The Sizemore Income Letter

September 2023

Where Do We Go From Here?

By Charles Lewis Sizemore, CFA

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

That quote, or something similar, is attributed to both the quantum physicist Niels Bohr and to the New York Yankees catcher Yogi Berra.

And yes… forecasting anything in the world of economics with any degree of precision is a challenge given the infinite numbers of variables.

But when has that ever stopped our fearless central bankers from giving it a try!

The Federal Reserve opted to keep the Fed Funds rate at 5.5%, which was widely expected. And indications were that we'd have one last rate hike before year end.

And here is where it gets interesting.

Each of the members of the Fed Open Market Committee gives their best estimate of rates going forward. And the average estimate has the Fed funds rate drifting lower from here.

By the end of next year, the average estimate is a rate of 5%. By 2026, the rate is estimated to be as low as 3.3%.

This implies some pretty aggressive cutting next year… which implies that either inflation will have broken, we hit a recession… or both.

We'll see. I think it's possible rates might stay higher for longer.

Fed Funds Rate Projections

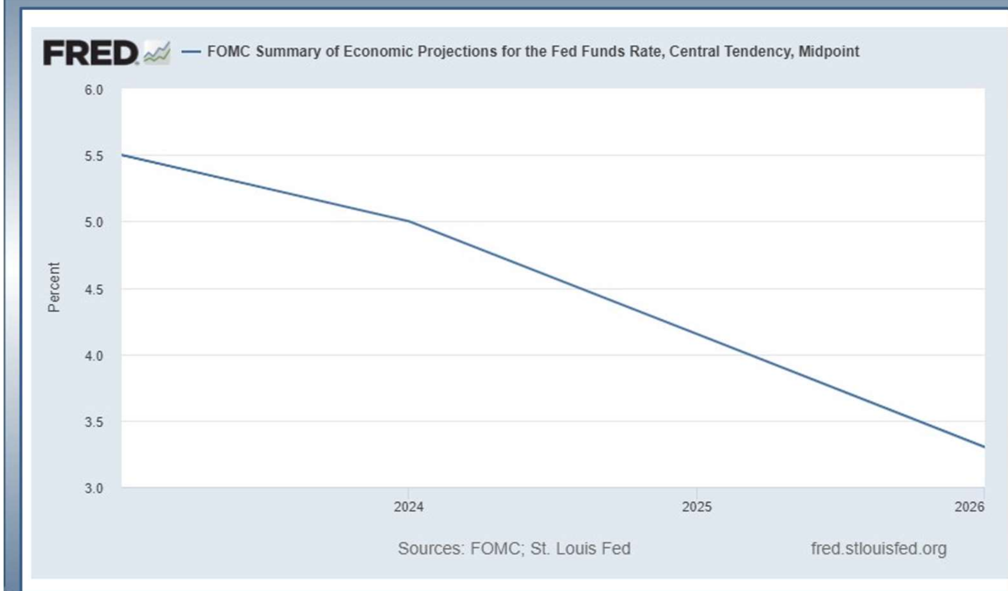

Figure 1

But in any event, we probably will be seeing falling rates in the not-to-distant future.

I'm going to keep buying T-bills as long as they remain juicy. 5.5% risk free isn't bad, even at today's inflation rates. But as rates comes down, whether it's next year or a couple years down the road, we'll want to rotate more aggressively into higher-yielding dividend stocks.

Of course, it also makes sense to be building up those positions *today*, when prices are depressed.

Let's take a quick look at two of my favorite "Forever" stocks, Realty Income (NYSE: O) and NNN REIT (NYSE: NNN)(Formerly National Retail Properties).

Both of these stocks have gotten utterly obliterated this year due to rising interest rates. **Realty Income is trading at 2015 prices and NNN REIT is trading at 2014 prices**.

But let's take a look at what is now on offer. Realty Income and NNN REIT yield 5.9% and 6.2%, respectively (Figure 3).

