VAN HULZEN ASSET MANAGEMENT

For Financial Professional Use Only

Option Income: The New Frontier!

A Commentary on Option Income

VAN HULZEN COVERED CALL STRATEGY

STRATEGY OBJECTIVE

The Strategy's investment objective is to seek total return with less volatility than equity markets in general.

Large Cap Blend/Value | **Targets Low Volatility** | **Option and Dividend Income**

INVESTMENT STRATEGY

- The portfolio consists primarily of high quality ultra large cap dividend-paying US stocks.
- Fundamental process for selecting stocks driven by a return-on-capital framework that provides for quality comparisons of companies across industries, sectors and geography.
- Seeks to generate portfolio income of 6-8% through dividends and option income.
- Risk management: Tolerable-risk models, values-at risk models and stop loss procedures to manage portfolio risk.

HOW TO INVEST

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Option Income: The New Frontier!

The world has changed. Inflation is here. Bonds are down approximately 5% year-to-date and are no longer the stable source of income that investors need. Dividend yields remain at record lows. Where are you to turn for income in this environment? For many investors, it is finally time to turn to the options market. It's no coincidence that the covered call strategy was born in the 1970s, the last time we saw persistently high inflation.

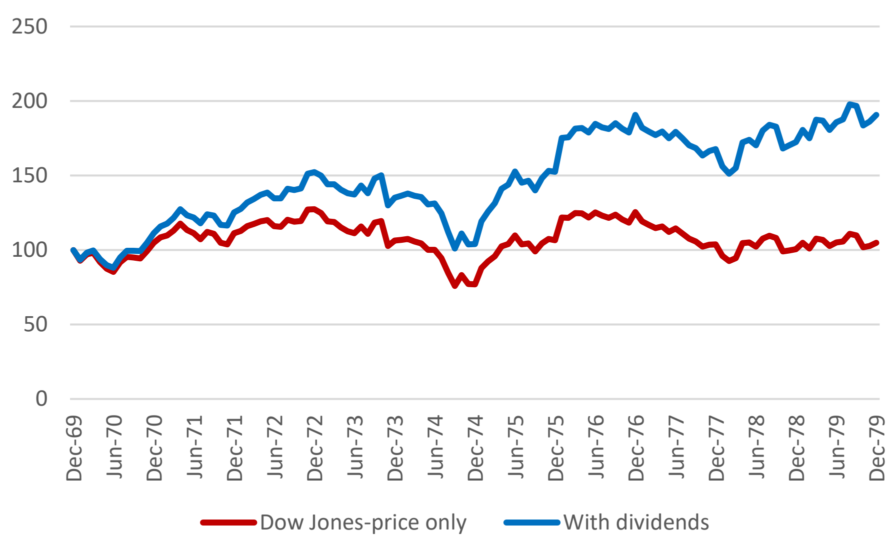
What We Can Learn From The 1970's

From a macro perspective, today there are two themes that are eerily similar to the 1970s. First, Fed spending (money printing) has once again spun out of control. The Fed's balance sheet has increased 5x since 2010. Money printing saw a similar explosion during the 1960s-1970s, in order to fund the Vietnam war (our first "credit card" war). You may recall that the US effectively defaulted in 1971, forcing Nixon to take us off the gold standard. This was the birth of fiat currency. So, we have been here before.

The oil shock we are seeing today is also reminiscent of the 1970s. Oil surged to $130 last week, more than double its price 12 months ago. This harkens back to the 1973 and 1979 crises. Then it was the Yom Kippur War and the Iranian Revolution that interrupted supply. Today it is the Russian invasion of Ukraine.

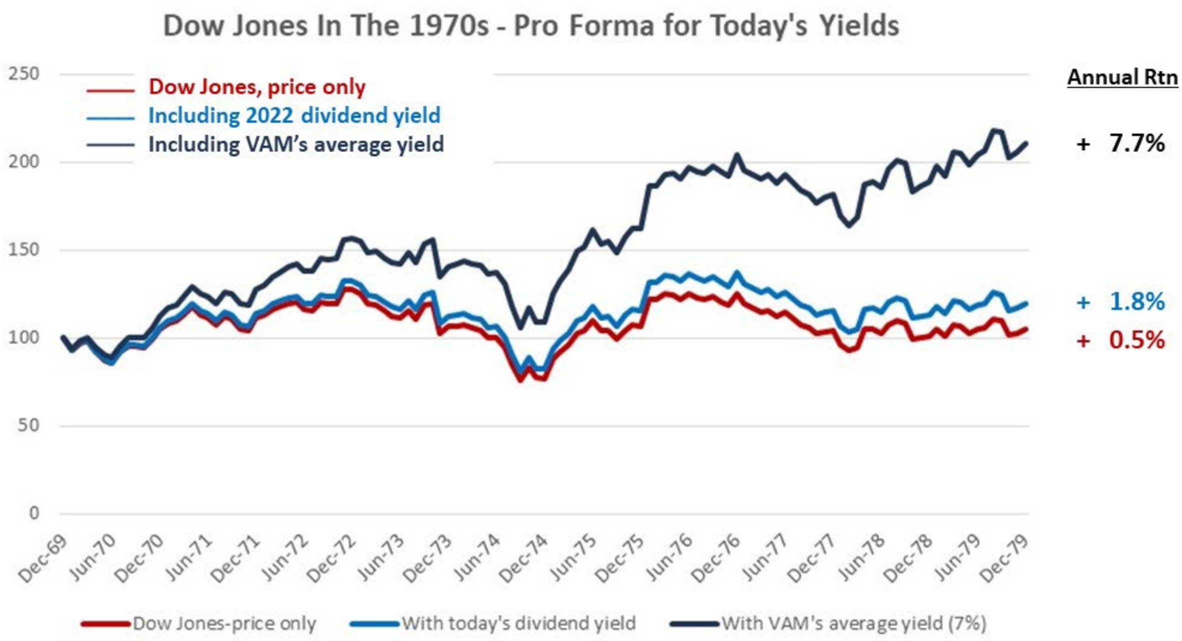
This doesn't bode well for stocks or bonds. The Dow Jones opened and closed the decade of the 1970s at roughly 800. Prices only increased by 0.5% per year. Fortunately for income investors at that time, dividends yielded approximately 6% for most of that decade (much higher than today). So total stock returns were able to scratch out a positive gain.

