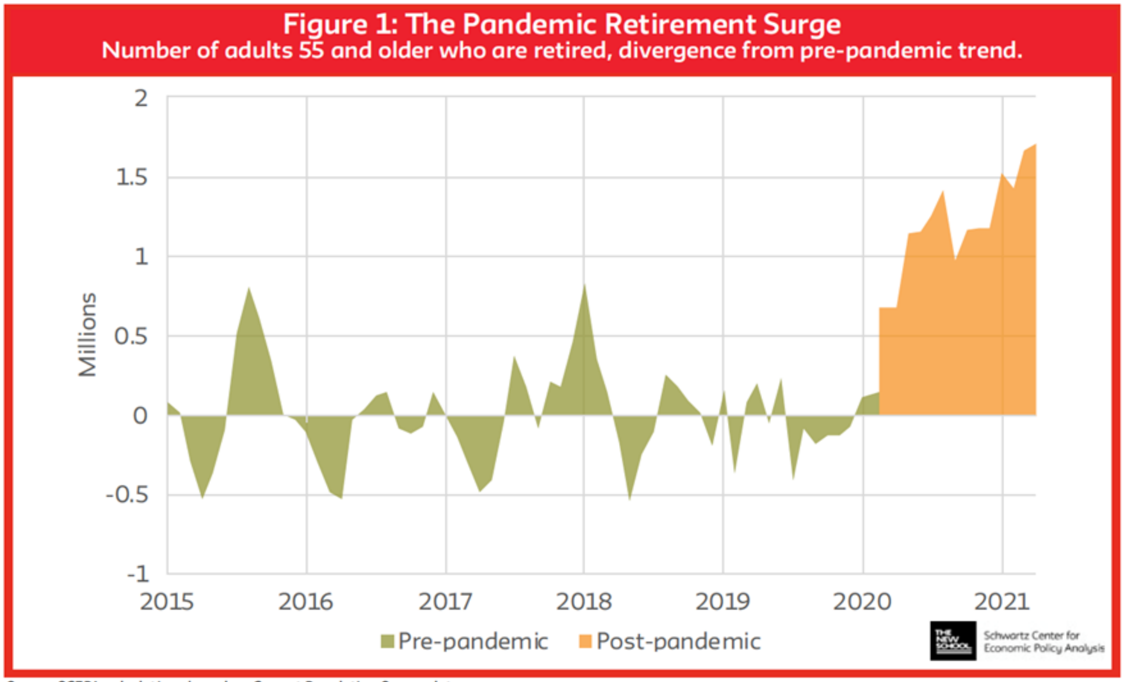
Q3 Covered Call Commentary

September | 2021

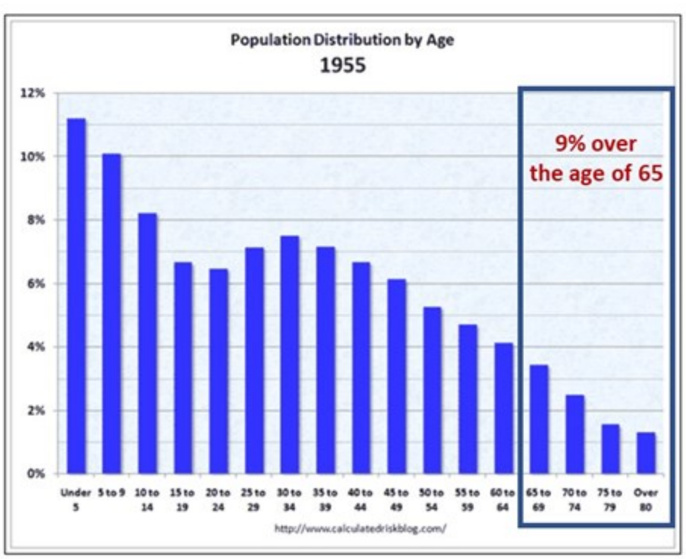
Boomer Beware

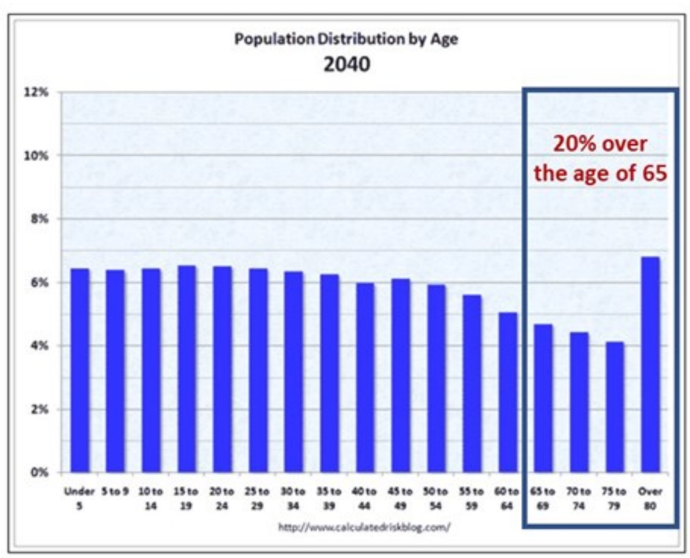
You may have heard statements like "10,000 baby boomers reach retirement age EVERY DAY." And its true. The largest wave of births in US history occurred between 1946-1964, during the post-World War II baby boom. And these people began retiring about 10 years ago, so you might say we're about halfway through this trend. But the mass retirement of the boomer generation accelerated even faster over the past two years because of Covid. This recent surge in retirement is clear from the chart below. It makes logical sense – the elderly have the highest risk of dying from Covid, so why risk it?



Source: SCEPA calculations based on Current Population Survey data.
Notes: See Technical Appendix for methodology.

And as you can see, the distribution of ages in the US population has changed dramatically as the boomers have matured. In 1955, the population over the age of 65 was only 9%. But based on current projections, this 65+ group will represent more than 20% between the years 2030–2040. See below.



