The Sizemore Income Letter

Early August 2023

Stating the Obvious

By Charles Lewis Sizemore, CFA

Note: Due to my travel schedule, the July issue is being published as Early August to be followed by a Late August issue towards the end of the month.

"Gee, ya think?"

Those were the first words that popped into my mind when bond ratings agency Fitch decided to downgrade America's credit rating.

Apologies in advance, but you're going to have to bear with me while I rant here.

I'm not angry that America's credit rating got downgraded from a pristine AAA to a slightly less pristine AA+.

I'm furious that it took Fitch this long to do it… and I wish they had gone further. If it were up to me, I would have assigned a CCC.

If you don't speak "bondese," AAA is a perfect credit rating. They then slide from there, AA, A and BBB, with BBB being the lowest rated that is still considered "investment grade." Anything lower than that is a junk bond.

BB means "speculative" and B means "highly speculative." CCC means "substantial credit risk, which is where I would Uncle Sam. (C means default is imminent. We're clearly not quite there yet, but give it time…)

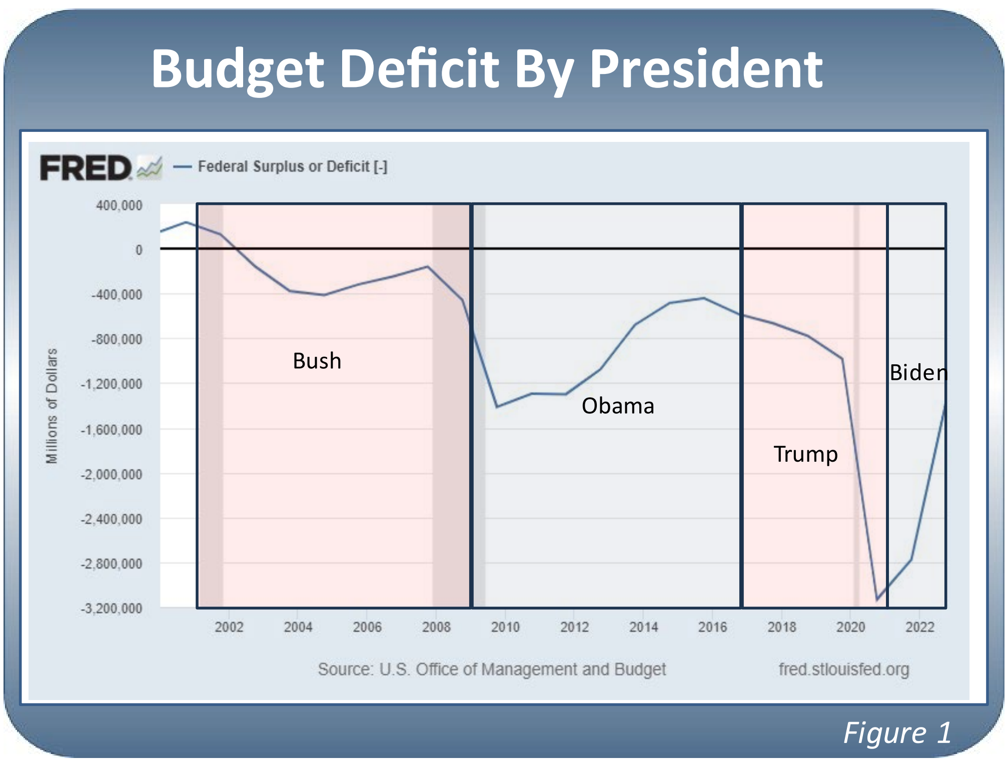

Figure 1

Am I being dramatic?

I don't know that I am, actually. Our country has managed to spend itself $32 trillion in debt. Yes, *trillion*, with a "t." And we added $1.4 trillion dollars to that total this past year and will be adding over a trillion dollars per year to it every year for the foreseeable future… with no obvious end in sight.

The U.S. government brings in $4.9 trillion a year in revenues. You would think we could run a government on that.

