Covered Call Commentary

October| 2021

What is a "Reliable Hedge?"

Stocks are at all-time high prices ***and*** all-time high multiples. More and more investors are taking note of this and looking into how to hedge their market exposure.

- Short the market? Either directly or through an ETF. Shorting stocks is risky and complicated. And inverse ETFs have their own problems (don't always behave as you would expect).
- Buy protective puts? This can be a very effective way to hedge. But options are complex. Are you an experienced options trader?
- Re-allocate to less risky strategies? This makes sense but where do you go?
- Hedge funds? All too often, these "hedge" funds have actually become leveraged vehicles with large, concentrated bets. Feel good about shorting Game Stop before a 200% spike?
- Bonds? Investment grade bonds are yielding next to nothing, and with inflation heating up, they are actually giving you ***negative*** real yields.
- High yield bonds? Don't get us started. We are risk managers. When rates start rising meaningfully and the Fed finally lets companies fail, there will be a blood bath in this area. Nearly 20% of US companies are "zombie companies" today (can barely pay their interest).
- Covered calls? This is a great way to hedge your risk ***and*** increase your yield. Let's discuss this further.

Top 5 reasons to choose covered calls

We have covered each of these topics in depth in previous white papers and commentaries. Please reach out if you would like us to send you some of this content.

1. Allow you to hedge/risk manage a portfolio when stocks are expensive
2. Allow you to boost your yield, from 1% to the high single digits
3. Allow you to capitalize on market volatility (option prices rise when markets are volatile)
4. Allow you to navigate through an inflationary environment
5. Income and quality will matter more than ever over the coming decade

Not all covered call strategies are the same

When you look under the covers, most options strategies are trading strategies with a relatively high beta and high turnover rate. Option income drives portfolio decisions, which in turn can lead to poor underlying quality. Others only pay lip service to covered calls, using them optimistically but not consistently. You have to look at the standard deviation to see this! We are completely different, by design. Our first priority is building a portfolio of high-quality companies with sustainable business models and above average dividends. The portfolio is built through fundamental equity research, and the options applied are tailor-designed for each individual underlying equity position. The objective is consistent returns, not home runs, with roughly equal parts income & growth.

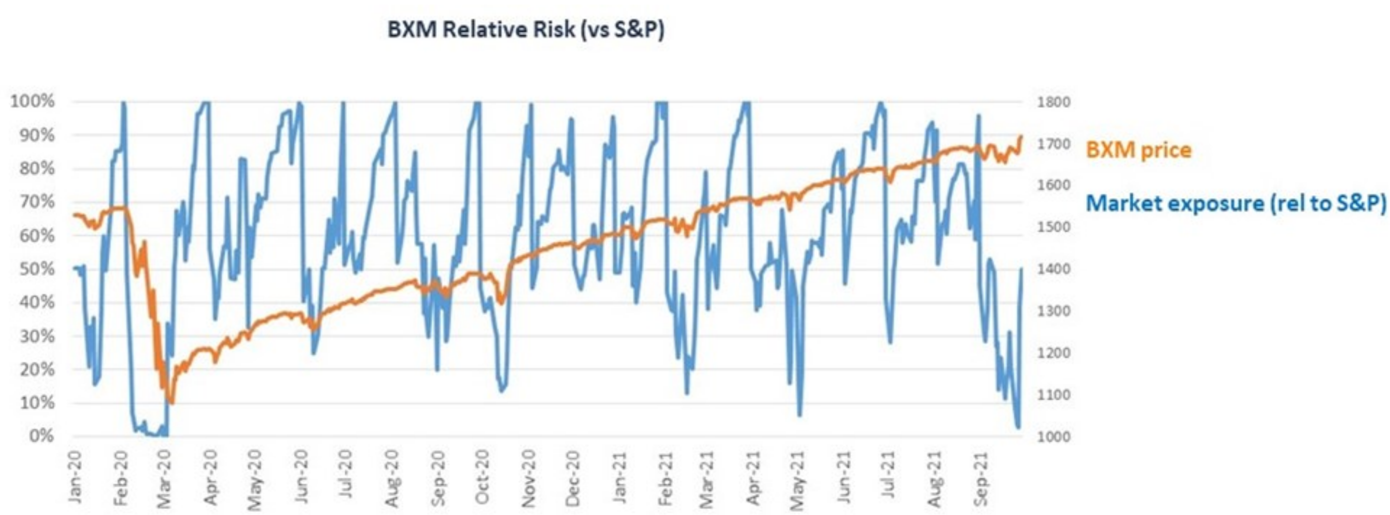
Common Covered Call Approach	Van Hulzen Covered Call Approach
• Generally option trading strategies are designed to derive alpha from implied volatility, or skewness, delta hedging or other derivative-specific goals.	• The first priority is building a portfolio of high quality companies with sustainable business models and above average dividends.
• Generally a higher beta portfolio with a high turnover rate and lower quality holdings. Option income drives portfolio decisions, which in turn can lead to poor credit quality.	• The portfolio is built through fundamental equity research. The options applied are tailor-designed for each individual underlying equity position and are dynamically managed.
	• The options add incremental income and downside protection, through strike price and option duration selection.
	• The objective is consistent returns, not home runs, with roughly equal parts income & growth.

