The Sizemore Income Letter

March 2023

Bank Crisis Averted?

By Charles Lewis Sizemore, CFA

I'll start with some good news! It's looking like we might have escaped a major wave of bank meltdowns.

Yes, Silicon Valley Bank died, as did Signature Bank. And First Republic Bank's fate is still an unknown. And I would be really surprised if we didn't see at least a few more failures of small and medium term banks before this year is over, particularly if we get a recession and bad loans start to pop up.

But at least for the moment, it's looking like there won't be a "Lehman moment" that takes down the system like the failure of Lehman Brothers did back in 2008.

Most of this comes down to the Fed.

Now, you know I hold the Federal Reserve in pretty low esteem these days. Their wild excesses during the pandemic helped inflame the "transitory" inflation (remember that word?) that they are now trying to kill with high interest rates. They move from one self-inflicted crisis to another.

But, the new emergency lending facility they set up seems to doing the trick. Under the Bank Term Funding Program, banks can borrow from the Fed using their underwater bonds as collateral. If a long-term Treasury on the bank's balance sheet has dropped from 100 cents on the dollar to, say, 80 cents, the y can borrow the full 100 cents against that collateral.

The banks have been taking them up on the offer. After declining for the past year, the Fed's balance sheet has ballooned by about $400 billion since the program was announced.

By allowing banks to swap their Treasury securities at face value for cash, the Fed has stopped the immediate liquidity problem.

Great!

But unfortunately, the story doesn't end there.

A bank that is having to swap out bonds for cash is a bank that is fighting to survive. It likely *will* survive. But a bank that is barely scraping by is not a bank that is going to be taking risk and making new loans. It's going to be cutting back, making loans only to its safest customers.

I've been writing about recession risk for a while. The yield curve has been inverted for months and remains inverted today (Figure 2).

Historically, this has been a major warning that a recession was coming in the near future. But I wasn't entirely sure what would trigger the recession. Now, I have a pretty good idea.

Small and medium sized banks provide a lot of the capital to start-up companies. I'm not talking about tech startups in Silicon Valley but rather regular mom and pop businesses… the type that employ about half of all working Americans.

A slowdown in lending by these smaller banks mean a slowdown in borrowing by small businesses and thus less investment and spending on growth.

Inverted Yield Curve

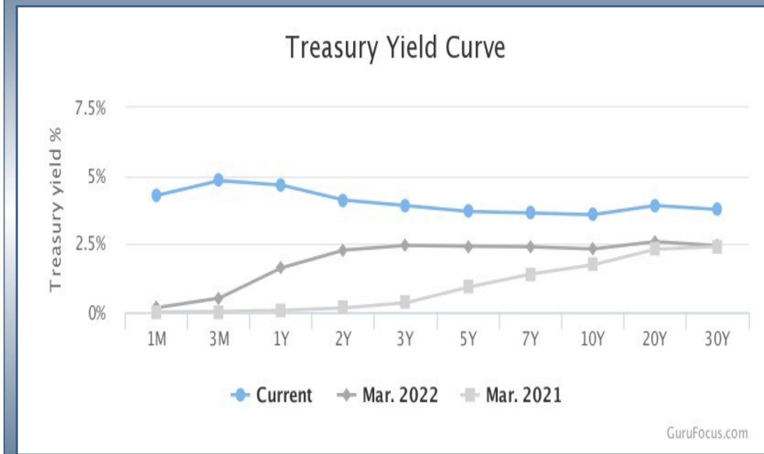

Figure 2

And *that's* how we get the next recession. Or at least that's my working theory.

Last month, rather than make a "normal" stock recommendation, I recommended you invest your excess cash in "boring, widows-and-orphans-appropriate U.S. T-bills."

I would reiterate that recommendation today. Even with the banking crisis seeming to stabilize for now, I think it makes sense to be a little more conservative than normal.

So, I'm not going recommend we take a *lot* of risk this month.

I do, however, see value in preferred stock that I haven't seen in years, and I see a nice opportunity to pick up some nice yields.

