Wealthpin Pro

NOVEMBER 2022

Well, it's been a month of contradictions.

It seems like one person could look at the economic news, and say:

> *"Everything is going to be fine!"*

While someone else could look at the same information and say:

> *"We're in trouble!"*

And the weird part is, both could be right.

Take earnings for instance.

On one hand, FAANG (Facebook, Apple, Amazon, Netflix, and Google) are getting hammered.

Facebook (now Meta) has lost $800 billion. Just a year ago, they were a trillion-dollar company.

Following their earnings call, Meta stock dropped 24% in just five days.

They're now down 73.7% on the year.

Google is down 42%.

Netflix is down 60%.

And Amazon is down 45%.

Apple has proven to be the most resilient of the tech stocks – it's only down 24%.

FAANG stocks comprise 15% of the S&P 500.

So, if these companies are down this much, you would think that the S&P 500 would be in free fall.

But that's just not the case.

In fact, the S&P 500 finished up 4% in October.

But this resiliency isn't just present in the S&P.

The Dow just finished its best month since 1976, rising 14%.

All of this on the back of multiple rate hikes by the Fed, less than stellar manufacturing data, a still-stagnant supply chain, and a crumbling housing market.

Now just that, but outside of tech stocks, earnings are holding up surprisingly well.

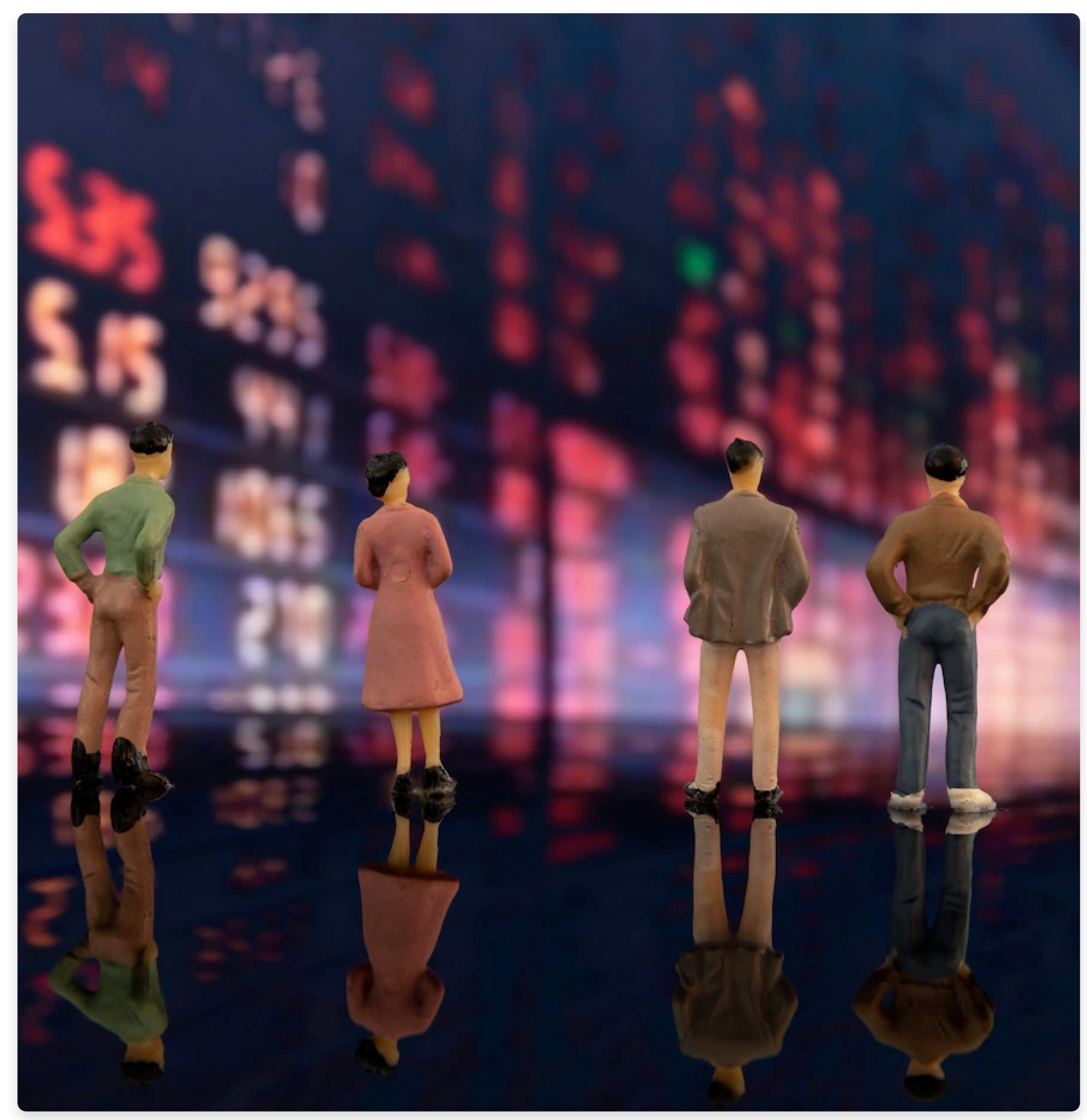
As of this writing, three quarters of reported earnings have topped forecasts.

