The Sizemore Income Letter

November 10, 2023

How Bad is It?

By Charles Lewis Sizemore, CFA

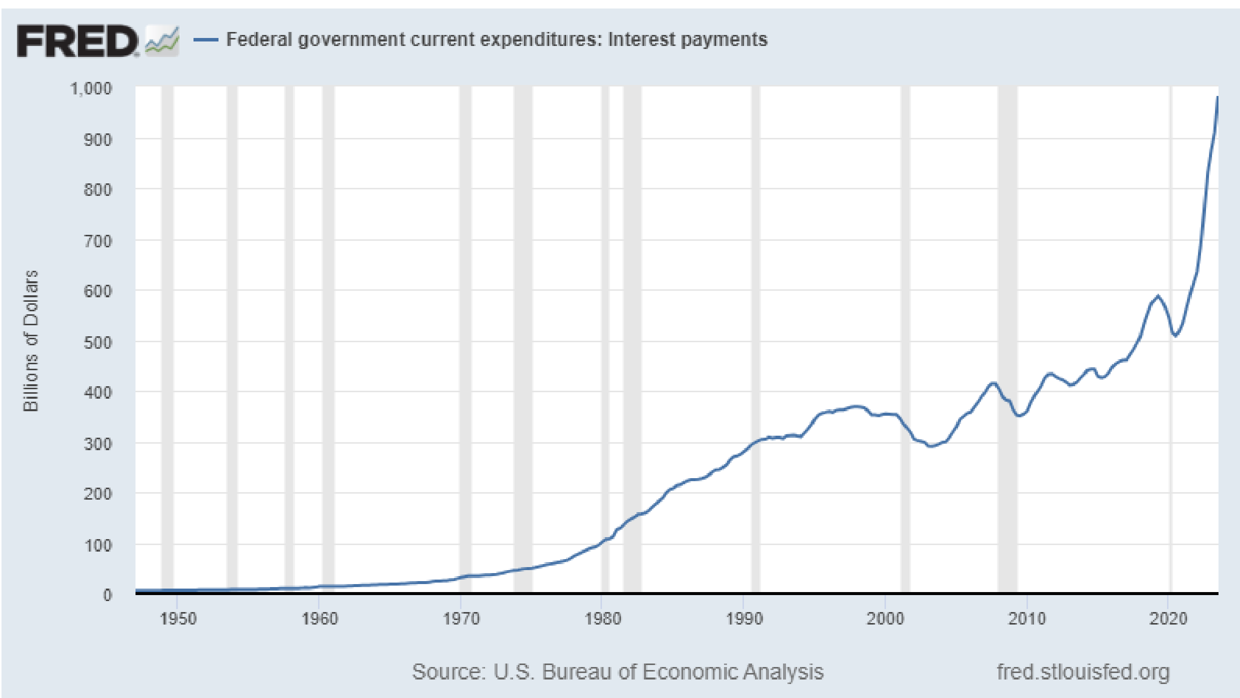
As I alluded last week, I'm doing things a little differently this month. I'm putting together an expanded combo issue, and I wanted to give a sneak preview of some of what I'm looking at.

Trends continue… until they can't anymore. Deficits don't matter… until they do. And the larger trend of a dysfunctional congress and executive branch essentially depending on the Fed to clean up their collective mess has reached the end of the road, it seems.

Let's play with those numbers, shall we?

In 1987, the totality of the federal budget – every nickel that Uncle Sam spent that year – crossed $1 trillion for the first time.

It's never been under a trillion dollars since.



In 2009, federal budget deficit – or the amount that Uncle Sam borrowed to spend – crossed $1 trillion for the first time. That was a pearl-clutching moment. And now it's not only normal, it's actually expected.

2023 marks an even more unfortunate trillion-dollar milestone. Just last month, the annual interest paid on our national debt is estimated to have crossed the $1 trillion mark for the first time. I say "estimated" because, government accounting being government accounting, the official numbers won't be known for a while.

And with the trillions of dollars of debt added to the pile during the pandemic spending spree soon being up for refinancing at what are now much higher rates, interest costs won't be dipping below $1 trillion any time soon. If we balanced the budget tomorrow – and we both know that there's a greater likelihood of me being drafted to play point guard for the Lakers at the ripe old age of 46 with two creaky knees and a blown out rotator cuff on my shooting arm than there is of our government balancing its books tomorrow – the interest expense would still continue to rise as older, lower-interest bonds get rolled into newer higher-interest ones.

Of course, whether I not I ever get that phone call from the Lakers, we know the congressional clown show won't be balancing the books any time soon. Their own purported in-house watchdog, the Congressional Budget Office, actually sees the budget deficit widening from $1.4 trillion in 2023 to $2.7 trillion by 2033… and most of that expansion -- $53% -- will be due to interest paid on debts already racked up.