What is Preferred Stock?

Let's again start with the basics.

You know what a stock is. It's a piece of the ownership of a company. As a company grows its sales and profits, most of those gains flow through to the shareholders. Of course, this also comes with risk. Stockholders are generally last in line to get paid. In the event that things go sideways, the bondholders and other creditors get paid first.

You also know what a bond is. A bond is a debt instrument. Bonds are safer than stocks, as the company is required to make its bond payments lest it face default. And in the case of bankruptcy, bond holders are the first in line to get paid.

Of course, because bonds are safer, they also tend to return less over time.

Preferred stock is something in the middle. It's not quite a bond, and it's not quite a stock. It's a little of both.

Like a bond, a preferred stock is first and foremost an income investment. Sure, you can trade them like stocks and look to flip them for a profit. But generally, their prices don't deviate all that much from their par values, generally around $25 per share.

Preferred shareholders are "preferred" in the sense that they have to get paid any dividends owed them before the common shareholders (i.e. regular shareholders) get paid a penny in dividends. But unlike with bond interest, which is contractual, a company is not in default if it misses a preferred dividend. Companies can suspend their preferred dividends if cash gets tight and not be in default. But they generally have to pay and all unpaid preferred dividends, even if it's years' worth, before they can pay common dividends.

Bonds have maturities. It might be tomorrow or it might be 30 years from now, but at some point that bond will reach the end of its life, and the investors will receive the par value of the bond.

That's generally not the case with preferred stock. Often a company will have the right to redeem the preferred shares, but that generally only happens when interest rates are falling. Otherwise, a preferred stock can be thought of as a perpetual bond that never matures.

I have certain rules when it comes to preferred stock. To start, I generally won't buy shares for more than their par value (again, usually $25 per share). I don't like the idea of paying $26 or $27 per share just to have the company turn around the next day and redeem it at $25.

Secondly, I tend to focus my preferred shares in companies that are established and stable. If I want to take risk, I'll do it with the regular common stock. The preferreds are supposed to be stress-free income.

And finally, I need to see decent trading volume. While preferreds tend to be fairly thinly traded, I need to see at least a couple tens of thousands of shares in daily volume.

Preferred Stock Trading at Deep Discounts

Stock	Ticker	Price	Discount t	Yield
AGNC Investment Corp Preferred	AGNCP	$19.72	-21%	8.04%
Goldman Sachs Series A Preferred	GS.PRA	$20.42	-18%	6.69%
Bank of America Corp Floating Rate Non-Cumulative Preferred Stock, Series 5	BML.PRL	$20.24	-19%	6.53%
Morgan Stanley | Floating Rate Non-Cumulative Preferred Stock, Series A	MS.PRA	$20.28	-19%	6.77%

So, with that as background, let's take a look at some of my favorites.

At the top of the list is a familiar name, AGNC Investment Corp. We currently own the common shares in the main newsletter portfolio.

At current prices, the preferred shares trade at a 21% discount to par and yield an attractive 8.04%.

Now, I don't expect these shares to trade back at par value any time in the immediate future. That would involve long-term bond yields dropping several percent. I expect that day will likely come, of course, and when it does I'll be happy to sell our shares at or around $25. But until then, we milk the preferred dividends.

Action to take: Buy shares of AGNC Investment Corporation Preferred Stock (AGNCP) at market. Note that the shares are somewhat thinly traded, so you should avoid making large market orders as you build your position.

Up next is the infamous vampire squid itself. Treasury Secretary Janet Yellen made it very clear that systematically important financial institutions would not be allowed to fail were the current banking crisis to take a turn for the worse.

Well, Goldman Sachs is the definition of systematically important. And given the sheer number of Goldman alumni at the Treasury Department and Federal Reserve, I think it's safe to assume that Goldman will never be allowed to fail. For better or worse, it's here to stay. And its Series A preferred shares trade at a nice 18% discount to par value and yield a nice 6.69%.