Every other country somehow manages to get by on far less. Yet we manage to *spend* $6.3 trillion a year, forcing us to borrow $1.4 trillion to cover the difference.

And perhaps the worst aspect of all: $970 billion of that $6.3 trillion is interest due on the debt accumulated in prior years. That's 15% of the total budget… used to pay the debts for money long since wasted on "investments" with zero return.

President Biden carries his share of the blame for this, of course, but he's not alone. Debt exploded under Trump's presidency (see Figure 1 on previous page), and we can't blame it on the pandemic. The deficit was already snowballing years before anyone had ever heard of COVID-19. "Draining the swamp" clearly had no effect on deficit spending.

George W Bush was also particularly egregious in blowing out the deficit under his presidency, with Vice President Dick Cheney famously declaring that "deficits don't matter." It turns out that running two wars and mismanaging a financial crisis are expensive. Who knew!

U.S. 30-Year Treasury Yield

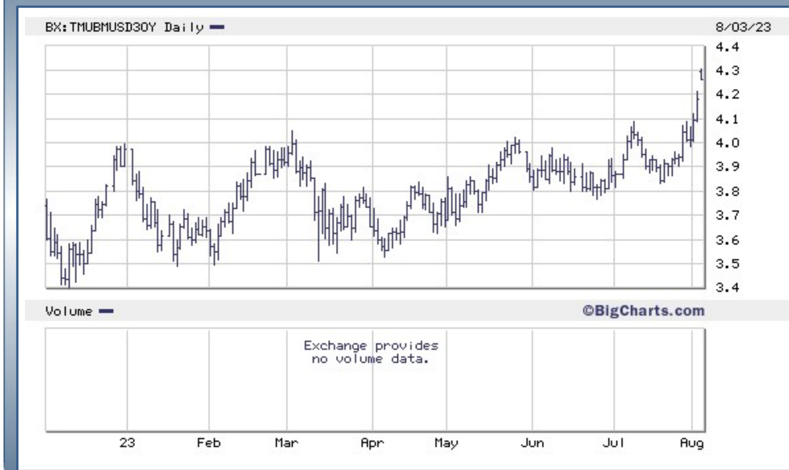

Figure 2

Average 30-Year Mortgage Rate

Figure 3

If anything good came out of the Obama and the congressional republicans it would be that the budget deficit shrunk to something that would almost seem reasonable during his presidency, 2009 to 2017, at least by the standards of the past 20 years. But I'd hardly call $400 billion deficits a model of responsibility.

I know my rant will do absolutely nothing to solve this problem because, frankly, it's unsolvable. Not a single candidate running for president in 2024 has a viable plan to get the national debt under control. And even if they did have a plan… and they somehow managed to get elected (we're clearly talking in impossible hypotheticals here!), they'd never get the proposals through congress.

There's only one way this ends.

Eventually, the financial markets will revolt, sending yields sharply higher and making it cost prohibitive for the government to borrow. Congress will somehow magically discover how to balance a checkbook when left with no other choice. Spending will get cut… and taxes will rise. It will be miserable to live through and will probably give us the deepest recession since the 1930s. But that's it. That's how this ends.

Yes, in theory, the Fed could just print the money to keep the government running. They've essentially been doing that since 2008, so it wouldn't be anything new. But there are limits to what the Fed can do without igniting inflation… as we've all learned the hard way over the past two years.

I don't know when the financial markets say *enough*. For what it's worth, high profile hedge fund manager Bill Ackman has already gone on the record saying he's aggressively shorting US government bonds. Yields have already been rising aggressively since December, and mortgage rates are back near multi-decade highs (see Figures 2 and 3 on previous page).

Is this the beginning of the end?

We'll see.

The more important question is *"How do we protect ourselves?"*

This is first and foremost an income letter. But I do think it is important to be a little more holistic when building a portfolio. For months, I've been arguing that it makes sense to have at least a small part of your net worth in cryptocurrencies like Bitcoin. For me personally, that number is modest at around 1%, though I'd like to grow to about 2% of my net worth over the next year.