The Strategy seeks to offer a high income, hedged equity solution. It is not an option trading strategy

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.

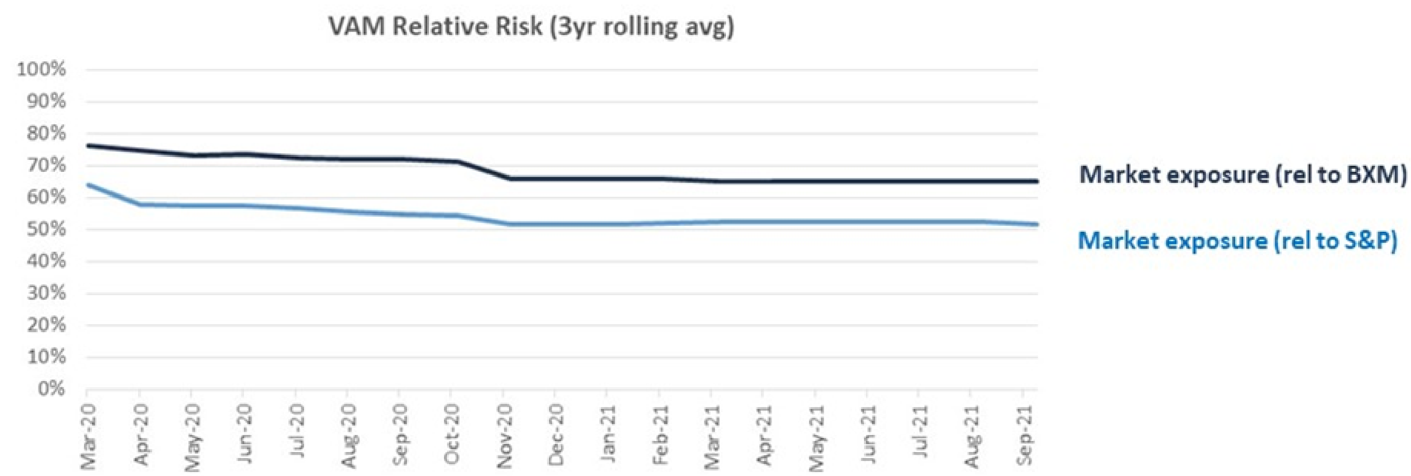
<u>Why not just buy a covered call ETF?</u>

The CBOE's covered call/buy-write index (BXM) is an interesting animal. It owns the entire S&P 500 and systematically writes call options on the entire index, each month. There is no discretion, and the entire portfolio is treated as if it was one security (the entire index is rolled at the same time). As a result, the net market exposure of the strategy can swing wildly between 0% to 100% throughout the month. What exposure it has when a crash occurs is a matter of chance. This, and the sudden spike in volatility, helps explain why the BXM actually lost more than the S&P during Q1 2020 (-22.2% versus -19.6% for the S&P). Our strategy lost only 15.4% during this storm, by the way. The net exposure of the BXM is shown below, from January 2020 to the present. But it looks very similar, regardless of the period selected.



Is this different for Van Hulzen's covered call strategy?

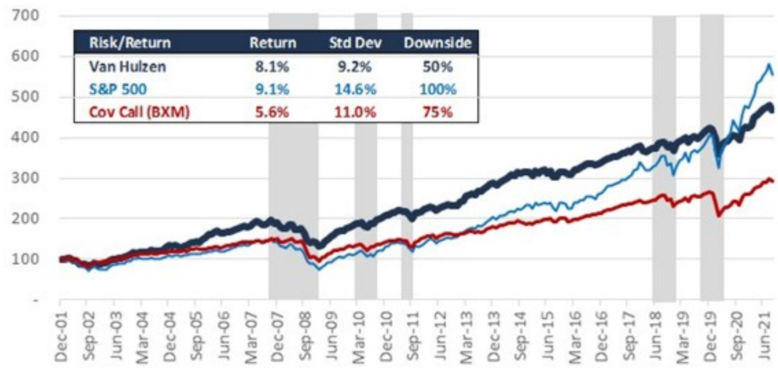
Yes! This is one of the key reasons to choose a manager like Van Hulzen. We own individual stocks (not the entire S&P 500) and write/manage call option positions on a stock-by-stock basis. We don't roll options for the entire portfolio at the same time like the BXM does. We also have a much longer option duration (4-5 months, on average, versus 30 days for the BXM). We do this because our holdings are high quality, dividend paying companies and we want to collect the dividends, plus longer-duration options generate higher income on day one, which provides more downside protection in the event of a large pullback. All of this creates a very different risk profile and a **much more stable market exposure**. See below, for our rolling market exposure over the same time period as the above BXM chart.



Which would you say in the "more reliable" hedge? An index (or ETF) where your market protection could range from 0 -100% at any given time? Or a tried and true, 20 year track record with long-term outperformance and a steady risk profile and market exposure?

