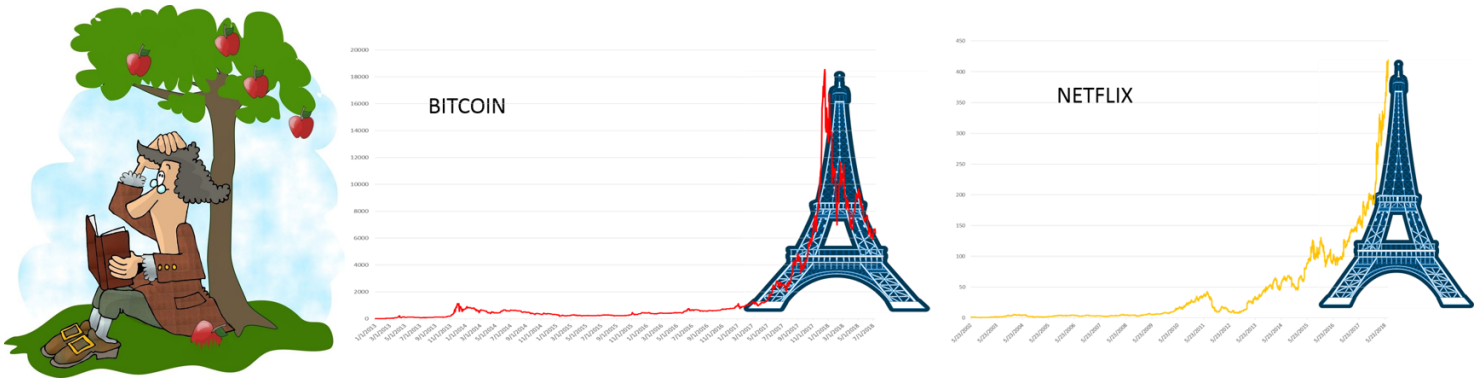
INVESTMENT COMMENTARY: Q2 2018

July | 2018

$F = Gm_1m_2/r^2$

The title is Newton's formula for calculating gravity. Looking at the history of financial markets, we sometimes need to remind ourselves that gravity still exists, especially when prices make large vertical moves.

When we observe these "Eiffel Tower" type price movements, we always have to remember that the Eiffel Tower has two sides. We have seen that in the past with gold, Nikkei, TMT, US housing, China, Biotech and of course Bitcoin. All these price moves fall victim to gravity. (and every time you hear people say...."this time it's different"). This is why in this month's publication we analyze why we own Disney and why we do not own Netflix.



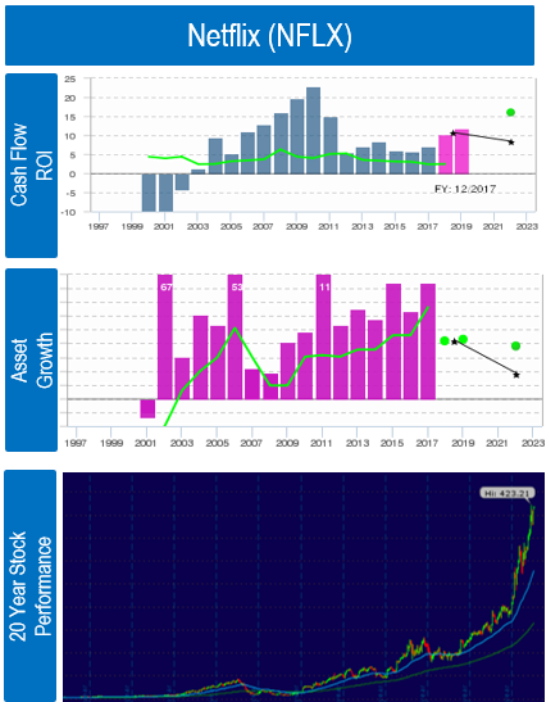
Although the S&P is now positive year to date, individual stock and sector dispersion has never been greater. The tech and consumer discretionary sectors have both risen more than 10% YTD while more than half of the sectors were actually negative through 6/30.

