	$130.77	4.62%	$ 4.18	47.15%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$22.96	$20.49	7.10%	$ 1.65	12.17%	Yes	Buy
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$47.80	$41.78	8.65%	$ 6.20	21.59%	No	Buy
Healthcare Trust of America	HTA	11/20/2020	$26.80	$27.42	$26.95	4.61%	$ 1.94	9.53%	Yes	Buy
Physicians Realty Trust	DOC	11/20/2020	$17.80	$17.14	$15.30	4.49%	$ 1.38	4.04%	Yes	Buy
Main Street Capital	MAIN	9/25/2020	$29.74	$37.31	$35.50	5.93%	$ 4.63	41.02%	Yes	Buy
Iron Mountain	IRM	8/25/2020	$30.22	$48.15	$42.57	5.30%	$ 4.95	75.72%	Yes	Hold
Starwood Property Trust	STWD	8/25/2020	$15.70	$21.18	$18.15	7.38%	$ 3.36	56.31%	Yes	Buy
Dow Inc.	DOW	6/24/2020	$38.45	$52.34	$48.78	4.53%	$ 5.60	50.69%	Yes	Buy
Ecofin Sustainable and Social Impact Term Fund	TEAF	6/24/2020	$10.73	$13.90	$12.53	6.14%	$ 1.79	46.18%	Yes	Buy
LyondellBasell Industries	LYB	5/22/2020	$60.39	$87.53	$79.23	4.27%	$ 15.11	69.96%	Yes	Buy
Ares Capital Corporation	**ARCC**	**4/23/2020**	**$11.35**	**$17.55**	**$17.94**	**8.20%**	**$ 3.72**	**87.40%**	**Yes**	**Sell**