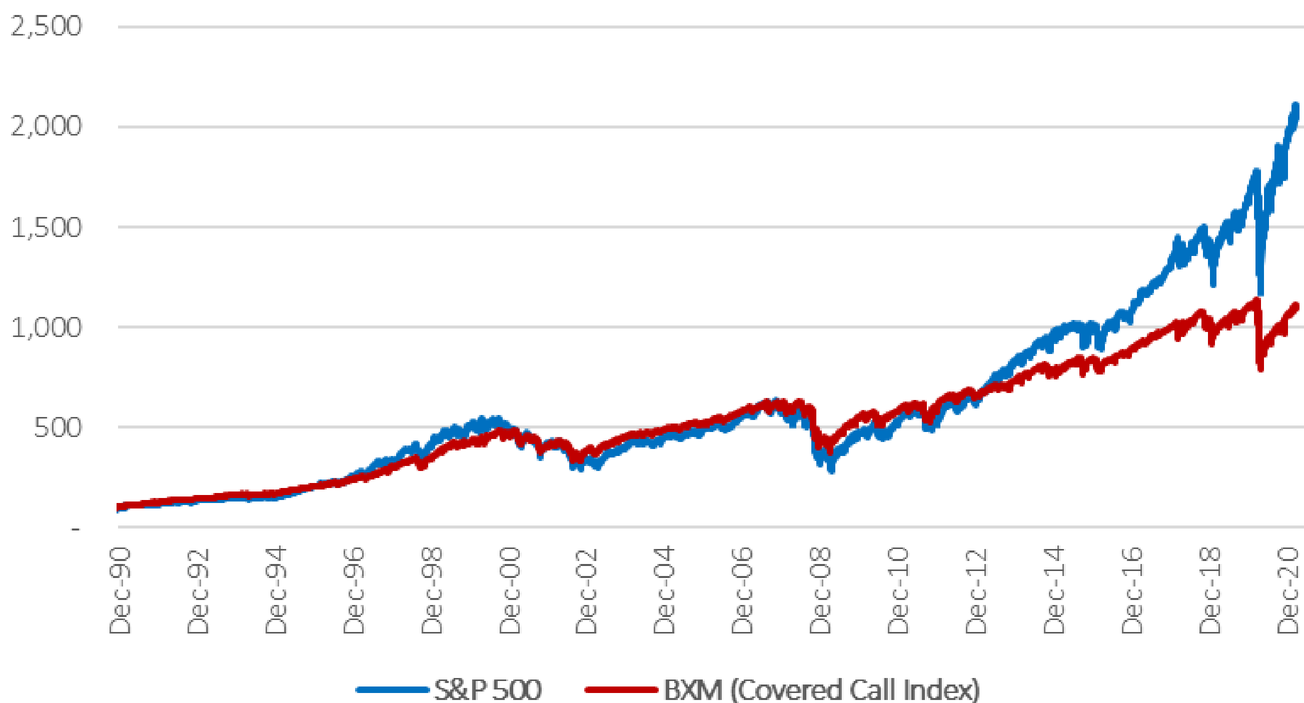
INVESTMENT COMMENTARY

February | 2021

Sticking to Our Knitting

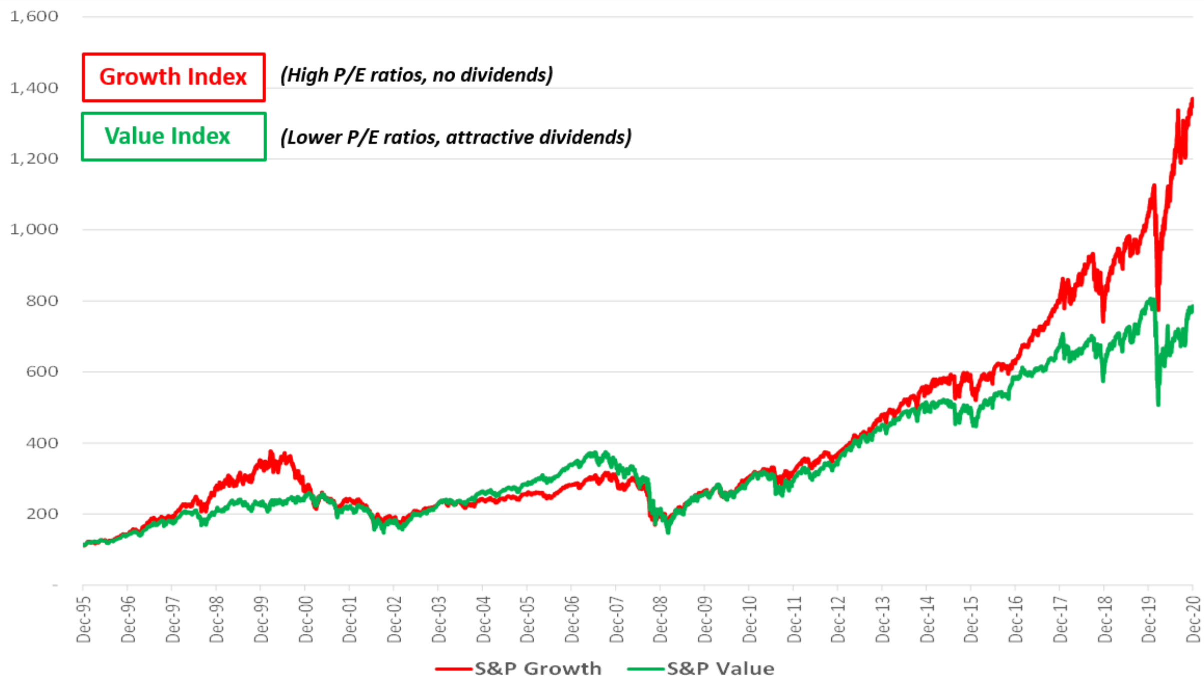
As many of you know, we manage one of the longest running covered call strategies available in the US. We launched our strategy in 2001 but for more than 10 years only offered it to our internal wealth management clients. In 2011, we decided to get the track record GIPS verified and in 2013, we "took the strategy to market" (made it available to other RIAs, brokers and institutions). Since 2013, we have solidified our place as one of the leading institutional covered call managers in the US. And we have experienced significant growth in our business.

But as we look back on this history, it is not lost on us that we went to market during one of the most difficult periods in history for the covered call category. After 25 years of delivering returns in line with the S&P 500 at about 1/3 less risk, the hedged covered call category has lagged the "full-risk" S&P 500 significantly. 2020 may have been the worst year ever for the category. See the chart below.