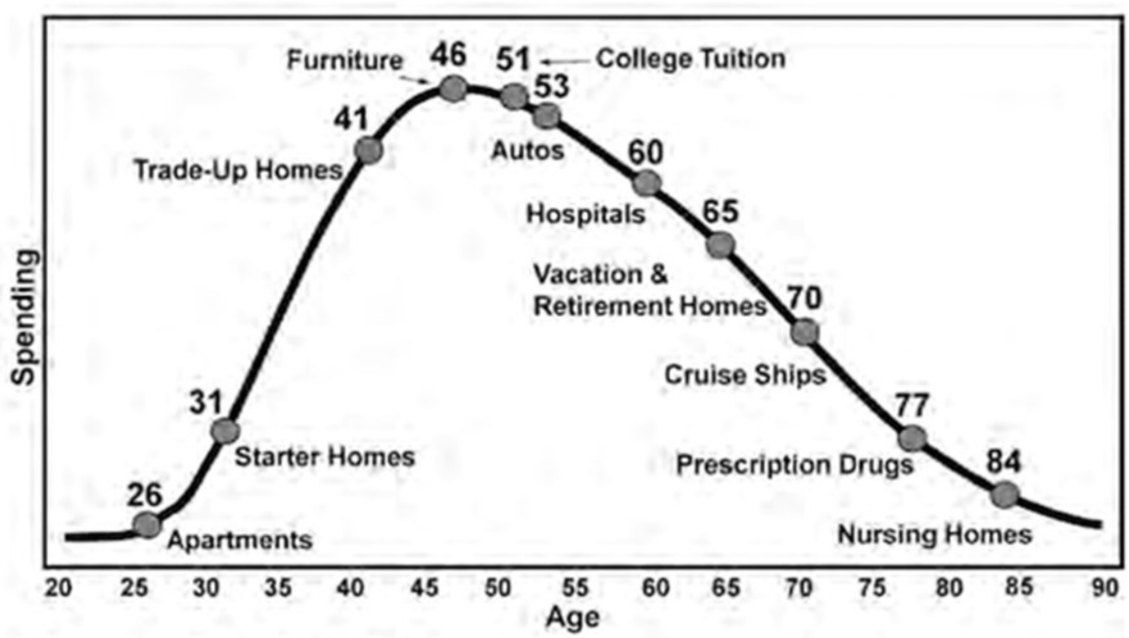


www.calculatedriskblog.com

Impact on the economy

This trend has several implications on the economy and stock market. First of all, studies have shown that spending patterns change dramatically during the average person's lifespan. Most people spend money on houses, furniture and cars between the ages of 30-50. Priorities shift later in life, with larger amounts going to hospitals, prescriptions and nursing homes. As you can see from the life cycle chart below, peak spending for most people occurs in their late 40s/ early 50s. Of course, this ignores other factors like the state of the economy, interest rates, and (a major factor as of late) government stimulus.

Figure 1-1: Consumer Life Cycle



Data Source: U.S. Census Bureau, Dent Research

Growth Headwinds

With respect to economic growth, an aging population has a direct impact. As a person retires, his/her spending drops dramatically, thereby subtracting from the growth of the overall economy. At the same time, they shift from net contributors to social security & Medicare to net users of those services.

Double Whammy

