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JEFF D. OPDYKE'S

Global Intelligence

Stock Pick of the Year: Tap This REIT for a 4.5% Yield

I'm calling 2024, the Year of the REIT—a year that, I'm expecting, will see real estate investment trusts shoot the moon.

We can thank Jerome Powell and his Securities and Exchange Commission brothers and sister for this likelihood. After insisting for months that the Fed would hold interest rates "higher for longer," the arbiters of the American economy blinked and told the financial markets in December that rate cuts were coming.

Only the most sycophantic Fed groupies believed the higher-for-longer spin. The rest of us suspected it was BS from the beginning.

And we were right.

Now, the Fed is set to cut interest rates—by its own admission—up to three times in 2024, and potentially four times in 2025. I suspect we might see more than three cuts this year, maybe four or five. But I won't quibble, because the only fact that really matters is that the Fed is primed to cut interest rates.

And that's going to propel a lot of financially sensitive stocks higher.

And among those, REITs are going to stand out.

That's why in December I previewed this January issue of the *Global Intelligence Letter* by recommending that you buy **KIMCO Realty Corp**. I did so because I didn't want the stock to run away from us, just in case 2024 trading opened with extreme bullishness.

I was premature in my excitement. The stock has remained in the same $20-to-$23 zone for the last month. But that's fine. I would rather err on the side of caution and send you a buy alert early than miss the opportunity because I was waiting to meet a publishing schedule.

Today, we remain in the buy zone. In fact, KIMCO has slipped a bit in early year profit taking and on decent jobs reports that have some people thinking, "Well, maybe the Fed *won't* cut rates..."

To the degree that assumption exists, it's wrong. The Fed will cut rates, and I will explain why in a moment.

But first, let me tell you why KIMCO and why REITs...

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Modernizing Strip Malls for Profit

KIMCO is America’s largest owner and operator of open-air shopping centers.

Think about the ubiquitous strip malls of the 1970s and 1980s—kinda grungy, a bit seedy, in desperate need of an overhaul… just the sort of place a slasher-movie might be filmed. Now, upgrade those strip-malls so that they’re stylish, open, inviting, airy and bright, with modern design and décor.

That’s KIMCO—a New York-based real estate firm that owns nearly 530 shopping centers along the West Coast, across the Sunbelt, up along the Atlantic Coast, and in the Midwest.

As opposed to a traditional strip mall, KIMCO’s retail centers are more akin to “destination shopping.” High-end and fast-casual dining chains. Landscaped streets and pedestrian walkways. Park benches. Ambient lighting. They’re almost like miniature planned communities. As such, they tend to be magnetic shopping destinations that draw in consumers from a wider sphere than just locals living within a couple miles.

Anchoring a typical KIMCO mall is a grocery store. Some are low-cost leaders such as Albertsons, Publix, Kroger, and Walmart; others are higher-end chains such as Trader Joes, Whole Foods, and Wegmans. Nearly 85% of KIMCO’s “average base rent” comes from its grocery tenants.

Between the anchors are brand-name big-box retailers such as Dick’s Sporting Goods, HomeGoods, Ulta Beauty, Talbots, Hobby Lobby, Home Depot, REI, Marshalls, TJX, PetsMart, Ross Dress for Less, and Burlington, among scores of others.

KIMCO shopping centers are also home to a broad portfolio of “small-shop” tenants that consumers rely on daily: Chase, Bank of America, and Wells Fargo bank branches; Starbucks, Taco Bell, McDonald’s, Five Guys, and Chick-fil-A fast-food eateries; T-Mobile, Verizon, and AT&T phone stores; UPS, Massage Envy, and Great Clips.

In short, KIMCO malls attract consumers because of the quality of the tenants.

Beyond anything else, I like owning exposure to America’s unrepentant and unstoppable consumer addiction. With KIMCO, we don’t have to focus on singling out a specific retailer. We gain exposure to hundreds of America’s top retailers. Basically, with KIMCO we’re buying a retailer-focused mutual fund dressed up in real estate clothing.

Which means we benefit greatly from tax rules that require REITs to distribute 90% of their income as a dividend to investors. Which is why KIMCO kicks off a very nice yield of 4.5%.