Bitcoin Year to Date Performance

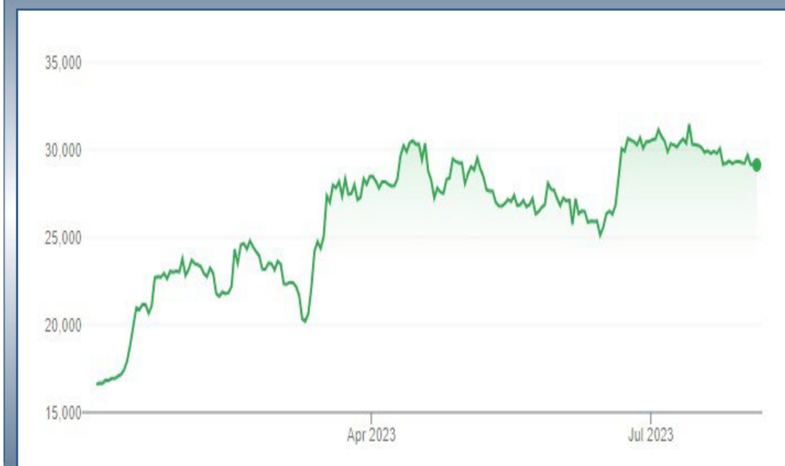

Figure 4

Essential Properties Realty Trust

Figure 5

Essential Properties Basics

Figure 6

Essential Properties Tenants

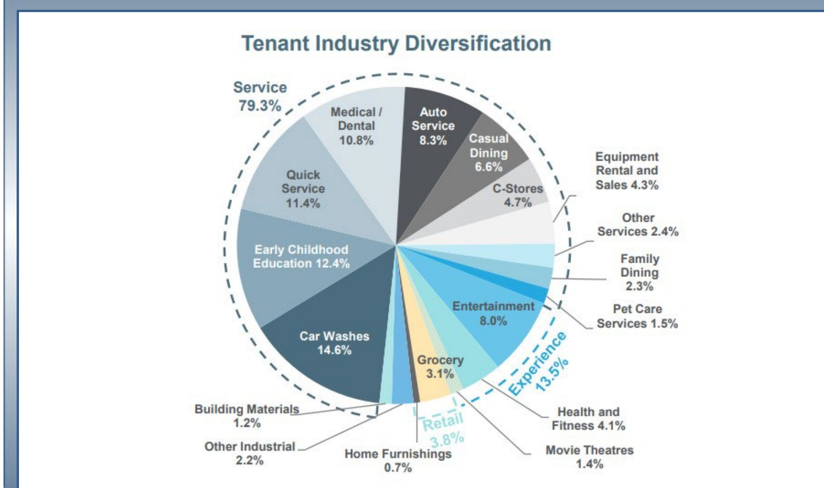

Figure 7

It's absolutely worth noting that Bitcoin has been in a solid uptrend for nearly a year now and has been remarkably stable of late.

I don't recommend that you put a massive chunk of your portfolio in Bitcoin. Frankly, there is still the risk that Bitcoin gets regulated out of existence of that a better cryptocurrency comes along to displace it. But 1-2% of your net worth in Bitcoin or other cryptocurrencies would really seem to make a lot of sense right now.

A New Income Play for 2023 and Beyond

You probably know I've been sniffing around for value in the REIT space all year, and I even added a blue-chip REIT in the last monthly issue.

Well, I have another REIT that I'm excited to add to the mix: **Essential Properties Realty Trust (NYSE: EPRT)**.

When I look for a REIT, I like to have a handful of criteria in place. To start, the REIT's portfolio needs to be "Amazon proof." I need to feel confident that the continued rise of e-commerce isn't going to make the properties redundant.

I also like to see geographic diversity. Recessions can be local, and I don't like having excessive exposure to one state or region. (Consider the decline of Detroit since the 1970s. I don't want that!)

And finally, I ideally like the REIT to be relatively small. While this adds a degree of risk, it also gives us a longer runway for growth and allows us to buy something that every Tom, Dick and Harry doesn't already own.