The End Result: Superior Risk Management & Alpha

We have studied all of the major pull-backs since the inception of our strategy, nearly 20 years ago. There have been 5 sell-offs of more than 10%, some worse than others. They are detailed below, along with the maximum draw-down of the S&P, BXM and our strategy over those periods. As you can see, we have significantly out-performed the BXM, both in absolute terms and in risk-adjust terms. And while we have under-performed the S&P over the long term on an absolute basis (only by 1% by the way), we have done so while providing 50% protection during these large downdrafts.



Key Point:
Van Hulzen's strategy has only lagged the S&P by 1% per year over the long term, but has provided approx. **50% protection** during major pullbacks

	ABSOLUTE RETURN			DOWNSIDE CAPTURE	
Time Period	S&P 500	BXM	VAM	BXM	VAM
A) October 2007 - February 2009	-50.9%	-35.8%	-33.7%	70%	66%
B) April 2010 - August 2010	-10.9%	-4.3%	-1.8%	39%	16%
C) April 2011 - September 2011	-16.3%	-12.2%	-8.7%	75%	54%
D) September 2018 - December 2018	-13.5%	-10.8%	-5.1%	80%	38%
E) February 2020 - March 2020	-19.6%	-21.3%	-14.6%	109%	74%
AVERAGE	**-22.2%**	**-16.9%**	**-12.8%**	**74.7%**	**49.7%**

Note: A major sell-off is defined as an S&P 500 pull-back of more than 10%. There is no assurance that the Strategy will achieve its investment objectives. The use of covered call strategies does not ensure profits or guarantee against losses. VAM returns are presented gross of fees.

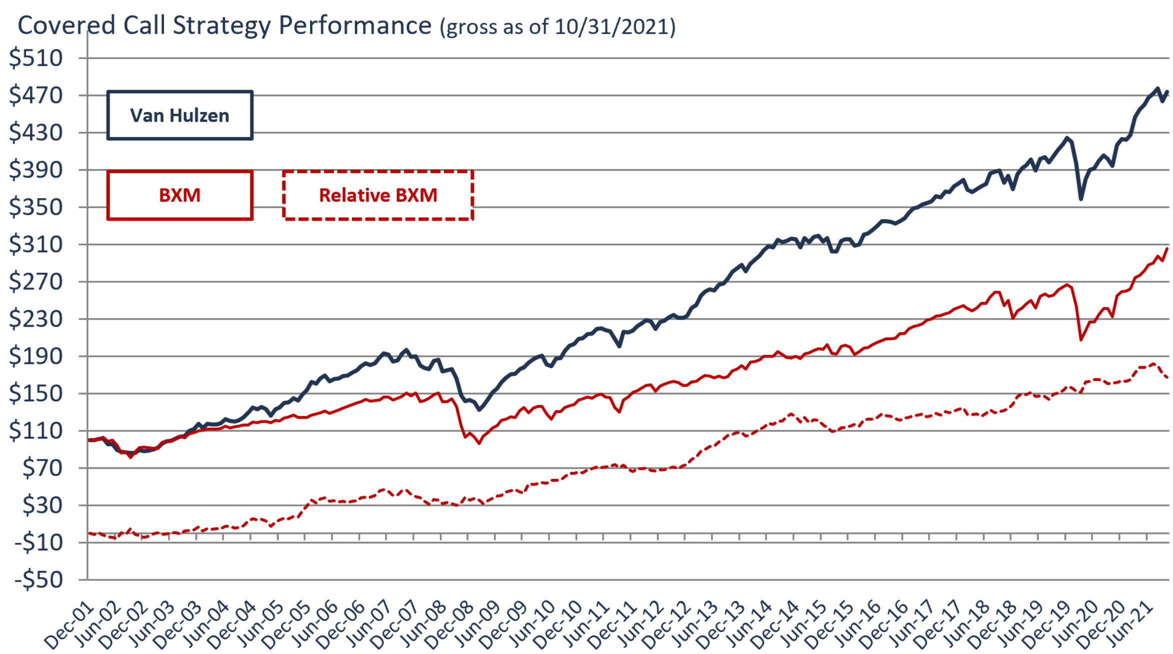
Alpha

a = Rp – [Rf + (Rm – Rf) ß]

	Rel to BXM	Rel to SPX
Rp = Realized return of portfolio	8.1%	8.1%
Rm = Market return	5.6%	9.1%
Rf = risk-free rate	0.1%	0.1%
ß = Beta	0.7	0.5
Alpha (relative to BXM)	**4.2%**	**3.2%**

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)*	Oct 2021	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	2.2%	0.4%	4.2%	11.9%	20.2%	8.0%	7.3%	6.1%	8.2%	8.2%
Van Hulzen (Net)	2.1%	0.2%	3.9%	11.3%	19.6%	7.4%	6.7%	5.5%	7.4%	7.3%
BXM	4.7%	5.6%	10.6%	17.9%	31.5%	7.7%	7.9%	7.2%	7.9%	5.8%
Difference (Gross-BXM)	-2.5%	-5.2%	-6.4%	-6.0%	-11.4%	0.2%	-0.6%	-1.1%	0.3%	2.4%

*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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