But before I jump into the financials, though, let’s look at the macro picture…

Leveraging 'Off-Mall Shopping' for Profits

The COVID-19 pandemic birthed a variety of consumer trends, including a ramp up in online-shopping, curbside pickup, and a preference for open-air malls as opposed to closed in spaces.

KIMCO's tenants are beneficiaries of those trends, which means that KIMCO shareholders are beneficiaries.

One of the bigger trends is something that has come to be known as "off-mall" shopping—or shopping closer to home, in smaller shopping centers (like those run by KIMCO) as opposed to the hassles of getting in and out of large, traditional malls. These smaller, local shopping centers put retailers closer to their customers, making shopping even more convenient, particularly online-shopping that leads to in-store delivery, which is becoming increasingly popular.

As Bath & Body Works reported in a conference call last spring, "We are prioritizing investments in… new off-mall store openings, including about 90 new off-mall stores… offset by about 50 closures mostly in [traditional] malls."

Driving this trend are consumers that are weary of hunting for parking in ocean-sized mall parking lots, and having to trek across those vast stretches of concrete only to then have to then navigate through a huge mall to reach their destination store.

Open-air centers, by contrast, often have abundant parking very near the store the consumer aims to visit. Moreover, open-air centers are far more convenient for curbside and in-store pickup/online-order return since the stores abut the parking lot. They're also more convenient for in-and-out retail/food pickup. And consumers clearly see this as a winner.

Home Depot last fall announced that "nearly half of our online orders were fulfilled through our stores." At Target, it was nearly 97%. Overall, the National Retail Federation reports that 70% of eCommerce sales are being fulfilled in-store these days. And that's great news for KIMCO because it means:

- More shopping-center visitors, who are likely to end up shopping at more than one retailer, or who will stop for lunch, dinner, coffee, or a snack.
- And more and more retailers interested in leasing space at KIMCO's collection of shopping centers to be nearer to and more convenient for their customers, which is good for me and you because demand drives lease revenue, which drives our dividend stream.

That's because of the legal quirk with REITs.

They don't operate like traditional companies, as least in terms of taxes.

With a traditional company like, say, McDonald's, revenues are taxed before net profits are distributed to shareholders, who are then taxed on the dividends they receive. It’s what I call a vaguely immoral arrangement in which the same dollar of profits is taxed twice—once at the corporate level, and again at the investor level.

Because of the way tax laws are written, REITs bypass corporate taxation. Instead, they must, by law, distribute at least 90% of their income as a dividend to shareholders, who are then taxed on that dividend. It’s a much fairer form of taxation in that almost all profits flow directly to shareholders, who then pay the taxes on those profits. Thus, profits are taxed just once.

For that reason, REITs historically have been go-to assets for income-oriented investors because REIT yields tend to be much larger than with the overall market. Indeed, KIMCO’s 4.5% yield is three times the S&P 500’s overall yield of about 1.5%.

REITs also differ in the way they’re valued.

Most companies report the ubiquitous “earnings per share,” (EPS) from which is derived the so-called P/E (price/earnings) ratio. (Nothing more complex that dividing the stock price by the per-share earnings as a way to gauge how much investors are currently paying to own $1 worth of a company’s annual earnings. Higher P/E ratios tend to attach to fast-growth companies, momentum stocks, and stocks that are overpriced for one reason or another. Lower P/E ratios tend to attach to slower-growth companies, undervalued stocks, and companies either in turn-around mode or in a dying industry.)

REIT earnings, however, are hit by all kinds of non-cash charges for items such as property depreciation, which is sort of odd given that property tends to appreciate in value. Those non-cash charges obscure a REITs true earnings power.

So, instead, the industry uses something called Funds from Operations, or FFO. It’s the REIT version of EPS.

KIMCO is a good example of what that looks like.

The company’s earnings per share for 2023 should come in at about $0.95. At a current share price of $20.85 as I write this, KIMCO’s P/E ratio is 21.9, a fairly high number which would potentially imply an overpriced stock.

But in terms of FFO, KIMCO should report $1.55 per share, which means the stock’s price-to-FFO is just 13.5. From a valuation perspective, that’s a far-cheaper stock, particularly relative to the overall market. The S&P 500 right now is trading at a P/E approaching 25—expensive and well above historic norms in the mid-teens.

