VAN HULZEN ASSET MANAGEMENT

For Investment Professionals Only

Q1 COVERED CALL COMMENTARY

April| 2021

Q1 2021: An Ideal Environment for Covered Calls

As we discussed in our October commentary, there are two macro factors that have historically contributed to an optimal covered call environment:

1. **Elevated volatility**. Covered calls do better during volatile markets, as call premiums are higher and provide more income.
2. **Preference for value stocks.** Covered calls are an income strategy and will do better when income-oriented value stocks out-perform growth stocks.

You might call this a "Double V" environment (Volatility & Value). It's been almost 10 years since we last saw these two factors working together. And while it's rare for a hedged strategy to out-perform long-only stocks in up markets, that's exactly what we saw in those early years. Our high quality, blue chip names were in favor **and** elevated market volatility allowed us to collect outsized option yields.

Q1 was also an ideal environment for covered calls, allowing us to turn in an S&P 500 level return while taking **40% less risk**. More on Q1 performance later.

But first, let's revisit our analysis from October…

As you can see below, our strategy out-performed the S&P from 2001-2011, a period when value stocks mostly out-performed growth stocks and market volatility was generally elevated. We then performed in-line with the S&P for 3-4 years (during a high vol/growth period) before the more recent period of Big Tech dominance, during which a huge growth bias developed and record low volatility drove new stock market highs and covered call under-performance.

Here is the (nearly) 19-year track record for our covered call strategy. The solid lines are the absolute performance for our strategy (dark blue), the S&P 500 (orange line) and the covered call index (BXM, red line). The dashed lines at the bottom represent our relative performance against each index. You will notice that we have also added some macro factors at the bottom of the chart, distinguishing between periods when value (or growth) stocks out-performed as well as periods of high (and low) volatility.

We then want to focus in on the relative performance lines (the dashed lines), as those really help demonstrate how macro factors can influence the results. In the first chart, it's important to note that our strategy has consistently and steadily out-performed its core benchmark (the covered call index, ticker BXM). But of course we understand that most people pay more attention to the S&P than the BXM.

Let's Focus on The Relative Lines….

Q1 Performance

Our strategy delivered a 5.5% return in Q1, as value stocks out-performed growth stocks and the VIX (volatility index) was in the mid-20s for most of the quarter. This performance is in-line with both the S&P 500 and BXM. But very importantly, our strategy carries approx. 40% less risk than the S&P and 23% less risk than the BXM.

Speaking of risk mitigation, the true gauge for a strategy's performance is of course its Alpha. Alpha is a good measure of performance because it compares the realized return with the return that should have been earned for the amount of risk borne by the investor.

The following calculation shows our Alpha for the whole track record ending March 31, 2021.

Alpha	
a = Rp – [Rf + (Rm – Rf) ß]	
Rp = Realized return of portfolio	8.1%
Rm = Market return	5.4%
Rf = Risk-free rate	0.1%
ß = Beta	0.7
Alpha (relative to BXM)	**4.4%**

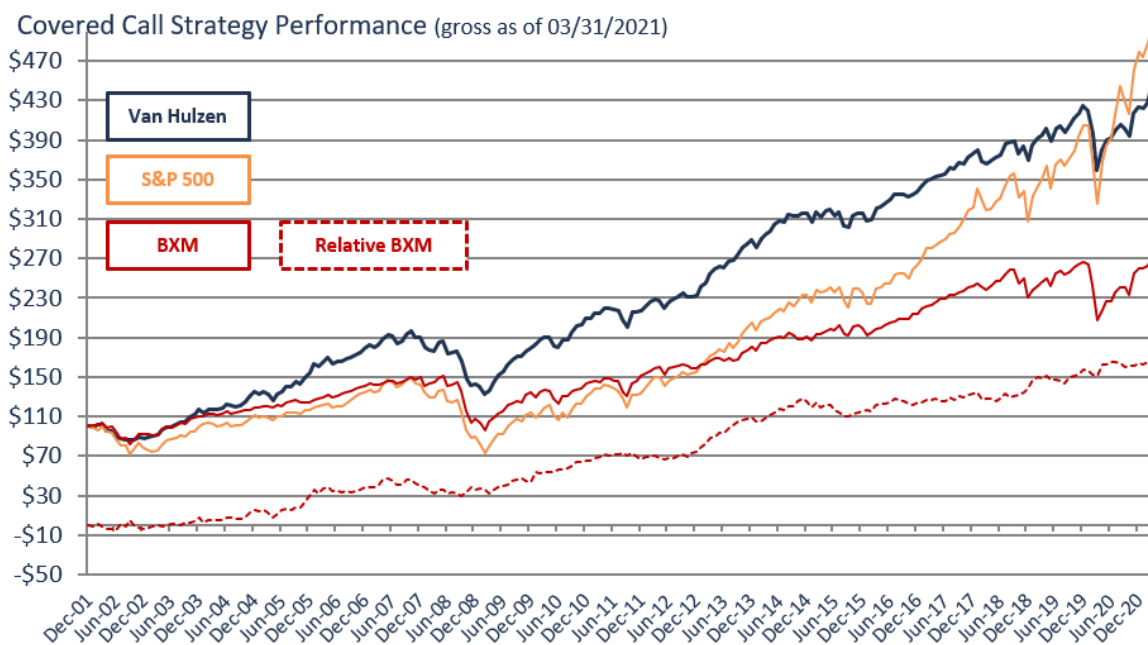
Example Position

We recently added BHP to our portfolio. BHP meets all our criteria for a good covered call candidate. It delivers strong, improving cash flow ROIs, has a strong balance sheet (zero percent default risk according to the Merton model), is reinvesting back into the business, has a strong dividend yield and an attractive valuation. It's also a name that should do well with the shift towards infrastructure spending. 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 January 75 calls, which gives us a 6.5% option yield for 9 months (8.5% annualized). Adding this to the dividend yield gives us an annualized total yield of more than 12%, plus another 7.5% potential price appreciation over the next 9 months.

Source: Credit Suisse HOLT™

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.



Returns (annualized)*	Mar 2021	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	4.5%	5.5%	11.2%	5.5%	24.4%	6.8%	6.8%	6.2%	7.6%	8.1%
Van Hulzen (Net)	4.5%	5.4%	10.9%	5.4%	23.7%	6.3%	6.2%	5.6%	6.8%	7.2%
BXM	4.5%	5.7%	13.7%	5.7%	32.2%	4.8%	6.7%	5.8%	6.6%	5.4%
Difference (Gross-BXM)	0.0%	-0.2%	-2.5%	-0.2%	-7.8%	2.1%	0.2%	0.3%	1.0%	2.7%

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

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