INVESTMENT COMMENTARY: Q3 2017

October | 2017

What's Wrong Warren?

During the market melt up in 1999 Barron's magazine ran this cover page for their main article. It was published in December of 1999.

Here is an excerpt from the article: *"But there's more to Berkshire's weak showing than just the operating and investment performance. To be blunt, Buffett, who turns 70 in 2000, is viewed by an increasing number of investors as too conservative, even passé. Buffett, Berkshire's chairman and chief executive, may be the world's greatest investor, but he hasn't anticipated or capitalized on the boom in technology stocks in the past few years."*

In 1999, Berkshire stock was down 22% versus +21% for the S&P 500. Since this article was published, 18 years ago, Berkshire's shares are up over 450% while the S&P 500 index is up over 150%.

It doesn't appear to us that Buffett has lost his touch. In his last annual investor letter explains why he is not buying back his own shares. He writes:

"I am authorized to buy large amounts of Berkshire shares at 120% or less of book value because our Board has concluded that purchases at that level clearly bring an instant and material benefit to continuing shareholders."

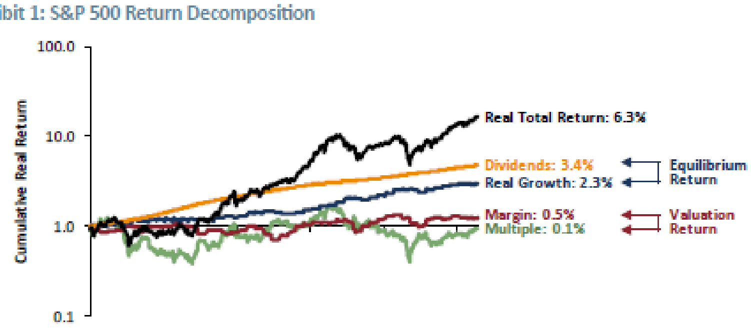
"By our estimate, a 120%-of-book price is a significant discount to Berkshire's intrinsic value, a spread that is appropriate because calculations of intrinsic value can't be precise. The authorization given me does not mean that we will "prop" our stock's price at the 120% ratio. If that level is reached, we will instead attempt to blend a desire to make meaningful purchases at a value-creating price with a related goal of not over-influencing the market. To date, repurchasing our shares has proved hard to do."

Currently the book value of Berkshire is 155%, which is 30% above what Warren Buffett would consider a "value." Berkshire is holding $90Bln in cash to find investable projects.

But how do stocks become expensive? We thought we would share some research from one of our favorite investment research firms, Grantham, Mayo, & van Otterloo (GMO). Their publications allow investors to take a step back and look at the market from a different perspective. In their August 2017 white paper, they decompose the total return of the S&P 500 in four factors: dividends, real growth, margin and multiple expansion

From the white paper: "*In the long term, the return is almost exclusively driven by dividends (growth and yield).*

Exhibit 1: S&P 500 Return Decomposition

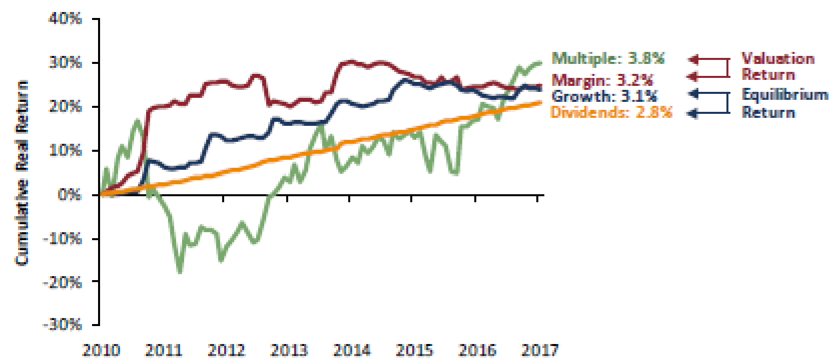


Equity owners need to be compensated for providing capital to companies to help fund their long-term investments. That compensation comes from the cash flows the companies generate from their risky investments via earnings and dividends. The two other ways to make money from owning an equity asset class from multiple (P/E) or margin expansion."

From exhibit 1 they conclude that margins and P/E are basically flat and that over the long term returns have been largely delivered by dividends.