And for the S&P 500 as a whole, revenue is expected to grow 8.6% over the next quarter.

Very confusing, indeed.

What should we make of this?

Well, I think we should make of it exactly what it's showing us:



That we have a robust economy that's being tamped down by aggressive fed rate hikes, and rather than crash, will move sideways until the inflation and/or Fed rates subside.

There's obvious cracks emerging in the economy, of course.

The collapse of tech stocks – which carried the markets to all-time highs over the last decade – are one of those cracks.

On the global scale, there are other cracks emerging, which we'll get to in a moment.

But for now at least, the economy is holding up well, albeit a bit unevenly.

However, while things may be going decently in the U.S., our cousins across the pond are having a tougher time of things.

CENTRAL BANKS BEWARE! THE BOND VIGILANTES ARE BACK

We've all read the comic books, or seen the movies.

Crime is running rampant, the law is useless, or maybe even participating in the crime itself.

In order to bring order to the world, a hero dons the cap and cowl.

And metes out vigilante justice to bring balance to the city.

In the 1970s, U.S. economist Ed Yardeni used this well-known comic book trope to coin the phrase "bond vigilantes."

If central banks failed to control the "crime" of inflation, Yardeni argued, these bond vigilantes would push up yields, trigger a recession, and bring inflation down themselves.

Not only that, but these bond vigilantes would mete out justice on budget deficits, too.

If politicians got a little too loose with the purse strings, the vigilantes would saddle up and cause interest rates to rise.

Voters would blame the politicians, who would in turn find it harder to increase spending or cut taxes.

Bond vigilantes were a powerful force in global financial markets up until the last 1990s.

But then they mysteriously disappeared for twenty years.

Until three weeks ago, when they reappeared on the world stage and played a key role in the U.K.'s near miss economic catastrophe.

But where did they go? Why did they come back? And what does this mean for the world economy?

UNMASKING THE VIGILANTES

First off, who are the bond vigilantes?

They're institutional investors who buy lots (I mean lots) of government bonds.

They can be:

- **Insurance companies**
- Pension funds
- **Bond funds**
- Hedge funds
- **Individual investors (but whale-sized)**

Usually, the vigilantes purchase bonds with an enormous amount of leverage and via complex derivative contracts.

To run with the superhero metaphor for a bit longer...

If bond vigilantes are Superman, what's their kryptonite?
Inflation.

They hate it.

Because inflation eats away at the purchasing power of bond yields.

Think about it.

If you hold a bond at a 4% interest rate, but inflation is at 8%, well, you're losing money.

A TWO-DECADE HIBERNATION

However, for twenty years, Central Banks around the world were able to keep the bond vigilantes at bay.

Post 2000, the world experienced a massive growth in globalization.

And along with that came a massive economic boom.

So, despite keeping interest rates low, central banks were able to avoid high inflation simply because the economic growth engine was humming like a well-oiled machine.

Well, that period has come to an end.

Inflation is out of control.

In Germany, it's over 10.7%.

In Britain, it's 9.9%.

Official numbers in the U.S. have it at 8.5%, though you have to take government numbers with a grain of salt.

In reality, it may be quite a bit higher.