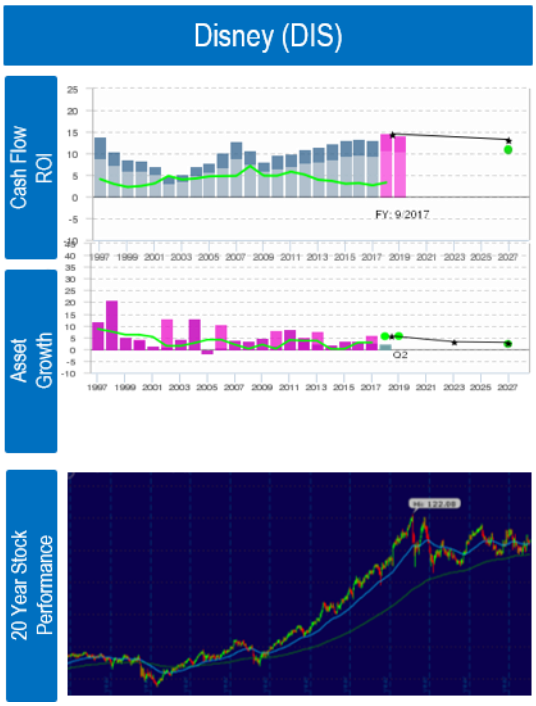
Of the YTD S&P 500 gain, just four stocks (MSFT, AMZN, AAPL & NFLX) were responsible for 84% of the index gains. Ten stocks were responsible for 122% of the gains. The other 490 stocks….who cares.

It’s no secret that “Big Tech” (and specifically the FANG stocks) has led the way. Netflix (NFLX) rose more than 100% in the first half, while Disney was -3% and blue chips like Colgate and Johnson & Johnson returned -13 and -12%, respectively.

Below we have compared screenshots of our fundamental analysis for Netflix (a stock we do not own) and Disney (one of our recent purchases). The top panel shows the trend in Cash Flow Return on Investment (the bars) compared to the future CFROI that is currently “priced into” the stock (the green dot on the far right). The bottom panel shows the 20 year price chart for each stock, which shows the impulsive pattern for NFLX, which has not taken a breather in more than 2 years but whose last “breather” was a two month, 40% pullback. And the current CFROI priced into the stock is nearly twice that of its current CFROI. Risky stuff.

In contrast, we have profiled Disney, which we own and has improved its CFROI consistently over the past 10 years. It is currently “priced” for an ROI below current levels. Disney’s price has consolidated sideways for nearly 3 years now and we believe is due for a breakout. Besides, we prefer real cash flows over speculation. And as covered call managers, we cannot (and will not) tolerate 40% pullbacks.

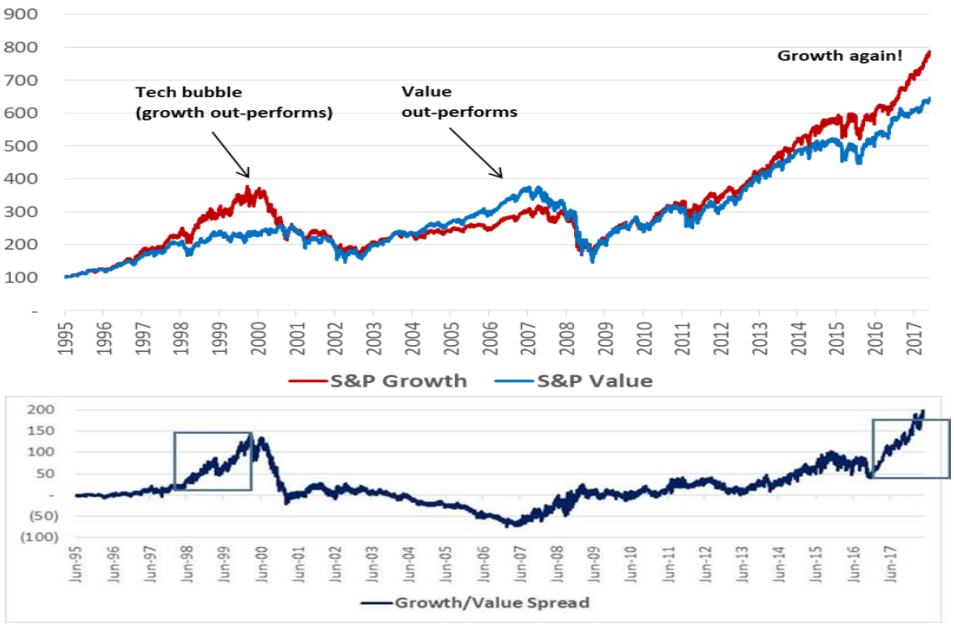




When we added DIS to the portfolio at $100, it had underperformed the S&P 500 by 10% in the first 5 months of the year. As you can see, the market implied expectation (green dot) are low in terms of CFROI and growth. By selling the January 2019 Call 105 the position, we hope to generate an 11% total return for a period of 7 months. Roughly 8% of the return will come from income.