Our "primary" budget deficit, or current spending over and above current revenues, will be "only" $1.3 trillion.

Our budget deficit will not be $2.7 trillion in 2033, and no, it isn't because I believe that Congress will get sober and rein in spending. I'm not delusional.

No, something will break long before that happens. Bond King Jeff Gundlach, manager of the DoubleLine family of bond funds, says that a "crack of doom" moment is needed to make both democrats and republicans take the deficit seriously. A bona fide crisis.

What will that crisis be?

Your guess is as good as mine. A rational person might have assumed that Fitch lowering Uncle Sam's credit rating might have been it.

It wasn't. It made not one iota of difference to government spending plans.

Will another downgrade matter?

Maybe. Maybe not. But we'll find out soon enough because there is no reality in this or any parallel universe where regular $2.7 trillion deficits year over year can be the norm in 2033. Something will break before then.

Will Social Security Be the Straw That Breaks the Camel's Back?

The current national debt is just over $33 trillion, of which $6.8 trillion is "intragovernmental" debt, or debt the government owes itself.
If you're wondering why the government owes itself money, this is debt owned mostly by the Social Security trust funds.

Here's the dirty little secret on the Social Security trust funds: There actually <u>is no trust fund</u> and never was. In the years when Social Security ran surpluses, bringing in more in tax revenues than it paid out in benefits, that surplus wasn't left sitting in a bank account somewhere. It was invested in government bonds. But all that means is that the money ostensibly set aside for Social Security got spent elsewhere by Congress and was replaced with an IOU. "Surpluses" by Social Security masked deficits elsewhere, but it at least made the accounting look good. (Ok, not "good," but at least slightly less terrible.)
Now even this accounting fantasy is untenable because the retirement of the Baby Boomers has put Social Security into deficit… and the imaginary trust fund that was never actually a trust fund is estimated to be fully depleted by 2034.

Now, what seems more likely to you, that 80 million Baby Boomers accept a Social Security check that's 20% lower each month in order to match current system inflows… or that they demand that their congressman make up the shortfall by pulling spending from elsewhere and divert it to Social Security?

I think we know how this ends. Congress will play with tax rates, lifting the cap on earnings subject to Social Security FICA taxes. They'll also make benefits fully taxable… and may even reduce the benefits paid to higher-income retirees who "don't need it" and Social Security effectively becomes welfare.

In fact, that's exactly what former New Jersey governor Chris Christie said in the November 8 Republican debates.

And I quote, *"The fact is on Social Security, it was established to make sure that no one would grow old in this country in poverty, and that is what we have to get back to.* ***Rich people should not be collecting Social Security****."*

Now, I'm not going to say Christie is "wrong," per se. But the devil is in the details on who exactly you consider rich. Call me a bit cynical, but I imagine anyone with two nickels to rub together will be considered "rich." But I also know that they can't cast that net too widely because they won't want to deal with legions of angry voters wanting their checks back.

I have a few takeaways here.

To start, Social Security benefits will not keep pace with inflation. The safest way politically to reduce the funding burden is to tinker with the inflation adjustment so that the payout grows slower than the actual rate of inflation. It's a stealth benefit cut that you might not notice the first year or two. But you'll notice it down the road.

Inflation also conveniently reduces the value of the outstanding national debt in real terms.

We'll also starting to see real discussion for the first time about means testing Social Security. That's going to be a tough sell politically because even "rich" people paid into the Social Security system expecting to get something in return. But if the money simply isn't there, it simply isn't there, and reducing or eliminating benefits to the top 10% of recipients by income is an easy enough way to partly plug the gap.

The biggest takeaway is that we're going to see a major shift in the government. This is not political. I'm not saying I want this or that it is way things "should" be. I'm saying the government will change because it won't have any other choice. It's broke. Balancing the budget would mean eliminating $1.4 trillion in spending. Hey, a trillion dollars isn't what it used to be, but you're going to notice $1.4 trillion disappearing. That government spending goes somewhere… it represents someone else's revenues.

And raising taxes won't fix it either because raising taxes by $1.4 trillion also takes that money out of the private sector.

Furthermore, cutting spending or raising taxes that aggressively would almost certainly push us into a recession, which would mean lower corporate profits and higher unemployment, both of which will erode the tax base.

There's just flat-out no easy escape from this, which is why I expect the next decade to be turbulent. We're on our own out there.

I'll have more to say on this next week, until then, keep cashing those dividend checks!