Central banks are tightening their belts and increasing interest rates to stem the tide of inflation.

At the same time, growth is stalling hard, so the central banks don't want to raise interest rates too much...

But this just prolongs inflation.

Instead of just ripping the band-aid off and quickly raising interest rates to where they need to be…

The Fed as well as other central banks have been taking a wishy-washy approach.

They've inched the interest rates higher bit by bit.

This has had the dual effect of slowing the economy, but not really helping inflation all that much.

Which makes the bond vigilantes very, very angry.

So, they've emerged from their slumber to exact revenge…

And force the central banks' hands.

U.K. ON THE BRINK

To illustrate just how powerful the bond vigilantes can be, last month they were responsible for overthrowing the Prime Minister of the U.K. and nearly collapsing the entire U.K. financial system.

Yeah, I told you they were powerful, didn't I?

No wonder central banks wanted to keep them locked away.

Here's how it all went down.

The way bond vigilantes enact their unique form of justice is, as you might have guessed, through the bond market.

When Liz Truss and the Conservative Party came to power in September, they immediately began to push the largest tax cuts since the 80s and a massive increase in spending.

LIZ TRUSS

In other words, **highly inflationary policies**.

Which was pretty tone deaf, considering that inflation at the time was over 10%, they were facing an energy crisis, and millions of U.K. citizens were being pushed into poverty by rising costs.

The bond vigilantes had had enough.

10-yr British gilts — the equivalent of U.S. Treasury bonds — spiked to 4.5% in a little under a month.

That's an ENORMOUS increase for such a short time.

And this sent the U.K bond market haywire.

You see, the main assets held by U.K. pension funds are gilts.

These are the British equivalents of U.S. treasury bonds.

Totaled up, the pension funds represent £1.5 trillion of assets. That's two-thirds of the U.K.'s entire GDP. These pensions are what's called "defined benefit" pensions.

This means, no matter what happens to the markets, pensioners are guaranteed a certain payout. Since gilts (like treasury bonds) rise or fall based on interest rates, fund managers needed a way to keep their assets stable and the payouts flowing.

To deliver on that promise, they turned to 'liability driven' investment plans, or LDI's for short.

There are plenty of complicated details to these LDI's, but the crux is this:

To maintain stable payouts, LDI's engage in multiple types of derivative trading, like interest rate swaps.

If derivatives sound familiar to you, it's probably because they're the same thing that triggered the Global Financial Crisis back in '08.

Derivatives are dangerous because they usually rely on leverage.

Which means the bankers get to play with money that they don't actually have.

And these U.K. pension funds? Most of them are operating at 2X-7X leverage.

This is all fun and games while the times are good.

But boy oh boy can things change fast.

Once things start going bad, leverage means you're losing multiple times the amount of money that you actually have.

In other words, you're bankrupt.

And that's what happened to U.K. pension funds In late September.

The sudden, enormous increase in U.K. interest rates caused the long-term gilts owned by the pension funds to drop in value.

And the funds got margin called.

Normally, they would have weeks or even months to come up with the cash.

But due to the complete and utter failure of U.K. financial policy over the past few years, the banks had literally hours.

And many of the funds didn't have anywhere near the amount of cash they needed.

So, what did they do?

They started selling their gilts — all at the same time.

So many gilts hitting the market pushed interest rates higher, increasing the margin calls on the pension funds.

In turn, the funds started selling more gilts.

It was a financial doom loop.

Eventually, the market seized up. Funds were faced with massive margin calls.

But so many gilts had flooded the market in such a short time, that according to one anonymous banker, at one point Wednesday morning, "there were no buyers for long-dated UK government bonds."

Which means no way for the funds to meet their debt obligations.

The entire U.K. financial system was about to implode.

To stop the carnage, the Bank of England stepped in.

They agreed to begin buying up government gilts again, to the tune of £65 billion.

And the Bank agreed to continue to do so at "whatever scale is necessary."

This is a perfect example of how powerful the bond vigilantes can be.

All of this economic chaos caused Liz Truss to be ousted. She would become the shortest-serving Prime Minister in history.

RISHI SUNAK

And now, **Rishi Sunak** — the Prime Minister who replaced Truss — is calling for austerity.

Which if you didn't know, it an anti-inflationary fiscal policy.

