VAN HULZEN ASSET MANAGEMENT

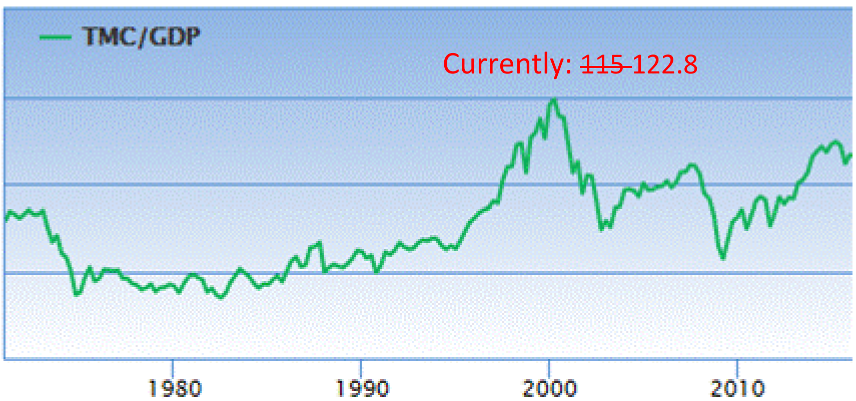
INVESTMENT COMMENTARY: Q2 2016

July | 2016

Time to sit down and reflect on the broader picture

In our Q1 report we looked at the Warren Buffet valuation tool. Although we realize that valuation is not a timing tool it allows us to look at the broader picture and also go back in history and check how this tool has done. If you are interested in how the stock market will do next week or next month please stop reading.

According to this model, based on historical ratios of total market cap to GDP (currently at ~~115.8%~~, 122.8%), the US stock market is expected to return 0.0% per year over the next decade from this level of valuation, including dividends.



On the Buffet scale that would make it significantly overvalued. We can see from the graph below, that during the past four decades the TMC/GNP ratio has varied within a very wide range. The lowest point was about 35% in the previous deep recession of 1982, while the highest point was 148% during the tech bubble in 2000.

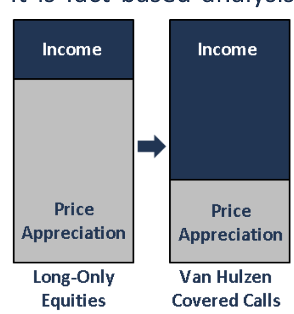
The market went from extremely undervalued in 1982 to extremely overvalued in 2000. With a likely annual return of 0.8% expected from the US stock market, it is worth considering how investment managers will go about driving total return.

From Gurufocus: *"Based on these factors, Warren Buffett has made a few market calls in the past. In Nov. 1999, when the Dow was at 11,000, and just a few months before the burst of dotcom bubble, the stock market had gained 13% a year from 1981-1998. Warren Buffett said in a speech to friends and business leaders, "I'd like to argue that we can't come even remotely close to that 12.9. If you strip out the inflation component from this nominal return (which you would need to do however inflation fluctuates), that's 4% in real terms. And if 4% is wrong, I believe that the percentage is just as likely to be less as more." Two years after the Nov. 1999 article, when the Dow was down to 9,000, Mr. Buffett said, "I would expect now to see long-term returns run somewhat higher, in the neighborhood of 7% after costs."*

"Nine years have passed since the publication of the article of November 22, 1999, and it has been a wild and painful ride for most investors; the Dow climbed as high as 14,000 in October 2007 and retreated painfully back to 8,000 today." Warren Buffett again wrote in Oct. 2008: "Equities will almost certainly outperform cash over the next decade, probably by a substantial degree."

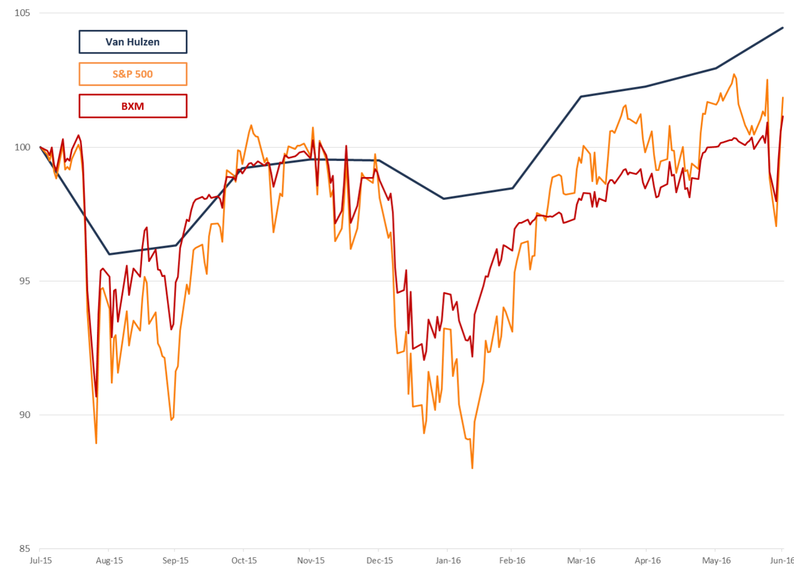
Every investor is off course entitled to use their own investment metrics. The point we are trying to make is that Buffett has been in our view the most consistent investor wary of the "flavor of the day" from Wall Street. It is fact-based analysis combined with common sense in the interest of the investors (pension) portfolio.