Fed Action in 2023 Will Mean Good News for REIT Investors

The other big macro issue is, as I mentioned at the outset, the switch from higher interest rates to lower.

REITs live and die by way of financing. They regularly take on large bags of debt to finance property acquisition and the upgrades that are almost always necessary.

When rates are low and money is widely available, REITs thrive. They have easy access to low-cost cash, which allows them to grow and expand, and to easily manage their debt burden. Investors love REITs in a low-rate environment because the growth and expansion means ever-increasing dividend payments since REITs are basically Wall Street's version of an ATM.

However, darkness falls upon the industry when rates are high and money is tight. In that environment, REIT life is suddenly more challenging.

Access to loans is limited or non-existent, and higher rates imply higher debt-repayment costs. That flows through a REIT's financial operations and hits its bottom line. Softer profits, in turn, temper investor interest in REITs and, so, REIT prices on Wall Street tend to sell off. Again, KIMCO serves as a good example of that, as well.

Between March 16, 2022, when the Fed launched its rate-hike campaign, through the end of last October, KIMCO's shares lost a quarter of their value.

Higher rates also hit REIT tenants. Higher rates slow consumer spending to a degree and, again, increase debt-servicing costs. As tenants crumble, REIT revenue suffers.

Which is what we've seen in the wake of the Feds' interest rate-hike cycle that began in March 2022.

Interest rates that were near 0% (free money, basically) are now at 5.5%. KIMCO's profits have taken a hit as a result, falling to about $0.95 per share from $1.60 in 2021. KIMCO executives highlighted the challenges in their third quarter conference call last year, the most recently reported quarter. Conor Flynn, the company's CEO, told Wall Street analysts that "the headwinds... cannot be ignored. As a result of the dramatic rise in the 10-year Treasury due to persistent inflation, in all likelihood we will remain in a higher-for-longer interest rate environment for the foreseeable future" that will impact KIMCO's operations.

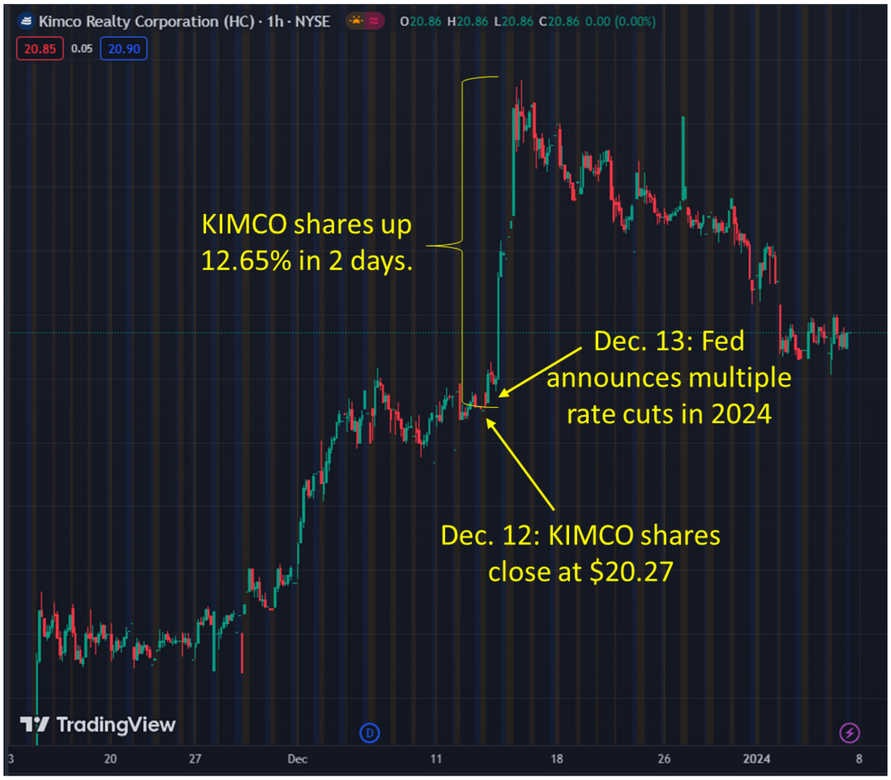
I will note that the CEO made those comments in late October, nearly two months before the Fed announced that higher-for-longer was morphing into cutting-sooner.