In other words, the bond vigilantes were literally responsible for replacing a head of state with another person more amenable tom their goals.

Very powerful, indeed.

With inflation still raging around the world, it will be interesting to see what other measures these bond vigilantes take in order to force the hands of central banks around the world.

THE RIGHT MOVES IN THE FACE OF UNCERTAINTY

If you've gotten anything out of this issue so far, it can be summed up in one word:

Uncertainty.

Inflation doesn't show signs of abating, the Fed is going to continue to tighten, equities are still performing well, and job growth remains strong.

All of these things shouldn't be happening at once.

But they are, so for investors trying to orient themselves, what do they do?

Do they take a risk-on approach, and dump their money in high-growth equities?

Or scale back and make defensive plays in stable equities and/or bonds?

We're going to split the difference this month, and recommend a company that can provide the best of both worlds.

FARMLAND PARTNERS INC. (NYSE: FPI)

PRICE AT RECOMMENDATION: $13.82

MARKET CAP AT RECOMMENDATION: $746.6 MILLION

SHARES OUTSTANDING: 54.58 MILLION

52-WEEK RANGE: $10.62-$16.43

THE ELEVATOR PITCH

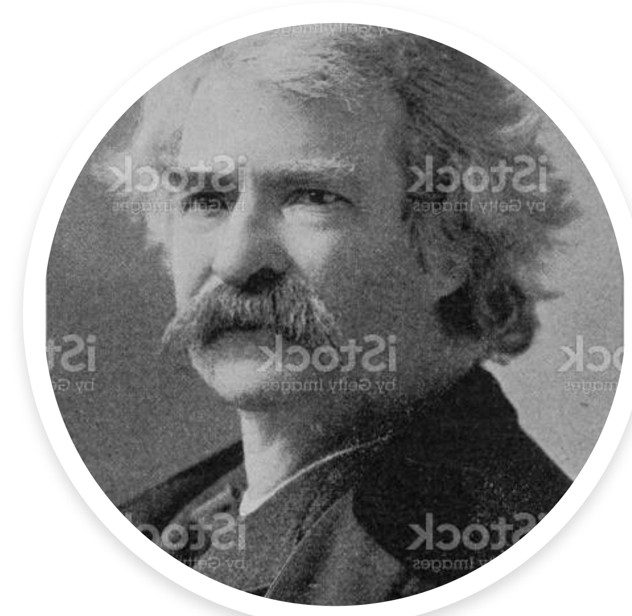
If there's one investment that's held up throughout all of human history, it's farmland.

The more people there are, the more food needs to be farmed.

And land is a very limited resource.

Like the great Mark Twain once said,

"BUY LAND, THEY AIN'T MAKING IT ANYMORE."



Take a look at this chart courtesy of TIAA:

Table 2: Asset return characteristics, 1970 to 2019[6]

Asset/Index	Annual average return	Standard deviation	Coefficient of variation	Correlation	Minimum return	Maximum return
		------------- 1970 - 2019 -------------				
U.S. ag 32 states	**10.2%**	**6.5%**	**0.64**	**1.00**	**-5.8%**	**27.0%**
U.S. equities	7.1%	16.5%	2.31	-0.25	-48.6%	29.3%
European equities	6.1%	20.3%	3.35	-0.23	-59.9%	51.2%
U.S. corporate bonds	7.5%	2.6%	0.35	0.09	3.4%	14.2%
U.S. 10 year bonds	6.3%	3.0%	0.48	0.15	1.8%	13.9%
U.S. 30 year mortgages	7.7%	3.6%	0.46	0.14	0.0%	16.6%
U.S. listed real estate	10.9%	16.8%	1.53	-0.08	-47.4%	38.9%
Gold	7.53%	22.2%	2.95	0.28	-39.5%	90.2%
PPI	3.40%	4.9%	1.44	0.60	-7.4%	19.0%
CPI	3.84%	2.8%	0.73	0.65	0.1%	12.5%

U.S. Equities: S&P 500 index; **European equities**: MSCI EAFE Index; **U.S. corporate bonds**: Moody's Seasoned Corporate AAA rated bonds; **U.S. 10 year bonds**: U.S. 10 year Treasury Constant Maturity Rate; **U.S. 30 year mortgages**: Average rate on 30 year fixed rate mortgage; **U.S. listed real estate**: FTSE NAREIT All Equity REITS Index; **Gold**: London Bullion Market Association Gold Price; **PPI**: Producer Price Index; **CPI**: Consumer Price Index.