At Van Hulzen Asset Management we try to execute in the same consistent manner. We have been managing our covered call strategy for over 14 years. The strategy tries to generate income and price appreciation on a high quality underlying equity portfolio. The launch of the Iron Horse Fund in 2011 has allowed mainstream, retail investors access to the sophisticated portfolio management team overseeing the strategy.



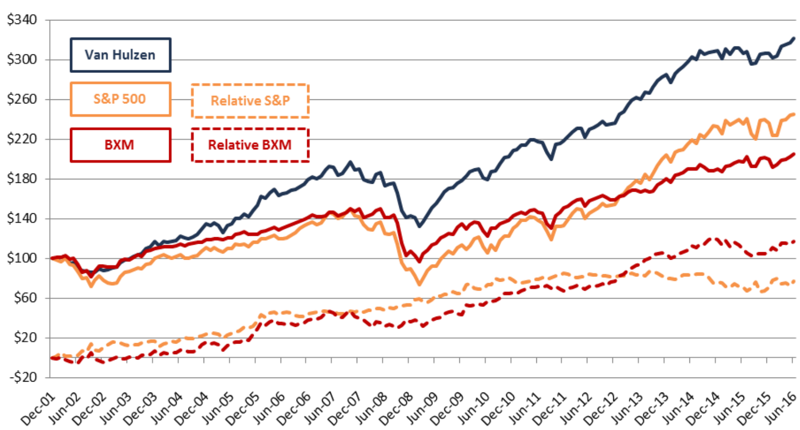
Covered Call Strategy in Review and Outlook

Over the last 12 months the equity markets have seen three fairly substantial breakdowns. Each time, markets have rallied back once the Fed made it clear it would hold off on its plans to raise rates. It's almost as if the market is an irresponsible teenager who knows it can rely on dear old Dad to step in and fix its problems. And as usual, the bond market has proven to be the more mature sibling, shrugging off Fed comments and sending yields down once again. It's no wonder many experts look to the bond market instead of the stock market for their gauge of real economic strength. We do the same and remain cautious as a result.



In the 18 months since the Fed discontinued its quantitative easing (QE) programs, the market has churned sideways with no real progress. And while the Fed continues to support this market, we believe downside risk still outweighs upside potential and investors should be cautious with their equity allocations. We believe covered calls are a good way to stay invested in equities while also adding incremental yield and downside protection. The CBOE website references several studies about the risk-return dynamics of covered calls. All studies conclude that over the long term, a passive buy-write strategy has a superior risk-return profile than long-only equities.

Over the last 12 months the Van Hulzen Covered Call Strategy has exactly done that. The volatility of the strategy was 25% less than the BXM (covered call index) over this period, and 50% less than the S&P 500. Year to date the performance of the Strategy is +5.0% versus +2.4% for the BXM +3.8% for the S&P 500.



Returns (annualized)*	Jun 2016	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	1.5%	2.5%	5.0%	5.0%	4.9%	7.3%	8.1%	10.9%	6.9%	8.4%
Van Hulzen (Net)	1.4%	2.1%	4.0%	4.0%	3.3%	5.8%	6.6%	9.5%	5.7%	7.2%
BXM	1.2%	3.2%	2.4%	2.4%	4.0%	7.1%	7.0%	8.5%	4.6%	5.1%
Difference (VAM-BXM)	0.3%	-0.7%	2.5%	2.5%	0.9%	0.2%	1.2%	2.4%	2.3%	3.3%

*Inception date : 12/31/2001. Figures greater than one year are annualized. Van Hulzen returns represent actual returns from composite of accounts

The Van Hulzen Covered Call approach is to find believed undervalued high quality stocks and sell call options to potentially enhance total return on the position. We believe that equity markets will continue to be more volatile than over the past few years. As covered call investors, we welcome back this higher volatility since it makes the total return performance less dependent on price appreciation.

It is not easy to buy low, or to sell high. Emotions can get in the way. But if we have the proper allocations and right level of cash and liquidity, covered call investors can use market volatility to the advantage.

Note: There is no assurance that the Strategy will achieve its investment objectives. Writing call options can result in an option exercise and may cause shares to be "called away" and sold. The use of covered call strategies does not ensure profits or guarantee against losses. Past performance may not be indicative of future results.

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