So, let's see how Essential stacks up!

I can credibly say that the REIT is Amazon proof, or at least as close to Amazon proof as you can get these days. Fully 93% of Essential's rents come from tenants offering services or experiences. To throw out a few examples, 15% of the portfolio is invested in car washes, 12%

is invested in daycare centers and 11% is invested in medical or dental offices.

Last I checked, Amazon wasn't sending anyone to your house to wash your car, watch your child or drill your teeth.

The focus on "experiences" is reminiscent of another one of our holdings, EPR Properties (NYSE: EPR), though Essential is less heavily weighted here. Just shy of 14% of the portfolio is invested in "experiences" properties, such as entertainment or health and fitness.

Essential is also geographically diverse. It owns a growing portfolio of 1,742 properties spread across 48 states, 360 tenants and 16 industries. And the average remaining lease is 14 years, giving the REIT stability and giving me the confidence that its 99% occupancy rate is sustainable for the foreseeable future.

The leases may not be up for renewal for 14 years, but that doesn't mean the cash flows will be stagnant. 81% of the portfolio has an annual rent escalation, and substantially the entire portfolio has rent escalations of one kind or another.

In other words, as rent inflation rages on, Essential's rents grow right along with it.

And as for size, Essential is right in the sweet spot I like to see. It has a market cap of $3.5 billion, meaning it is big enough to be stable but not so big so as to be a slow-growth behemoth.

Let's talk dividends.

At current prices, the REIT yields an attractive 4.6%. But importantly, Essential also raises its dividend at a fast clip. It's raised its dividend three times since the start of 2022.

Essential Properties Dividends

Figure 8

Frankly. I don't know when the wheels come off of the US financial system. It might happen next week, or it might be long after we're dead and in the ground. But I know that regardless of when that day comes, I'm a lot more likely to survive and thrive with a portfolio of strong, durable assets throwing off reliable streams of income. And Essential Properties fits that bill.

So, with no further delay…

Action to Take: Buy shares of Essential Properties Realty Trust (NYSE: EPRT) at market. Set an initial stop loss at $18.10 based on closing prices.

That's going to wrap it up for now. As I mentioned at the beginning, I'll be publishing another issue towards the end of August.