Behind listed U.S. real estate, farmland has had the highest average annual returns of any listed asset classes since 1970.

More importantly, it's had the lowest negative returns of all listed assets, too.

While in any given year equities may be drawn down tremendously, farmland stays relatively stable.

One of the most important insights we can draw from the above table, however, is farmland's low level of correlation with other asset classes.

Gold bugs have been picking up steam over the last two year on the back of rising inflation, but the bad news for gold bugs is this:

Gold is no longer reverse correlated to equities.

In other words, when equities rise, gold rises too, but not as much.

And when equities fall, gold falls too, almost as much.

So, gold is no longer the safe haven asset that it was in the 1970s-1980s.

However, farmland is what gold pretends to be:

A stable, appreciating, inflation-protecting asset class that maintains its independence from the broader market.

BUT HOW TO INVEST IN FARMLAND?

How do you even go about buying farmland, anyways?

And once you buy it, how do you farm it?

You might come from a farming family, but for the vast majority of Americans, investing in farmland has been off the table due to a lack of knowledge and/or money.

But Farmland Partners (FPI) changes that.

Farmland Partners is a real-estate investment trust (REIT).

REITs are publicly-traded companies that own and collect rent on real estate properties.

There are REITs for industrial properties, office space, data centers — there's a REIT for pretty much every type of real estate asset.

Including **farmland.**

REITs are required to pass 90% of their revenue to their shareholders in the form of dividends.

By investing in a REIT, you can collect monthly or quarterly payments just like a landlord, without having to do any of the hard work yourself.

Because REITs own real estate, which is typically a resilient sector, and also hand out the majority of their revenue to shareholders, they're an excellent defensive play during a recession.

Or periods of economic uncertainty, like the one we're in now.

Like their name implies, Farmland Partners is an agricultural REIT.

They own 185,000 acres across the U.S., spread out between a variety of different crops.

Their land grows everything from soybeans and corn, to avocados and citrus.

LET'S BREAKDOWN THE FINANCIALS

Farmland Partners IPO'ed in 2014 and initially enjoyed strong results.

But then the farm economy went into a recession for a few years, and FPI's share price fell from $12 to $5.

However, this ended up being a blessing in disguise.

Farmland Partners was able to focus on streamlining its operations and shoring up its financials.

The lean years also forced it to maximize efficiency.

Now, FPI is perfectly-positioned to take advantage of the booming agricultural commodity sector.

	As reported For the nine months ended September 30,			Adjusted for litigation (1) For the nine months ended September 30,		
Financial Results:	**2022**	**2021**	**Change**	**2022**	**2021**	**Change**
Net Income (Loss)	$ 5,250	$ (3,055)	NM	$ 6,500	$ 3,813	70.5 %
Net income (loss) per share available to common stockholders	$ 0.05	$ (0.39)	NM	$ 0.08	$ (0.18)	NM
AFFO	$ 5,764	$ (8,493)	NM	$ 7,014	$ (1,625)	NM
AFFO per weighted average common shares	$ 0.11	$ (0.26)	NM	$ 0.14	$ (0.05)	NM
Adjusted EBITDAre	$ 19,649	$ 12,219	60.8 %	$ 20,899	$ 19,087	9.5 %
Operating Results:						
Total Operating Revenues	$ 39,387	$ 31,693	24.3 %	$ 39,387	$ 31,143	26.5 %
Operating Income	$ 12,496	$ 5,490	127.6 %	$ 13,746	$ 12,358	11.2 %
Net Operating Income (NOI) (2)	$ 28,815	$ 24,727	16.5 %	$ 28,815	$ 24,177	19.2 %

This year, their net operating income was $28.8 million.

A 19% year over year increase.

At the same time, they've been drawing down their debt.

Right now, debt is at $410.5 million, down from $513.4 million in 2021.

That's a 20% reduction in debt load.

Totaled up, their liabilities sit at $427 million.