And that's the flipside I want exposure to as an investor.

While higher-for-longer hurt KIMCO and most other REITs, lower rates will benefit them greatly.

It means easier and increasing access to cash they can use to expand. It means increased profits as debt-servicing costs decline. And it means consumers will have more money to spend since their debt-servicing costs decline as well.

It’s a very simple calculus, not a lot of highbrow analysis to it. Nevertheless, that simple calculus shapes investor sentiment, and investors immediately rushed into KIMCO shares on news that the Fed expects to cut rates multiple times in 2024. Consider this chart of KIMCO’s stock price:



KIMCO shares up 12.65% in 2 days.

Dec. 13: Fed announces multiple rate cuts in 2024

Dec. 12: KIMCO shares close at $20.27

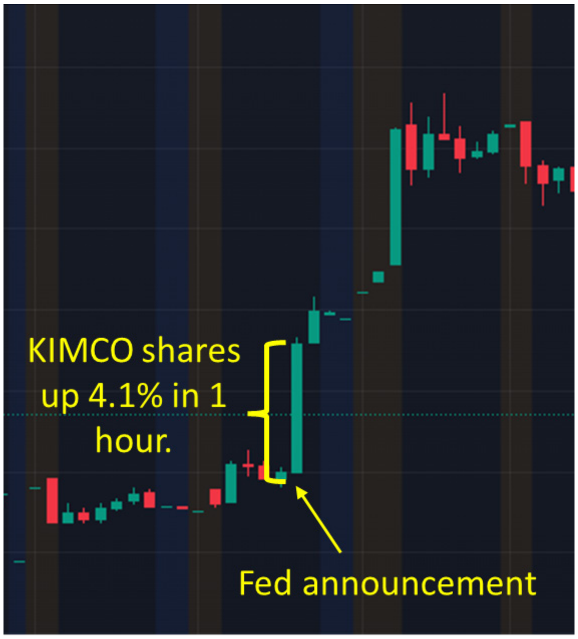
The Fed’s rate-cut announcement came on the afternoon of Dec. 13. By the market’s close on Dec. 14, KIMCO shares had risen nearly 13% in just two days.

They have since retreated back toward their starting point. Part of this, no doubt, is the annual event known as “tax-loss selling” that investors use to mitigate their taxes for the year. And some of it was just investors taking quick and easy profits.

But it’s the message of that increase I want you to hold onto: Investors immediately aped into KIMCO on the Fed news because they reflexively know rate cuts are great news for REITs.

Thus, as 2024 unfolds, and as those rate cuts materialize, KIMCO’s share prices will rise.

We want to get into KIMCO early because we don’t know when the Fed will actually announce the first rate cut. Waiting until that moment will be too late. The shares will rise in anticipation of a pending cut, and they will shoot higher before we can react. Indeed, here’s a smaller, expanded sliver of that same KIMCO price chart (right).



KIMCO shares up 4.1% in 1 hour.

Fed announcement

KIMCO shares surged more than 4% within one hour of the Fed's rate-cut announcement.

Once the Fed officially announces its first rate cut, KIMCO will pop, and it will likely keep drifting higher across the year as investors anticipate upbeat quarterly earnings reports from the company, and as they anticipate future Fed rate-cut activity.

As I always say, it's better to arrive to a party early and wait around for the fun to begin than it is to arrive after everyone has already started drinking and dancing. In Wall Street terms, arriving early means you're there for the "easy money"—the big, early gains. That's where I want to be.

RECOMMENDATION: Buy KIMCO Realty Corp. (symbol: KIM) at prices up to $23.50 per share.

Risk: I'm assigning KIMCO a higher risk rating because this is a stock in the financial sector, and financial stocks can be very volatile and prone to knee-jerk reaction to economic news. That said, I will say that we are going into a REIT-friendly environment, and I think that will mitigate some of the downside risk.

Because KIMCO is a U.S.-based company, you will find it available through any U.S.-based brokerage firm, so you will have no trouble trading it in a traditional brokerage account or in a retirement account such as an IRA, or a 401(k) with a brokerage window.

My price target is between $35 and $40 per share, which, if we see the high end of that range, would imply a doubling from the current price.