That's higher than what you'll get in T-bills, **and** it's taxed at a more favorable rate **and** the payout is likely to grow rather than fall, as we see in T-bill land (Figure 1).

Let's talk about that.

Over the past 10 years, these two dividend workhorses have raised their dividends at 4.5% and 3.5% per year, respectively. Now, I have no guarantee for you that the next 10 years will look the same. Maybe growth is higher or lower.

Realty Income (NYSE: O)

Figure 2

NNN REIT (NYSE: NNN)

Figure 3

Competitive Yields

Realty Income Current Dividend Yield	5.9%
NNN REIT Current Dividend Yield	6.2%
Realty Income 10-Year Dividend Growth Rate	4.5%
NNN REIT 10-Year Dividend Growth Rate	3.5%
Realty Income Projected Yield on Cost in 2033	8.6%
NNN REIT Projected Yield on Cost in 2033	8.8%

Figure 4

But just for grins, let's assume the next 10 years look like the past 10. Assuming growth remains the same, we'd be enjoying yields on cost of 8.6% and 8.8%, respectively.

In case you need a refresher, yield on cost is the current dividend divided by your original purchase price. It's a measure of how much cold hard cash your original investment is throwing off. And naturally, if you reinvest your dividends and grow your share count, the numbers get substantially bigger.

I have large positions in both Realty Income and NNN REIT and I have no plans to divest of either any time soon. When I call these "forever" stocks, I mean it.

Whatever the Fed funds rate ends up being 10 years from now, I am certain that my investments in my Forever Stocks will be throwing off a *lot* more income.

Now is the time. Little by little, month by month, add a little more to the Forever Portfolio. You have an extra couple hundred bucks, pick one and buy a few shares. Then next month, buy a different one. Build your positions slowly. And in 10 years, you'll thank yourself.

Update on Pipelines

I mentioned that "bond king" Bill Gross was aggressively allocated to MLPs in the last weekly update.

Well, so are we!

We own **Energy Transfer (NYSE: ET)** (Figure 5) is the main newsletter portfolio and has been for nearly two years. We're up about 80% and I expect more gains to come. We also own non-MLP pipeline operator **ONEOK (NYE: OKE)** and pipeline-focused closed-end fund **Clearbridge Energy Midstream Opportunity Fund (NYSE: EMO)**.

Energy Transfer (NYSE: ET)

Figure 5

Enterprise Products (NYSE: EPD)

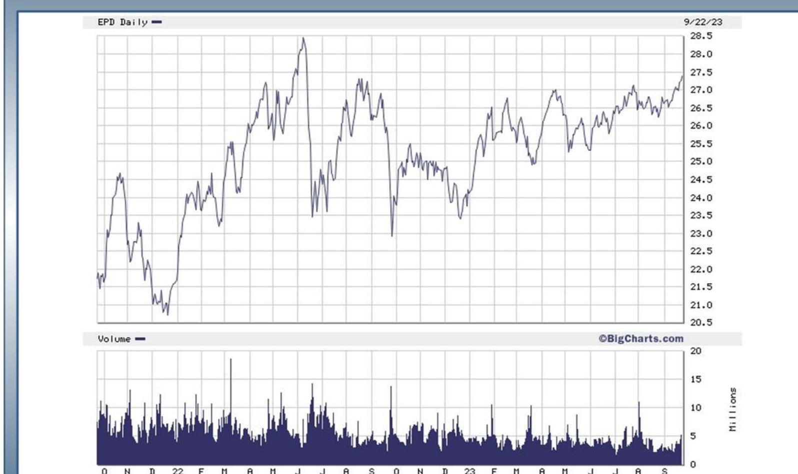

Figure 6

In the Forever Portfolio, we also have **Enterprise Products Partners (NYSE: EPD)** (Figure 6) and non-MLP pipeline operator **Kinder Morgan (NYSE: KMI)**.