LIABILITIES AND EQUITY		
LIABILITIES		
Mortgage notes and bonds payable, net	$ 408,372	$ 511,323
Lease liability	368	107
Dividends payable	3,333	2,342
Derivative liability	—	785
Accrued interest	3,578	3,011
Accrued property taxes	2,856	1,762
Deferred revenue	111	45
Accrued expenses	8,855	9,564
Total liabilities	427,473	528,939

Their total assets are $1.1 billion.

ASSETS		
Land, at cost	$ 969,360	$ 945,951
Grain facilities	10,918	10,754
Groundwater	12,602	10,214
Irrigation improvements	53,431	52,693
Drainage improvements	12,528	12,606
Permanent plantings	53,698	53,698
Other	6,995	6,848
Construction in progress	14,125	10,647
Real estate, at cost	1,133,657	1,103,411
Less accumulated depreciation	(43,224)	(38,303)
Total real estate, net	1,090,433	1,065,108
Deposits	269	58
Cash	8,869	30,171
Assets held for sale	34	530
Notes and interest receivable, net	5,910	6,112
Right of use asset	368	107
Deferred offering costs	53	40
Accounts receivable, net	6,632	4,900
Derivative asset	2,014	—
Inventory	3,123	3,059
Equity method investments	4,149	3,427
Intangible assets, net	2,060	1,915
Goodwill	2,706	2,706
Prepaid and other assets	1,256	3,392
TOTAL ASSETS	$ 1,127,876	$ 1,121,525

Total shareholder equity then is $700.4 million.

Which gives us a debt-to-equity ratio of 0.6.

So, like I said above, Farmland Partners is a well-capitalized company that's in a strong financial position.

THE DIVIDEND

Farmland Partners annual dividend yield is 1.73%, or $0.06/share.

It's not huge.

Especially compared to our pick from last month – Altria.

However, even a small dividend is something you can add to your portfolio each quarter.

The dividend growth rate has actually been negative (-15.48%) over the last five years.

This coincided with the farming downturn that we mentioned earlier.

However, along with improving financials comes improving dividends.

In July, management raised the dividend by 20%.

However, I don't expect the dividend to track much higher than the 1.73% yield it's at currently.

POTENTIAL PITFALLS FOR FARMLAND PARTNERS

I don't see the dividend increasing sizably for a few reasons:

One, Farmland Partner's has funded the majority of its purchases with debt.

That means rising interest rates will affect the company's cash flows over the coming years.

Debt Summary as of September 30, 2022

($ in thousands)		
Total Outstanding Principal	$	410,486
Debt Issuance Costs		(2,114)
Total Debt, net	$	408,372
Fixed Rate to Maturity	$	24,987
Fixed Rate Adjusting Periodically		261,999
Floating Rate		123,500
Total Outstanding Principal	$	410,486
Weighted Average Cost of Debt [2]		3.59 %

Last year, their average debt cost was 2.96%.

As per their Q3 earnings release, that debt is now being serviced at 3.59%.