I get to my price estimate by looking at where KIMCO's price-to-FFO has typically traded in normalized situations, meaning low-rate environments and those not impacted by, say, a global pandemic.

You have to go back to the early 2010s for that. Interest rates were rising starting in 2015, and then the world suddenly fell apart when COVID arrived in 2020. So that last eight years aren't prototypical years for a REIT.

But the early 2010s were great. Rates were falling or were stuck near 0%. KIMCO's price-to-FFO was regularly in the high teens because investors were high on the stock in a falling/low-rate environment—exactly what we're going into.

When I look out to 2026-27, I see an FFO in the range of $2.00 to 2.25 per share.

I am giving KIMCO a P/E ratio of 17 to 18, a modest expansion from the current level, and in line with what the company sported in the early 2010s, when the financial environment was beneficial to its operations. Based on those numbers, we get to a price somewhere between $34 and $41—thus, my price range.

Along the way, we're going to collect dividends that will amount to $0.92 per share in 2024 and likely more as two recent acquisitions flow through the income stream.

Those acquisitions are a good place to begin wrapping up this issue of *Global Intel*.

Despite the way I described the high interest-rate environment as challenging for REITs, it can also be an exploitable opportunity for deep-pocketed REITs with cash to spare. Which is the case with KIMCO.

The company has used the high-rate environment to its advantage in acquiring new assets that will help grow revenue, profits, and dividend distributions.

In the last several months, the company has closed on two beneficial deals.

In August, it snapped up Stonebridge at Potomac Town Center, a high-end shopping center anchored by Wegmans. It's in metro DC and is populated by a demographic of consumers whose average household income is $115,000, more than double the national average.

FIREBIRDS
FIREBIRDS

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Stonebridge at Potomac Town Center—Woodbridge, Virginia

As the company's chief investment officer Ross Cooper noted in the October conference call, "Historically, [Stonebridge] is an asset that every institutional owner would be chasing and would likely have" offered premium pricing to own. "However, with financing tight and for a large deal size, Kimco stood out with its ability to close" with an all-cash deal and at great terms for KIMCO.

And late last year, the company closed on its purchase of RPT Realty, snapping up 56 properties from Florida, up through Tennessee, parts of the Midwest, and into

Massachusetts. That purchase in particular is expected to immediately add to KIMCO's funds from operations, which means it will boost our quarterly dividends across 2024 and beyond.

MARY BRICKELL VILLAGE
LA FITNESS
Publix
STARBUCKS COFFEE

©GreenBench Companies

Mary Brickell Village—Miami, Florida

I suspect we're going to see KIMCO announce other, similar purchases in 2024. The company has noted that it's in conversations with other real estate companies that are facing debt maturity issues (the high-interest rate problem). Rates won't come down fast enough for some of those companies to keep going, and so they'll be looking to sell offer prized properties this year.

KIMCO, as the biggest player in the field, and with access to roughly $2.4 billion in immediate liquidity, is in a great position to snap up signature assets that, in turn, will drop more money into our wallets by way of increasing dividends.

All those reasons—falling interest rates, portfolio growth, cash to exploit more opportunities—is why I fundamentally believe KIMCO is going to be a winner in the Year of the REIT.

PORTFOLIO REVIEW

Bitcoin Leading the Charge on Cryptocurrency

Where to start this month's portfolio review seems obvious: Bitcoin.

After years of saying *no* to an exchange-traded fund based on bitcoin's spot price (the ever-changing price you see quoted during the day), the Securities and Exchange Commission finally said yes.

The agency in mid-January gave the nod to a number of bitcoin ETF applications.

And in response... bitcoin has fallen.

It's a "buy the rumor, sell the news" event. It's common on Wall Street. Hearing rumors Microsoft will blow away analysts' quarterly earnings expectations? You buy Microsoft shares for the run-up to the conference call, when the shares are rising.

Then... dump when the expected news is announced.

Very traditional. And very short-term in focus. I mean, a stock's share price in the moment has no impact on a company's business model. Whether or not Microsoft is up or down on a given day doesn't really change the fact that Microsoft is still selling and developing products. All we really care about as investors is Microsoft executing over the long run.

Same with bitcoin.

All we really care about is the long-term dynamics driving bitcoin and the new ETFs.