There is no question that the Federal Reserve has fueled the risk-on market of the past 5-6 years. And record low volatility translated to underperformance by covered call strategies relative to long-only stocks. But this wasn't purely a covered call issue. All hedged strategies have significantly under-performed the S&P over this period.

But this environment was particularly difficult for income/value strategies, which have seen record under-performance relative to their "growth" competitors. Blue chips and dividend stocks, which have actually out-performed growth stocks over the very long term, have fallen way behind over the past 5 years. The chart below demonstrates this very well. And 2020 was actually the most egregious example, as growth stocks out-performed value stocks by a whopping 34%!



Battling Through the Headwinds

We have battled three (3) distinct headwinds over the past 5 years:

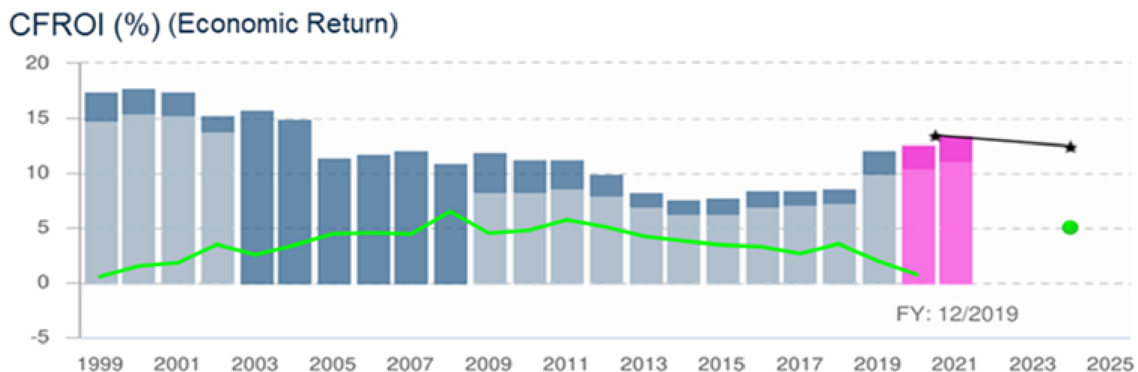
1. Hedged strategy in a risk-on market environment
2. Options strategy that thrives on market volatility, during record low vol
3. Strong value-tilt in a growth market (more than 75% of our holdings are considered "value")

We have stuck to our knitting, despite these headwinds. We own high quality stocks with great management teams, strong ROIs and fortress balance sheets.