Today's retiring population faces an additional challenge that most generations have not: record low interest rates. It is an incredibly difficult time to start relying on a fixed income, with yields at record lows (lower income) and consumer prices beginning to accelerate (higher costs). Plus, according to the Federal Reserve SCF (Survey of Consumer Finances), the average 65 year old in the U.S. has retirement savings of approximately $220,000. The median is much, much lower. So for many folks who have lived most of their lives during a period of strong economic growth, their most challenging years may still be ahead of them.

How Does This Affect Your Retirement?

A few months ago we discussed negative interest rates and highlighted how they are bad for pensions and retirees. What these demographic trends tell us is that the magnitude of the problem is quite large. Many retirees will be bailing water out of a sinking boat for a while. The days of putting your retirement account in a 6% bond portfolio and calling it a day are over. We will revisit some of the data from last past commentaries to illustrate this point.

According to the world's leading investment firms, future stock returns (over the next 7-10 years) are expected to be in the low-mid single digits. See below.

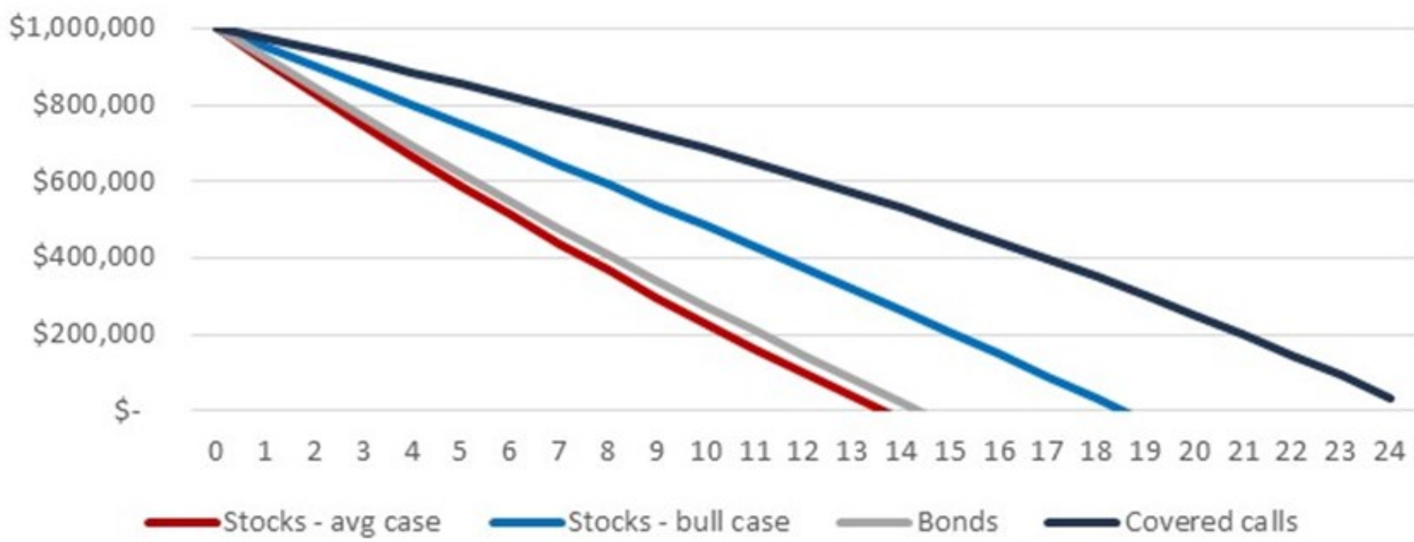
Future Stock Return Forecast (7-10 years)	
Blackrock	6.1%
JP Morgan	5.6%
Grantham	-4.4%
Morningstar	1.7%
Research Affiliates	0.3%
Vanguard	4.5%
Average	**2.3%**