Action to take: Buy shares of the Goldman Sachs Series A Preferred Shares (GS.PRA) at market. Note that the shares are somewhat thinly traded, so you should avoid making large market orders as you build your position.

* Also note that the ticker symbol might look different at your broker. It could be GS.PRA, GS-PRA or simply GS-A. If you have a hard time finding it, you may want to call your broker to ask for help.

Continuing the theme of too big to fail, Bank of America also has some nice preferred shares on offer. **The Bank of America Corp Floating Rate Non-Cumulative Preferred Stock, Series 5 (BML.PRL)** were inherited from Merrill Lynch after Bank of America took over the broker. The shares trade at a nice 19% discount to par and yield 6.53%.

Action to take: Buy shares of Bank of America Corp Floating Rate Non-Cumulative Preferred Stock, Series 5 (BML.PRL) at market. Note that the shares are somewhat thinly traded, so you should avoid making large market orders as you build your position.

As was the case with the Goldman preferreds, the ticker symbol can show up differently at different brokers. Just be aware of that, and consider picking up the phone to call your broker if you have any doubts placing the trade.

And finally, we have the **Morgan Stanley Floating Rate Non-Cumulative Preferred Stock, Series A (MS.PRA).**

This preferred trades at a 19% discount to par and yields an attractive 6.77%. And again, it's Morgan Stanley. We all know they will not be allowed to fail.

Action to take: Buy shares of Morgan Stanley Floating Rate Non-Cumulative Preferred Stock, Series A (MS.PRA) at market. Note that the shares are somewhat thinly traded, so you should avoid making large market orders as you build your position.

I hope to have more "normal" income positions in next month's issue. But frankly, I'm not going to rush it. My objective here is to find solid, stress-free income investments that will continue to pay us even if things get nasty from here. Whether it's recession, bank failure or some entirely new risk I haven't considered yet, I want us to feel secure knowing the dividend checks are going to keep coming.

These preferred stocks fit the bill.

I would also reiterate one last time that I still consider T-bills a great place to park money at the moment. Though following weeks of panic in the bond market, the highest yields are actually just 3-5 months out.

You don't need to lock up your cash here. You can park it in a bill maturing in July and still collect a nice annualized yield of about 4.6%. If you're unsure of where you want to park your cash, this is absolutely your best bet.

That's going to wrap it up for this month.

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. <u>We manage a suite of low-volatility strategies offering low correlation to the S&P 500.</u> 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
AGNC Investment Corp Preferred	AGNCP	3/31/2023	$19.72	$19.72	N/A	8.04%	$ -	0.00%	Yes	Buy
Goldman Sachs Series A Preferred	GS.PRA	3/31/2023	$20.42	$20.42	N/A	6.69%	$ -	0.00%	Yes	Buy
Bank of America Corp Floating Rate Non-Cumulative Preferred Stock, Series 5	BML.PRL	3/31/2023	$20.24	$20.24	N/A	6.53%	$ -	0.00%	Yes	Buy
Morgan Stanley Floating Rate Non-Cumulative Preferred Stock, Series A	MS.PRA	3/31/2023	$20.28	$20.28	N/A	6.77%	$ -	0.00%	Yes	Buy
Nuveen Real Estate Income Fund	JRS	1/30/2023	$8.46	$7.18	$6.41	9.77%	$ 0.17	-13.12%	Yes	Buy
iShares MSCI Brazil ETF	EWZ	12/26/2022	$28.79	$27.01	$20.15	13.00%	$ -	-6.18%	Yes	Buy
Atlantica Sustainable Infrastructure	AY	11/22/2022	$27.75	$28.31	$20.41	6.22%	$ 0.89	5.23%	Yes	Buy
AGNC Investment Corporation	AGNC	11/3/2022	$8.16	$9.93	$9.30	14.50%	$ 0.36	26.10%	Yes	Hold
Cheniere Energy Partners	CQP	8/4/2022	$46.49	$47.25	$41.42	7.39%	$ 1.07	3.94%	No	Buy
Citigroup Inc	C	6/23/2022	$47.34	$45.95	$36.00	4.44%	$ 1.02	-0.78%	Yes	Buy
ONEOK, Inc.	OKE	4/28/222	$65.50	$62.01	$47.91	6.03%	$ 2.81	-1.05%	Yes	Buy
Energy Transfer Partners	ET	12/27/2021	$8.16	$12.20	$8.59	7.54%	$ 0.87	60.17%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$37.18	$33.92	8.88%	$ 3.20	-15.49%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$160.86	$132.62	3.53%	$ 7.02	62.47%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$27.72	$20.49	7.36%	$ 2.68	38.56%	Yes	Buy
Magellan Midstream Partners	MMP	1/29/2021	$44.41	$53.82	$41.78	7.71%	$ 9.33	42.20%	No	Buy