EXAMPLE POSITION

A great example of this is Merck, a position we recently added to our portfolio. Merck (MRK) meets all our criteria for a good covered call candidate. It delivers strong cash flow ROIs, has a strong balance sheet, is reinvesting back into the business, has a strong dividend (3.5%), and an attractive valuation. After selecting the name based on its fundamentals, we then turn to the options market and create a good total return for a certain period. In this case, we sold the June 80 calls, which allows us to capture at least two dividends and creates almost 4% income for 3.7 months (annualized 12.5%). If the stock price rises, our total return on this position could be as high as 13% in just 3.7months!

MERCK RELATIVE WEALTH CHART

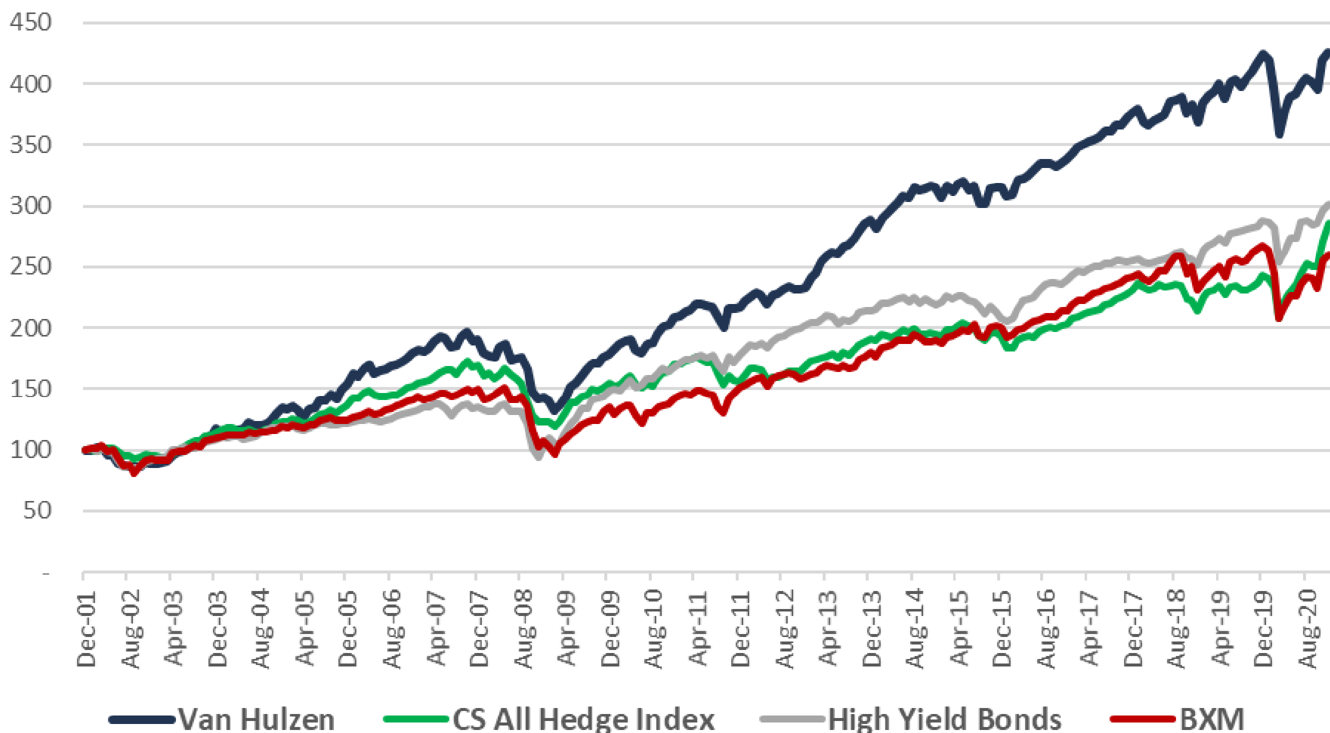


This disciplined process has allowed us to far out-perform the asset classes with similar risk profiles. See below for a comparison of our performance relative to covered calls, high yield bonds and hedge funds.

RISK/RETURN MATRIX

Van Hulzen Covered Call Strategy

The Van Hulzen Covered Call strategy invests in US companies that we consider to have high shareholder yield (dividends and share repurchases) and uses call options with the goal of reducing portfolio volatility and creating incremental income. The goal is a portfolio that has equity exposure while seeking higher than average annual income (target of 6-8% annual), although there is no guarantee that the strategy will achieve its objective, generate profits or avoid losses. Below you will find the graph of the Van Hulzen Covered Call Strategy and the Covered Call Index BXM



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