That's a lot of exposure to pipelines, but frankly, I can't say I'd rather be overallocated anywhere else.

Pipeline companies have really matured over the past eight years.

In the years leading up to the 2015 energy crash, most of the major operators developed a reputation for reckless growth. They would pay out every last available dollar as distributions, which left them nothing in the way of retained earnings to fund growth. So, they resorted to borrowing aggressively or perpetually issuing new shares and diluting their exiting investors!

A nasty bear market in energy has a way of forcing changes. Today's MLPs are far more conservatively and responsibly run.

Take a look at Figure 7, which breaks down Energy Transfer's capital allocation. The company pays out about 53% of its distributable cash flow as cash distributions. But that is after it allocates 27% to 40% to funding new growth. (Whatever cash is left over goes to repurchasing shares.)

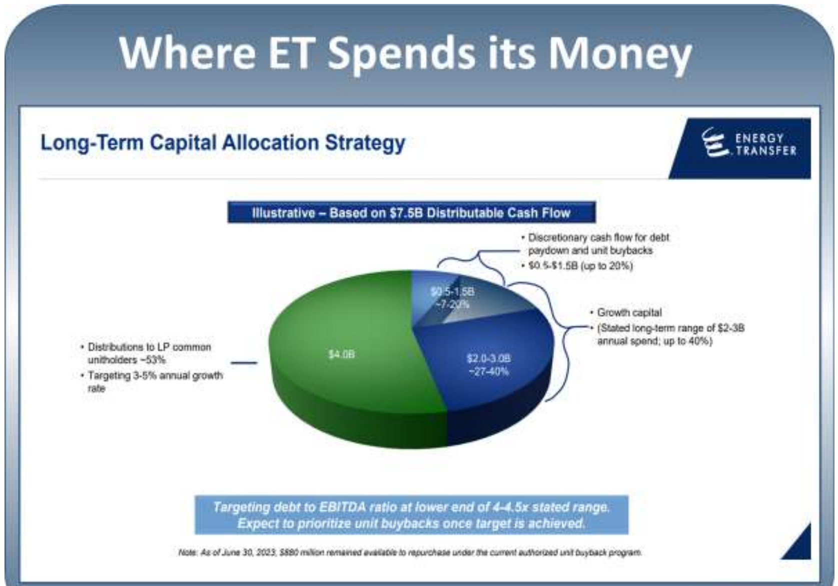

Figure 7

That's not cowboy capitalism. That's solid, responsible management. Along the same lines, take a look at Figure 8. Kinder Morgan has been steadily reducing its outstanding debt over the past several years. With every passing year, even as the company has raised its dividend, it's also managed to find enough cash to chip away at its debt load.

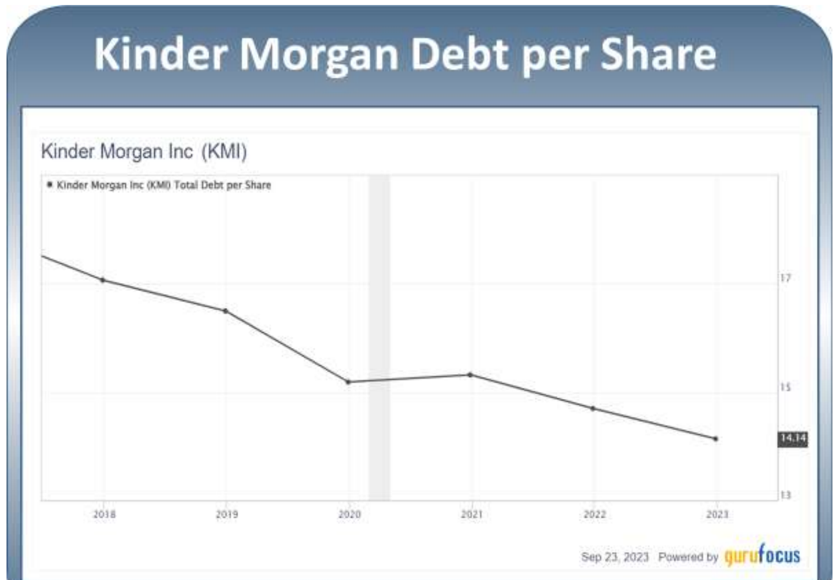

Figure 8

Let's talk yield.