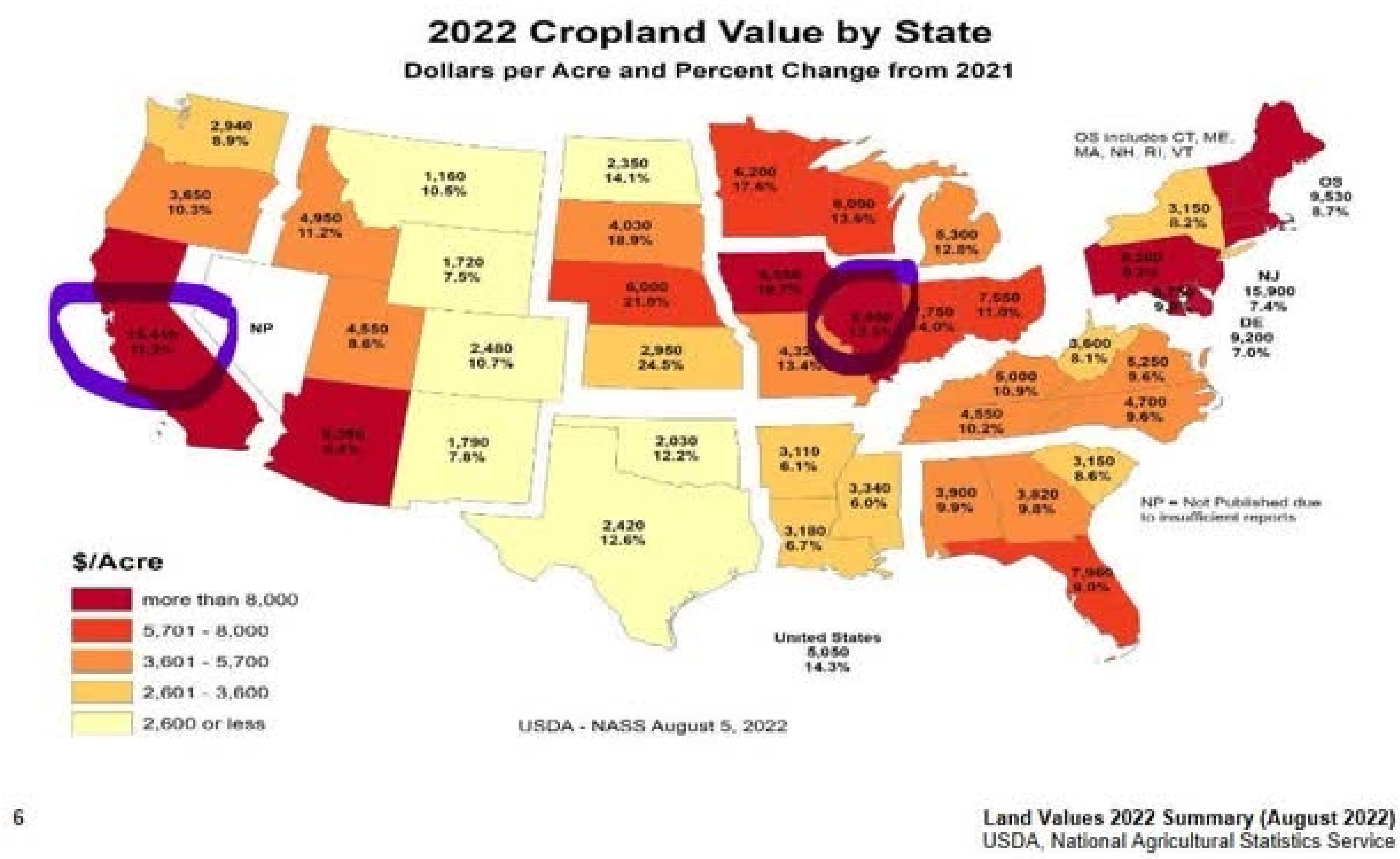
On their current balance of $410 million, that's an annual debt service increase of $2.6 million.

However, between Q1 and October of 2023, they have a total of $174 million worth of debt that will rollover into the higher interest rate environment.

This will lower their free cash flow.

Not only that, but higher interest rates will also slow the pace of land acquisition.

However, these increased operating costs will be offset by rising rents across FPI's properties.



The majority of FPI's land is located in California and Illinois.

> According to the USDA, farmland have appreciated significantly in both California (+11.2) and Illinois (+13.3).

Structural macro issues, like the Ukraine War and a renewed focus on domestic supply chains have brought a renewed focus on farmland as a strategic national interest.

So, I expect these gains to continue – albeit perhaps a little more slowly – into 2023 and beyond.

All this to say that the rising interest rates will be offset by rising rents (+15%), which, while FPI may not be able to grow its dividend, will at least allow it to remain stable.

BUY THE ASSETS, NOT THE CASH FLOW

Farmland Partners offers investors the chance to diversify their portfolio into a stable, anti-inflationary asset class.

A modest dividend can provide cash flow, but what investors are really getting with Farmland Partners is access to farmland.

Look at the news.

I'm extremely bullish on farmland as an investment thesis.

A deglobalizing world will make domestic food production a vital national security interest.

Rising costs (especially with food) will cause considerable cash flow appreciation for farmers.

And the constant demand for arable land will do what it's always done, and cause farmland to increase in value.

With Farmland Partners, you get exposure to this one-of-a-kind asset class.

Which is why we're marking it a buy.

> ** *Please see the most recent monthly issue for current buy limit and price target.* **