Charles Lewis Sizemore, CFA

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'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	$22.56	$18.10	4.61%	$ 0.28	-3.18%	Yes	Buy
National Storage Affiliates Trust	NSA	6/30/2023	$34.82	$30.47	$26.98	7.35%	$ 0.56	-10.88%	Yes	Buy
Nintendo Company Ltd	NTDOY	5/26/2023	$10.69	$11.68	$8.34	3.49%	$ -	9.26%	Yes	Buy
iShares MSCI Brazil ETF	EWZ	12/26/2022	$28.79	$31.80	$20.15	11.04%	$ 0.76	13.08%	Yes	Buy
Cheniere Energy Partners	CQP	8/4/2022	$46.49	$57.34	$41.42	6.09%	$ 1.07	25.64%	No	Buy
Citigroup Inc	C	6/23/2022	$47.34	$41.50	$36.00	4.92%	$ 1.02	-10.18%	Yes	Buy
ONEOK, Inc.	OKE	4/28/222	$65.50	$63.82	$47.91	5.99%	$ 2.81	1.72%	Yes	Buy
Energy Transfer Partners	ET	12/27/2021	$8.16	$13.02	$8.59	9.52%	$ 0.87	70.22%	No	Buy
EPR Properties	EPR	11/29/2021	$47.78	$44.65	$33.92	7.39%	$ 3.20	0.15%	Yes	Buy
Chevron Corporation	CVX	9/30/2021	$103.33	$141.93	$132.62	4.26%	$ 7.02	44.15%	Yes	Buy
ClearBridge Energy Midstream Opportunity	EMO	5/26/2021	$21.94	$31.60	$20.49	8.23%	$ 2.68	56.24%	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	$ 38.22	None	5.76%	$ 2.22	3.49%	Yes
Conagra Brands	CAG	6/23/2022	$ 32.47	$ 27.95	None	4.72%	$ 1.67	-8.79%	Yes
The Clorox Company	CLX	6/23/2022	$ 132.28	$ 132.32	None	3.57%	$ 5.92	4.51%	Yes
Campbell Soup Company	CPB	6/23/2022	$ 47.04	$ 40.64	None	3.64%	$ 1.85	-9.66%	Yes
Flowers Foods	FLO	6/23/2022	$ 24.97	$ 22.16	None	3.97%	$ 0.89	-7.67%	Yes
General Mills	GIS	6/23/2022	$ 67.90	$ 65.53	None	3.30%	$ 2.75	0.56%	Yes
J.M. Smucker Company	SJM	6/23/2022	$ 123.83	$ 109.13	None	3.74%	$ 5.14	-7.72%	Yes
Target Corporation	TGT	6/23/2022	$ 141.08	$ 106.79	None	4.05%	$ 5.42	-20.46%	Yes
Coca-Cola Company	KO	4/27/2022	$ 65.56	$ 56.67	None	3.11%	$ 2.22	-10.17%	Yes
Prologis	PLD	10/29/2021	$ 146.67	$ 103.27	None	3.06%	$ 5.53	-25.82%	Yes
Crown Castle International	CCI	10/29/2021	$ 181.90	$ 95.61	None	6.15%	$ 10.58	-41.62%	Yes
Philip Morris International	PM	3/30/2021	$ 89.35	$ 89.80	None	5.66%	$ 10.03	11.73%	Yes
Altria Group	MO	3/19/2020	$ 37.10	$ 40.10	None	9.38%	$ 12.48	41.71%	Yes
Realty Income	O	3/19/2020	$ 48.08	$ 50.17	None	6.12%	$ 9.93	24.99%	Yes
AT&T	T	3/19/2020	$ 23.69	$ 15.63	None	7.10%	$ 6.35	-7.23%	Yes
Enterprise Products Partners	EPD	3/19/2020	$ 14.52	$ 25.90	None	7.72%	$ 6.50	123.11%	No
Kinder Morgan	KMI	3/19/2020	$ 11.20	$ 16.21	None	6.97%	$ 3.81	78.71%	Yes
Ventas	VTR	3/19/2020	$ 19.98	$ 42.08	None	4.28%	$ 6.64	143.86%	Yes
Public Storage	PSA	3/19/2020	$ 187.60	$ 246.61	None	3.24%	$ 41.15	53.39%	Yes
International Paper	IP	3/19/2020	$ 30.13	$ 33.25	None	5.56%	$ 6.62	32.32%	Yes
STAG Industrial	STAG	3/19/2020	$ 21.71	$ 34.34	None	4.25%	$ 4.97	81.07%	Yes
Retail Opportunity Investments	ROIC	3/19/2020	$ 7.25	$ 11.90	None	5.04%	$ 1.57	85.79%	Yes