However turning to exhibit two gives a completely different outcome. From the white paper: "*Using the same decomposition over the last seven years, we see quite a different story in Exhibit 2. Earnings and dividends have grown as one would expect, but the P/E and margin expansion have significantly contributed to returns with multiple expansion actually providing the biggest boost of the four.*

Exhibit 2: S&P 500 Return Decomposition—Total Real Return of 13.6% for the Last 7 Years



As of 06/30/2017 Source:GMO, Worldscope, Compustat, MSCI. Note: The "Multiple" driver includes a rebalancing effect (essentially the impact of the more expensive companies entering the index and cheaper companies exiting).

This is typical of short-term periods, where the volatility of returns is dominated by shifts in the valuation components."

Many observers wrote about the subdued total return expectations for the years to come. The US stock market is positioned for a low single digit annualized return based upon the historical valuations of the stock market. In times like this it is important to stay the course, like Buffett did in 1999.

With the above knowledge of the current total return decomposition and the fact that Buffett sees subdued value, the investor should ask again:

"Who's wrong.... Warren Buffett or Mr. Market?

Van Hulzen Covered Call Strategy in Review and Outlook

Our strategy gained 2.8% in Q3 compared to 2.5% for the BXM and 4.5% for the S&P 500. The IT sector led the charge leaving staples and utilities behind. We notice that more and more stocks do not participate in the advance of the market. This is an increasing worrisome sign. Broad market participation point to healthy underlying drivers.

The volatility index (VIX) was down 14%. This index is a key determinant of the level of option premium received when writing call options.

Our investment process is focused on finding undervalued high quality stocks and selling call options to potentially enhance the total return and risk profile on each position. We believe that equity markets are likely to experience heightened volatility in the coming years. As covered call investors, we welcome back this higher volatility as it makes the total return performance less dependent on price appreciation.

VAN HULZEN ASSET MANAGEMENT

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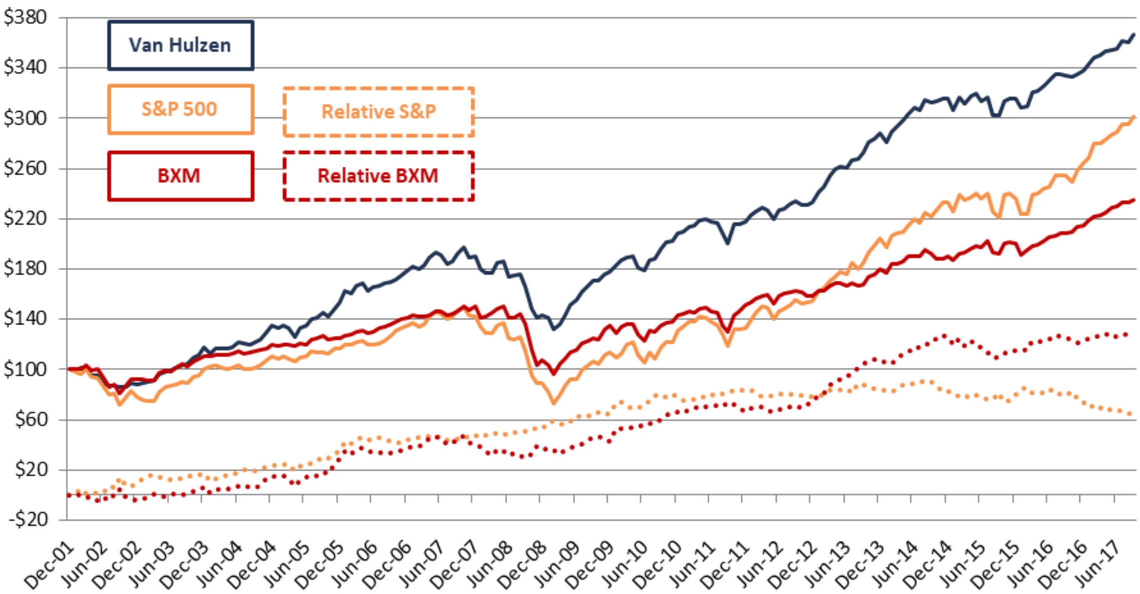
Covered Call Strategy Performance (gross as of 09/30/2017)



Returns (annualized)*	Sep 2017	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	1.6%	3.0%	4.8%	8.5%	9.6%	5.5%	9.4%	9.4%	6.7%	8.6%
Van Hulzen (Net)	1.6%	2.8%	4.4%	7.9%	8.9%	4.9%	8.6%	8.5%	5.7%	7.6%
BXM	0.9%	2.5%	5.7%	9.9%	12.8%	7.1%	7.6%	8.3%	4.8%	5.6%
Difference (Gross-BXM)	0.7%	0.4%	-0.9%	-1.5%	-3.2%	-1.6%	1.7%	1.1%	1.8%	3.0%

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

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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