It's rare to find high-yield companies that are also growing. Along with REITs, MLPs are one of those precious few exceptions. The lowest-yielding of the group still yields more than the T-bill rate while also offering distribution growth potential of 5% per year or better.

I like every pipeline stock across both portfolios. But if you're wanting to pick and choose, I would break it down like this.

For taxable, non-IRA money, Energy Transfer is my favorite. This has traditionally been one of the more aggressive MLPs, and it remains unabashedly a growth stock. But it's also more conservative than it used to be, so I'm not expecting the heartburn that often came with this stock in the past. And with a yield of about 9%, you're going to have a hard time finding anything that yields more than that without taking a lot more risk.

If you want something a little less aggressive, Enterprise Products is also a fantastic long-term grower and one that takes more of a slow and steady approach than Energy Transfer. It yields about 7.4%.

I expect both of these to do exceptionally well over the next year or more, so ideally you'd buy or add to both.

With IRA money, your options are a little more limited, but I still really like Kinder Morgan. The risk profile is roughly the same as Enterprise Products, and the yield is in the same ballpark at 6.8%.

But again, I like every pipeline play in the portfolio, and if your spare cash allows, I'd recommend allocating to all.

I have no new recommendation this month, but I do strongly recommend revisiting your pipeline positions. Of all the positions currently in the portfolio, I believe these are the most likely to generate strong, market-beating returns for the remainder of this year.

So…

Action to take: Consider adding additional capital to your pipeline investments. In particular, consider adding to Energy Transfer (NYSE: ET) and to Enterprise Products (NYSE: EPD).