Source: https://www.morningstar.com/articles/962169/experts-forecast-long-term-stock-and-bond-returns-2020-edition

We would also like to revisit an illustration from a past commentary. **Assume a retiree has $1,000,000 saved up** at the time of their retirement. Now let's assume this person needs to withdraw approximately $5,000 per month (6% annual) for livings expenses. In the old days, when inflation was relatively low, bonds yielded 6% and stock dividends were 3-4%, this was a very achievable scenario. But today, bonds are only getting ~2% and dividends are just over 1%. And let's assume an inflation rate of 5%, which may seem high but is well below the levels we saw in the 1970s, when inflation spiked as high as 14% and averaged approximately 7% for the decade.

Let’s do the math. If this retiree is invested in stocks at the average forecasted return of 2.3% (from above), he or she would be out of money after 13 years! Even assuming the most bullish forecast for stocks (Blackrock’s 6.1%), this person’s $1,000,000 nest egg would be gone in 18 years.

One asset class that stands to do well during an inflationary environment, of course, is covered calls. Re-read our April 2021 commentary for the detailed evidence and analysis on that. For this category, we have assumed the average stock return of 2.3%, plus an additional 6% for annual net option yield (total of 8.3%). This is in line with our 20 year average annual return. And because the past 20 years have been deflationary, not inflationary, we believe this is fairly conversative.



Asset Class	Gross Rtn	Inflation	Net Rtn	Years Funded
Stocks - avg case	2.3%	-5.0%	-2.7%	13
Stocks - bull case	6.1%	-5.0%	1.1%	18
Bonds	3.1%	-5.0%	-1.9%	14
Covered calls	**8.3%**	**-5.0%**	**3.3%**	**24**

Note: 3.1% bond return is the average from the three inflationary decades (1940s, 1960s & 1970s)