The Forever Portfolio

Stock	Ticker	Entry Date	Buy Price	Recent Price	Stop Loss	Yield	Cumulative Dividends	Total Return	IRA Friendly?
National Retail Properties	NNN	9/29/2022	$ 39.07	$ 42.87	None	5.13%	$ 1.10	12.54%	Yes
Conagra Brands	CAG	6/23/2022	$ 32.47	$ 37.56	None	3.51%	$ 0.99	18.72%	Yes
The Clorox Company	CLX	6/23/2022	$ 132.28	$ 155.50	None	3.04%	$ 3.54	20.23%	Yes
Campbell Soup Company	CPB	6/23/2022	$ 47.04	$ 54.62	None	2.71%	$ 1.11	18.49%	Yes
Flowers Foods	FLO	6/23/2022	$ 24.97	$ 27.17	None	3.24%	$ 0.44	10.59%	Yes
General Mills	GIS	6/23/2022	$ 67.90	$ 85.03	None	2.54%	$ 1.62	27.61%	Yes
J.M. Smucker Company	SJM	6/23/2022	$ 123.83	$ 157.57	None	2.59%	$ 3.06	29.72%	Yes
Target Corporation	TGT	6/23/2022	$ 141.08	$ 158.11	None	2.73%	$ 3.24	14.37%	Yes
Coca-Cola Company	KO	4/27/2022	$ 65.56	$ 61.86	None	2.85%	$ 1.32	-3.63%	Yes
Prologis	PLD	10/29/2021	$ 146.67	$ 119.88	None	2.64%	$ 3.79	-15.68%	Yes
Crown Castle International	CCI	10/29/2021	$ 181.90	$ 130.97	None	4.49%	$ 7.45	-23.91%	Yes
Philip Morris International	PM	3/30/2021	$ 89.35	$ 94.72	None	5.36%	$ 7.49	14.39%	Yes
Altria Group	MO	3/19/2020	$ 37.10	$ 44.52	None	8.45%	$ 10.60	48.57%	Yes
Realty Income	O	3/19/2020	$ 48.08	$ 62.04	None	5.10%	$ 8.40	46.50%	Yes
AT&T	T	3/19/2020	$ 31.15	$ 19.00	None	5.84%	$ 5.79	-20.41%	Yes
Enterprise Products Partners	EPD	3/19/2020	$ 14.52	$ 25.59	None	7.42%	$ 5.51	114.15%	No
Kinder Morgan	KMI	3/19/2020	$ 11.20	$ 17.25	None	6.43%	$ 3.24	82.98%	Yes
Ventas	VTR	3/19/2020	$ 19.98	$ 43.98	None	4.09%	$ 5.74	148.86%	Yes
Public Storage	PSA	3/19/2020	$ 187.60	$ 290.24	None	2.76%	$ 35.15	73.45%	Yes
International Paper	IP	3/19/2020	$ 30.13	$ 35.07	None	5.28%	$ 4.77	32.22%	Yes
STAG Industrial	STAG	3/19/2020	$ 21.71	$ 33.35	None	4.38%	$ 4.23	73.11%	Yes
Retail Opportunity Investments	ROIC	3/19/2020	$ 7.25	$ 13.42	None	4.47%	$ 1.27	102.62%	Yes