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

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 alternatives that can offer competitive 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
NextEra Energy Partners, LP	NEP	6/30/2023	$50.66	$48.84	$38.75	6.78%	$ -	-3.59%	Yes	Buy
Essential Properties Realty Trust	EPRT	8/4/2023	$23.59	$22.53	$18.10	4.61%	$ -	-4.49%	Yes	Buy
National Storage Affiliates Trust	NSA	6/30/2023	$34.82	$32.93	$26.98	6.80%	$ 0.56	-3.82%	Yes	Buy
Nintendo Company Ltd	NTDOY	5/26/2023	$10.69	$10.37	$8.34	3.49%	$ -	-2.99%	Yes	Buy
W.P. Carey Inc	WPC	4/26/2023	$73.59	$57.68	$59.92	7.40%	$ 1.07	-20.17%	Yes	Buy
Nuveen Real Estate Income Fund	JRS	1/30/2023	$8.46	$6.80	$6.41	9.77%	$ 0.34	-15.60%	Yes	Buy
iShares MSCI Brazil ETF	EWZ	12/26/2022	$28.79	$31.17	$20.15	11.26%	$ 0.76	10.89%	Yes	Buy
Atlantica Sustainable Infrastructure	AY	11/22/2022	$27.75	$20.75	$20.41	8.48%	$ 1.34	-20.41%	Yes	Buy
Cheniere Energy Partners	CQP	8/4/2022	$46.49	$55.23	$41.42	6.32%	$ 1.07	21.10%	No	Buy
Citigroup Inc	C	6/23/2022	$47.34	$40.92	$36.00	4.99%	$ 1.02	-11.41%	Yes	Buy
ONEOK, Inc.	OKE	4/28/222	$65.50	$66.19	$47.91	5.77%	$ 2.81	5.34%	Yes	Buy
Energy Transfer Partners	ET	12/27/2021	$8.16	$13.82	$8.59	8.97%	$ 0.87	80.02%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$41.89	$33.92	7.88%	$ 3.20	-5.63%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$166.28	$132.62	3.63%	$ 7.02	67.72%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$32.27	$20.49	8.06%	$ 2.68	59.30%	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	$ 36.09	None	6.10%	$ 2.22	-1.96%	Yes
Conagra Brands	CAG	6/23/2022	$ 32.47	$ 28.86	None	4.57%	$ 1.67	-5.97%	Yes
The Clorox Company	CLX	6/23/2022	$ 132.28	$ 132.66	None	3.56%	$ 5.92	4.76%	Yes
Campbell Soup Company	CPB	6/23/2022	$ 47.04	$ 42.61	None	3.47%	$ 1.85	-5.47%	Yes
Flowers Foods	FLO	6/23/2022	$ 24.97	$ 22.92	None	3.84%	$ 0.89	-4.63%	Yes
General Mills	GIS	6/23/2022	$ 67.90	$ 64.82	None	3.33%	$ 2.75	-0.49%	Yes
J.M. Smucker Company	SJM	6/23/2022	$ 123.83	$ 126.59	None	3.22%	$ 5.14	6.38%	Yes
Target Corporation	TGT	6/23/2022	$ 141.08	$ 112.60	None	3.84%	$ 5.42	-16.35%	Yes
Coca-Cola Company	KO	4/27/2022	$ 65.56	$ 57.60	None	3.06%	$ 2.22	-8.76%	Yes
Prologis	PLD	10/29/2021	$ 146.67	$ 114.07	None	2.77%	$ 5.53	-18.46%	Yes
Crown Castle International	CCI	10/29/2021	$ 181.90	$ 91.98	None	6.39%	$ 10.58	-43.62%	Yes
Philip Morris International	PM	3/30/2021	$ 89.35	$ 94.93	None	5.35%	$ 10.03	17.47%	Yes
Altria Group	MO	3/19/2020	$ 37.10	$ 42.33	None	8.88%	$ 12.48	47.74%	Yes
Realty Income	O	3/19/2020	$ 48.08	$ 51.56	None	5.95%	$ 9.93	27.89%	Yes
AT&T	T	3/19/2020	$ 31.15	$ 15.12	None	7.34%	$ 6.35	-31.08%	Yes
Enterprise Products Partners	EPD	3/19/2020	$ 14.52	$ 27.39	None	7.30%	$ 6.50	133.37%	No
Kinder Morgan	KMI	3/19/2020	$ 11.20	$ 16.60	None	6.81%	$ 3.81	82.23%	Yes
Ventas	VTR	3/19/2020	$ 19.98	$ 42.56	None	4.23%	$ 6.64	146.26%	Yes
Public Storage	PSA	3/19/2020	$ 187.60	$ 263.98	None	3.03%	$ 41.15	62.65%	Yes
International Paper	IP	3/19/2020	$ 30.13	$ 34.07	None	5.43%	$ 6.62	35.04%	Yes
STAG Industrial	STAG	3/19/2020	$ 21.71	$ 34.73	None	4.20%	$ 4.97	82.87%	Yes
Retail Opportunity Investments	ROIC	3/19/2020	$ 7.25	$ 12.82	None	4.68%	$ 1.57	98.48%	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	$22.05	-12%	8.04%	$ -	11.82%
Goldman Sachs Series A Preferred	GS.PRA	3/31/2023	$20.42	$21.30	-15%	6.69%	$ -	4.31%
Bank of America Corp Floating Rate Non-Cumulative Preferred Stock, Series 5	BML.PRL	3/31/2023	$20.24	$20.91	-16%	6.53%	$ 0.33	4.96%
Morgan Stanley | Floating Rate Non-Cumulative Preferred Stock, Series A	MS.PRA	3/31/2023	$20.28	$21.79	-13%	6.77%	$ -	7.45%