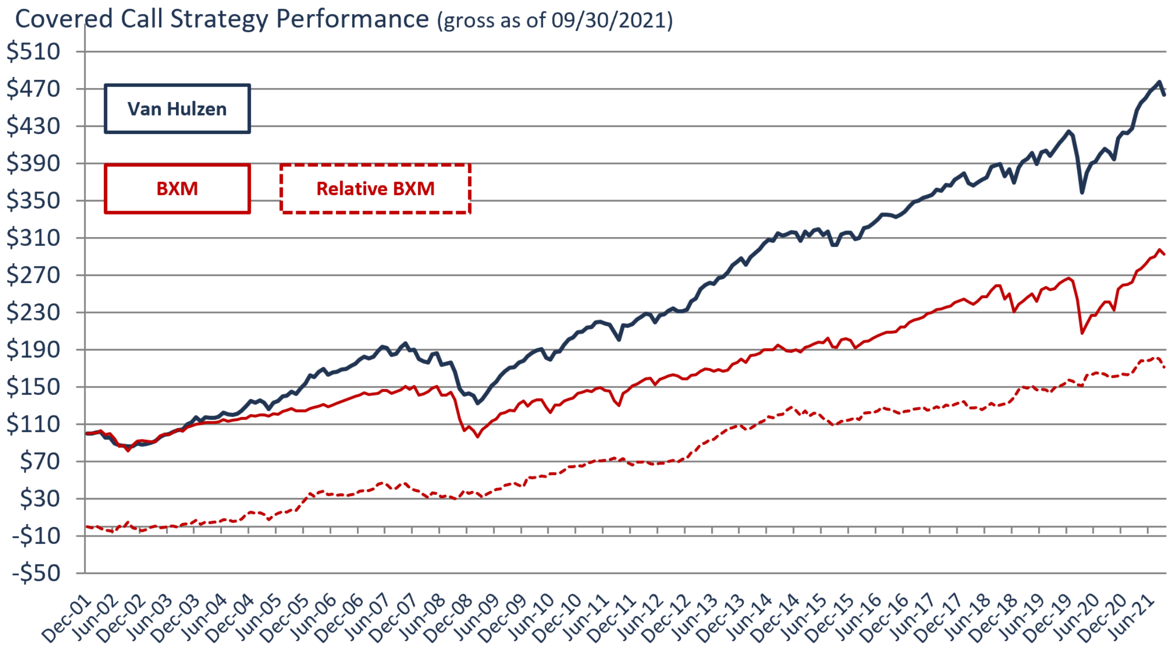
If you’re wondering if these forecasted stock returns are too low, we would just remind you that the S&P 500 has only approached today’s sky high valuation multiples twice in the past 100 years, in 1929 and 1999. And the 10 year average annual stock return for the decade following these periods was 1.8% and 1.4%, respectively.

Key Takeaways

Our aging population is going to have a negative affect on economic growth. Combing this trend with record corporate debt, record low interest rates and rising inflation poses an even larger problem for future portfolio returns. We continue to believe investors need to stick with quality and start thinking about incremental sources of income and downside protection. We believe covered calls present a unique solution to these challenges.

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)*	Sep 2021	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	-3.0%	-0.9%	3.7%	9.5%	15.3%	6.0%	6.7%	5.8%	8.7%	8.1%
Van Hulzen (Net)	-3.0%	-1.0%	3.5%	9.0%	14.7%	5.4%	6.1%	5.2%	8.0%	7.2%
BXM	-1.7%	1.4%	6.5%	12.6%	21.1%	4.2%	7.0%	6.2%	8.4%	5.6%
Difference (Gross-BXM)	-1.3%	-2.2%	-2.8%	-3.1%	-5.8%	1.8%	-0.2%	-0.4%	0.3%	2.5%

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

The foregoing content reflects the opinions of Van Hulzen Asset Management and is subject to change at any time without notice. Content provided herein is for informational purposes only and should not be used or construed as investment advice or a recommendation regarding the purchase or sale of any security. There is no guarantee that these statements, opinions or forecasts provided herein will prove to be correct. Past performance is not a guarantee of future results. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns. All investing involves risk including the potential for loss of principal. There is no guarantee that any strategy will be successful. The CBOE S&P 500 BuyWrite Index (BXM) is a benchmark index designed to track the performance of a hypothetical buy-write strategy on the S&P 500 Index. The BXM is a passive total return index based on (1) buying an S&P 500 stock index portfolio, and (2) "writing" (or selling) the near-term S&P 500 Index (SPXSM) "covered" call option, generally on the third Friday of each month. The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. It is widely used as a benchmark of U.S. equity performance. It is not possible to invest directly in an index: FPAC- 0375-21