Those dynamics include the trillions of dollars that will be moving into these ETFs in coming weeks and months as institutional players in particular look to fill their ETFs with bitcoin.

The conspiracy theorist in me thinks the sell-off is also tied to institutional players purposefully driving down the price so they can load up their ETFs at a better price. I could be wrong about that, but we've seen things like this in the past, so there's that.

Whatever the case, I continue to recommend you add to your position in bitcoin, as well as Ethereum, the world's #2 crypto.

After spending much of the last year without BTC and ETH positions solidly underwater, we are now in the green.

BTC is up more than 20%, while Ethereum is up about 8%.

Our Grayscale Ethereum Trust is still down more than 1%, but that's because the trust doesn't track ETH 1:1. That's a function of the quirky nature of a trust vs. and ETF that reflects the current value of the underlying assets.

That said, the Grayscale ETH Trust is an interesting play at the moment. Grayscale will very likely end up converting the trust to an ETF. Several applications for an ETH ETF are in front of the SEC and it seems obvious the agency will approve those now that is have approved a BTC ETF. When (if) that happens, the value gap between the trust's price and the value of its assets will instantly close. If that were to happen tomorrow, it would mean the Grayscale ETH Trust would almost instantaneously surge to a roughly 8% gain from a 1.4% loss.

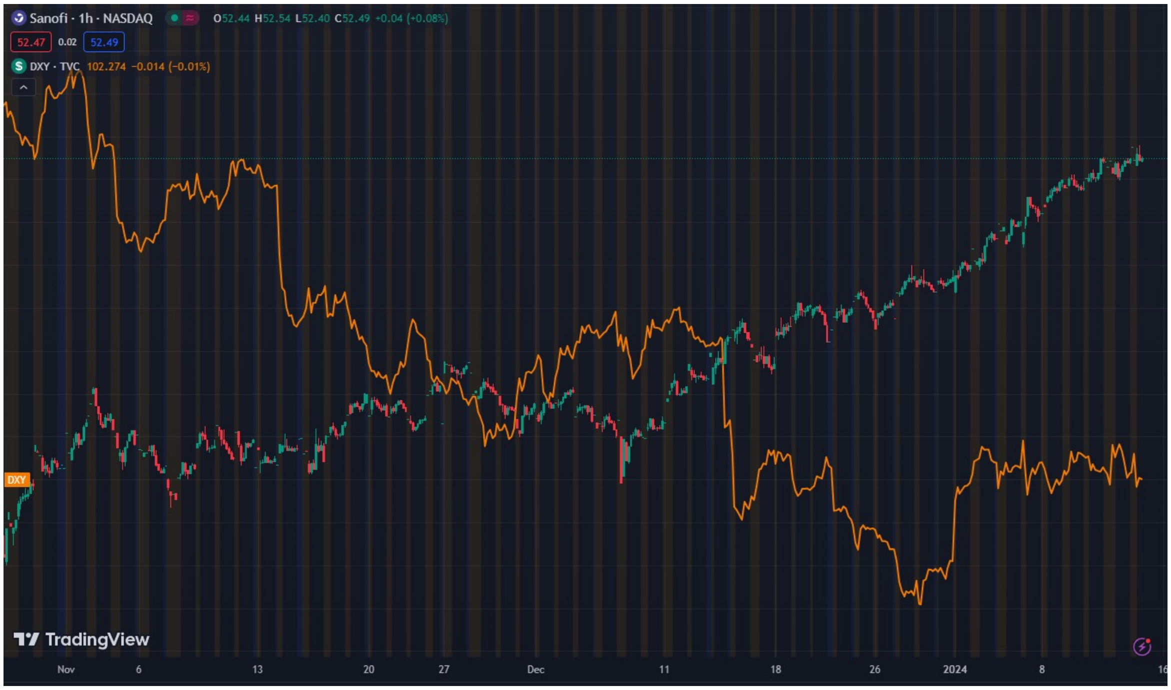
So, if you're a risk-tolerant investor, this is an opportunity. (Also, to address why we have the Ethereum and the Grayscale trust in the portfolio, it's because not everyone wants to trade crypto through a crypto exchange like Coinbase. Some would rather trade crypto in their retirement account or a traditional brokerage account. With the Grayscale Trust, you can do that. So, I originally recommended Ethereum and the trust at the same time so that everyone had a way to play that trade, if they wanted to.)