High Level Takeaways

The S&P growth index (SGX) has extended its streak in 2018, and the spread between growth and value stocks has now exceeded that of the 2000 tech bubble. Our strategy leans towards quality and value. The average sales growth rate in our portfolio is actually higher than the average for the S&P 500. But averages don't seem to matter in the face of the Big Tech craze.



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As you have seen from our track record, our strength lays in downside capture, and produce consistent returns over time. A so-called "singles and doubles" strategy. We do not "swing for the fence" in seeking a Netflix type stock. Our strategy satisfies with owning Disney instead. Going forward, we believe the art of downside capture comes back into play for the years ahead of us. We have dealt with various difficult market environments.

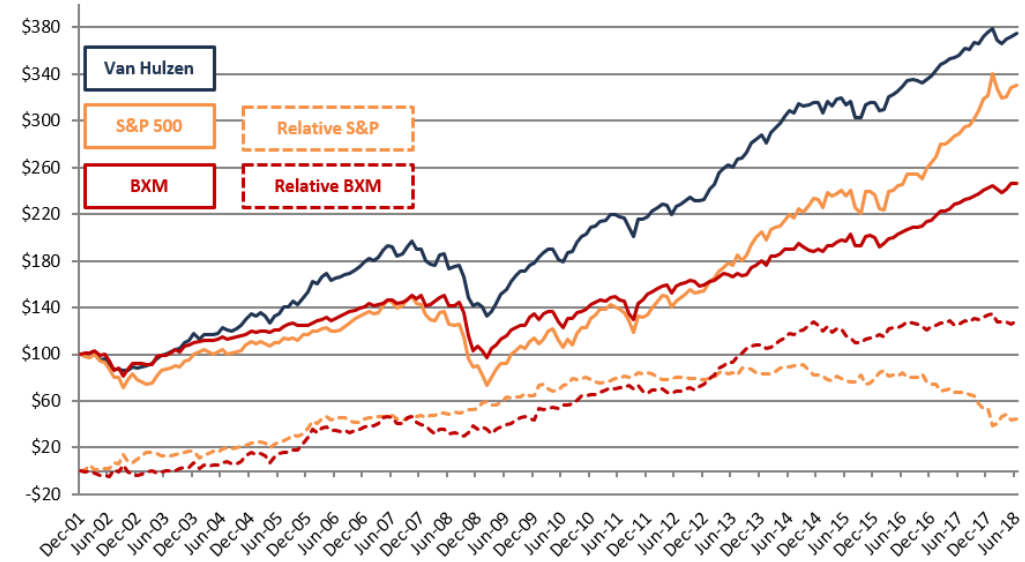
This changing environment is a great time to reflect on what investing is all about:

The goal of investing should be:
•To keep money
•To make money

Money managers who successfully protect your capital and make money for you in changing environments are truly serving you. Those whose goal is to beat the S&P 500 by holding speculative holdings, will eventually serve you up.

We continue to believe in long term mean reversion and will continue to stick to our guns.

Covered Call Strategy Performance (gross as of 06/30/2018)



Returns (annualized)*	Jun 2018	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	0.8%	2.5%	-0.1%	-0.1%	5.4%	6.2%	7.6%	8.1%	8.0%	8.3%
Van Hulzen (Net)	0.8%	2.3%	-0.4%	-0.4%	4.7%	5.6%	6.9%	7.2%	7.1%	7.4%
BXM	-0.1%	3.4%	1.8%	1.8%	7.3%	7.7%	8.1%	7.7%	5.7%	5.6%
Difference (Gross-BXM)	0.8%	-0.9%	-1.9%	-1.9%	-1.9%	-1.5%	-0.5%	0.3%	2.3%	2.7%

*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.