So, on that note, have a good week, 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 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
Essential Properties Realty Trust	EPRT	8/4/2023	$23.59	$23.59	$18.10	4.61%	$ -	0.00%	Yes	Buy
National Storage Affiliates Trust	NSA	6/30/2023	$34.82	$34.15	$26.98	6.56%	$ -	-1.92%	Yes	Buy
Nintendo Company Ltd	NTDOY	5/26/2023	$10.69	$11.16	$8.34	3.49%	$ -	4.40%	Yes	Buy
W.P. Carey Inc	WPC	4/26/2023	$73.59	$66.83	$59.92	6.39%	$ -	-9.19%	Yes	Buy
Nuveen Real Estate Income Fund	JRS	1/30/2023	$8.46	$7.47	$6.41	9.77%	$ 0.17	-9.69%	Yes	Buy
iShares MSCI Brazil ETF	EWZ	12/26/2022	$28.79	$32.29	$20.15	10.87%	$ -	12.16%	Yes	Buy
Atlantica Sustainable Infrastructure	AY	11/22/2022	$27.75	$22.92	$20.41	7.68%	$ 0.89	-14.20%	Yes	Buy
Cheniere Energy Partners	CQP	8/4/2022	$46.49	$52.25	$41.42	6.68%	$ 1.07	14.69%	No	Buy
Citigroup Inc	C	6/23/2022	$47.34	$46.21	$36.00	4.41%	$ 1.02	-0.23%	Yes	Buy
ONEOK, Inc.	OKE	4/28/222	$65.50	$65.96	$47.91	5.67%	$ 2.81	4.98%	Yes	Buy
Energy Transfer Partners	ET	12/27/2021	$8.16	$12.84	$8.59	7.17%	$ 0.87	68.01%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$43.01	$33.92	7.67%	$ 3.20	-3.29%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$159.67	$132.62	3.56%	$ 7.02	61.32%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$31.39	$20.49	6.50%	$ 2.68	55.29%	Yes	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	$ 40.14	None	5.48%	$ 1.10	5.55%	Yes
Conagra Brands	CAG	6/23/2022	$ 32.47	$ 32.51	None	4.06%	$ 0.99	3.17%	Yes
The Clorox Company	CLX	6/23/2022	$ 132.28	$ 166.13	None	2.84%	$ 3.54	28.27%	Yes
Campbell Soup Company	CPB	6/23/2022	$ 47.04	$ 45.63	None	3.24%	$ 1.11	-0.63%	Yes
Flowers Foods	FLO	6/23/2022	$ 24.97	$ 25.00	None	3.52%	$ 0.44	1.90%	Yes
General Mills	GIS	6/23/2022	$ 67.90	$ 74.52	None	2.90%	$ 1.62	12.14%	Yes
J.M. Smucker Company	SJM	6/23/2022	$ 123.83	$ 150.05	None	2.72%	$ 3.06	23.65%	Yes
Target Corporation	TGT	6/23/2022	$ 141.08	$ 132.73	None	3.25%	$ 3.24	-3.62%	Yes
Coca-Cola Company	KO	4/27/2022	$ 65.56	$ 61.64	None	2.86%	$ 1.32	-3.97%	Yes
Prologis	PLD	10/29/2021	$ 146.67	$ 123.81	None	2.55%	$ 3.79	-13.00%	Yes
Crown Castle International	CCI	10/29/2021	$ 181.90	$ 104.93	None	5.60%	$ 7.45	-38.22%	Yes
Philip Morris International	PM	3/30/2021	$ 89.35	$ 97.42	None	5.21%	$ 7.49	17.41%	Yes
Altria Group	MO	3/19/2020	$ 37.10	$ 44.30	None	8.49%	$ 10.60	47.98%	Yes
Realty Income	O	3/19/2020	$ 48.08	$ 58.84	None	5.10%	$ 8.40	39.85%	Yes
AT&T	T	3/19/2020	$ 31.15	$ 14.09	None	7.88%	$ 5.79	-36.17%	Yes
Enterprise Products Partners	EPD	3/19/2020	$ 14.52	$ 26.66	None	7.13%	$ 5.51	121.52%	No
Kinder Morgan	KMI	3/19/2020	$ 11.20	$ 17.46	None	6.36%	$ 3.24	84.86%	Yes
Ventas	VTR	3/19/2020	$ 19.98	$ 48.22	None	3.73%	$ 5.74	170.09%	Yes
Public Storage	PSA	3/19/2020	$ 187.60	$ 286.98	None	2.79%	$ 35.15	71.71%	Yes
International Paper	IP	3/19/2020	$ 30.13	$ 36.62	None	5.05%	$ 4.77	37.36%	Yes
STAG Industrial	STAG	3/19/2020	$ 21.71	$ 35.61	None	4.10%	$ 4.23	83.52%	Yes
Retail Opportunity Investments	ROIC	3/19/2020	$ 7.25	$ 14.98	None	4.01%	$ 1.27	124.14%	Yes

Preferred Stock Trading at Deep Discounts

Stock	Ticker	Buy Date	Buy Price	Current Price	Discount to Par	Yield	Cumulative Dividends	Total Return
AGNC Investment Corp Preferred	AGNCP	3/31/2023	$19.72	$20.92	-16%	8.04%	$ -	6.09%
Goldman Sachs Series A Preferred	GS.PRA	3/31/2023	$20.42	$20.32	-19%	6.69%	$ -	-0.49%
Bank of America Corp Floating Rate Non-Cumulative Preferred Stock, Series 5	BML.PRL	3/31/2023	$20.24	$20.52	-18%	6.53%	$ 0.33	3.04%
Morgan Stanley | Floating Rate Non-Cumulative Preferred Stock, Series A	MS.PRA	3/31/2023	$20.28	$21.10	-16%	6.77%	$ -	4.04%