Crypto is going to see sharply higher highs this year. Buying on temporary sell-offs will prove very beneficial to your wealth.

Before wrapping up, I want to point you toward Sanofi, the French drugmaker we own.

Sanofi has been executing well and kicking off dividends, so all is copasetic. But what I specifically want to address is Sanofi vs. the U.S. dollar. One of *Global Intel's* underlying themes is diversifying some of our assets away from the dollar because of financial prudence and opportunity.

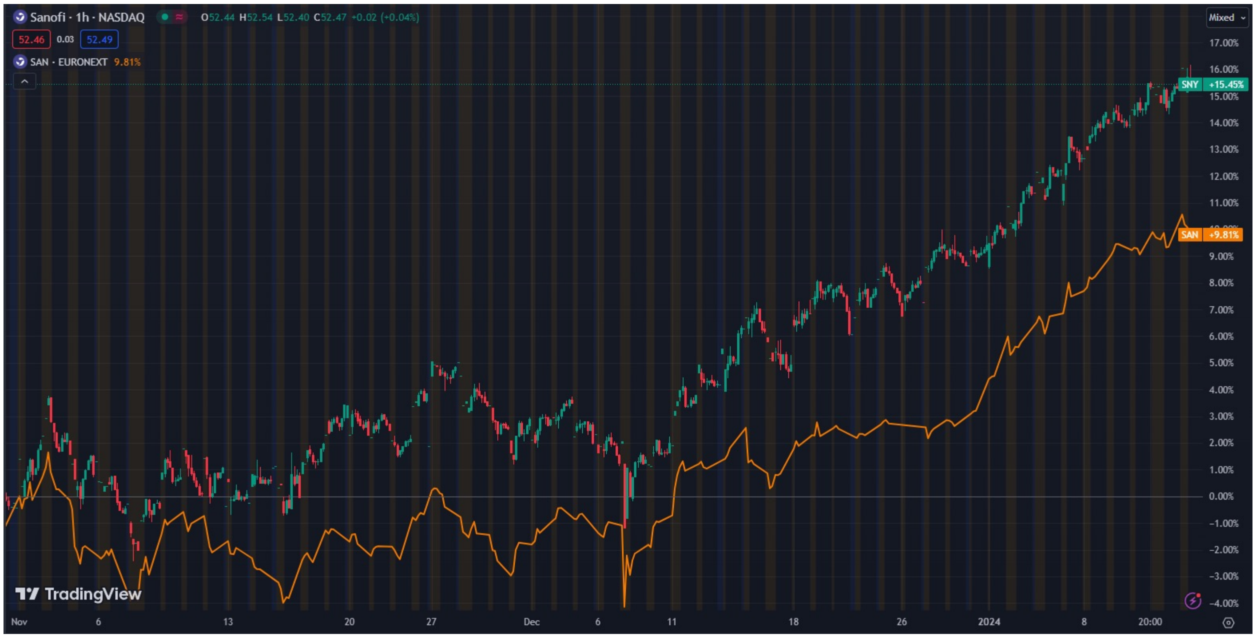
These two charts explain my reason for bringing Sanofi to your attention:



The orange line is the U.S. Dollar Index, the red/green line is Sanofi. This goes back about 3 months.

During that time, the dollar has been falling as Sanofi has been rising. Now, that could be just a function Sanofi executing well and nothing to do with the dollar.

True, but consider this chart:



That's Sanofi vs. itself.

Red/Green is the Sanofi shares we own in the U.S. Orange is Sanofi back on its home market in Paris.

The Parisian shares are up 9.8% in the last three months... the U.S. share are up 15.5%.

The gap is entirely because the dollar is falling in value relative to the euro (and other currencies).

This is why I want foreign-stock exposure on our portfolio. As 2024 progresses, we're likely to see the dollar continue to yield ground. The Fed will be cutting rates and that wilk make the dollar increasing less attractive to investors, who will sell it to own the euro and other currencies.

So, assuming the foreign companies we own continue to execute well, we're likely to have a weak-dollar tailwind boosting our returns this year.

Thanks for reading, and here's to living richer.

Jeff D. Opdyke

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Editor, *Global Intelligence Letter*

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