Dow Jones In The 1970s



Today, yields are in the range of 1.3% and inflation is running at 7%! This is not a good combination. While we would expect inflation to normalize somewhat in the coming years, today's dividend yields clearly won't cut it. And bond yields won't help retirees much either.

Covered calls are potentially a great solution to this income dilemma. We target 6-8% yields (dividend plus option income) and run at approximately 40% less risk than the overall market. In the chart below, we have applied today's dividend yield to the 1970s price chart for the Dow. We have then added our targeted yield of 7% for comparison. This is of course a proforma exercise, but it's worth noting that our yield profile could double your money in 10 years, even in a "lost decade" scenario.



So, what can we learn from the 1970s? Income matters!

Are We Embarking On Another "Lost Decade?"

The greatest secular bull market in history began in the early 1980s. The total return of the S&P 500 for that period was roughly 12000%. The price component of that return was ~4000%, so income matters.

But over the past 10 years, the total return of the S&P 500 was 300% (16.5% annual!). The price component of that return was 235%. This is leaps and bounds higher than its long-term average of 10%. And with multiples pushing well above previous all-time highs in 2021 and inflation rapidly increasing, investors are beginning to wonder if we are embarking on another "lost decade."

This is not a new concept. There have been two decades in the past 50 years where stock prices went nowhere for 10 years. The last time stocks were this expensive was the late 1990s. The decade of the 2000s began with the crash of the internet bubble in 2001-02 and ended with the great financial crisis of 2008-09. For the 10year period of the 2000s, the S&P 500 delivered just 1.6% per year. Virtually all this return came from dividends. Price returns were zero, and inflation adjusted returns were negative.

We're not predicting whether this is in the cards or not, but we do acknowledge that these periods do happen, typically after several decades of out-sized returns (like we've just seen). And it's important to understand what types of macro forces could cause this, and what types of investment strategies are best suited for this environment.

What Can We Learn From 2001-2010?

The last "Lost Decade" followed the raging bull market of the 1980s-90s and the blow off top of the internet bubble of 2000. During these preceding 20 years, inflation was in the 2-3% range (after spending much of the 1970s in the double digits), and interest rates were on a steady decline. We also had favorable demographics as a tailwind, as the Boomer generation was in its peak spending years. Things simply got over-heated, especially with the emergence of the internet and real advances in efficiency that came from technological advances.

The 2001 recession brought growth stocks back down to earth, but we soon saw value stocks (led by the banks) explode as leverage spun out of control. This led to the sub-prime crisis and the great recession of 2008-09.

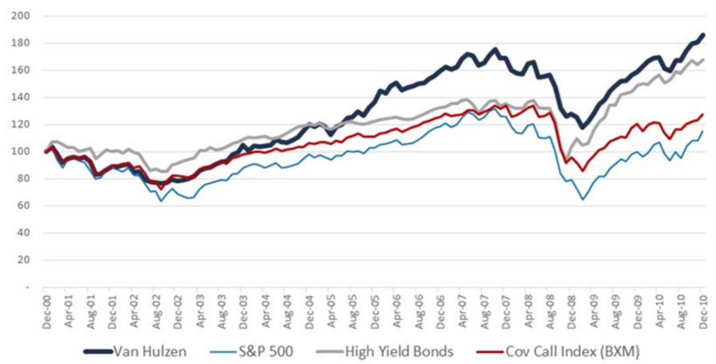
In summary, the lost decade of 2001-2010 resulted from the deflation of over-heated markets (first tech, then financials) and a leverage reckoning.

Covered Calls and High Yield Bonds Out-Performed Stocks, By A Lot

As you can see from the chart below, stocks were a terrible asset class to be in during this 10year period, returning only 1.6%. High yield bonds, in contrast, delivered a 5.9% annual return, despite their decline in the 2008 crash. But rates declined over this period, whereas they are increasing now. Our covered call strategy delivered an average annual (gross) return of 7.1% during the "lost decade," at a third less risk than the S&P. We attribute our out-performance to:

1. Our focus on quality (we do not speculate)
2. Our preference for income overgrowth (dividends and call premiums help make our return more certain, placing less reliance on stock price appreciation)

Relative performance during the Lost Decade of the 2000s

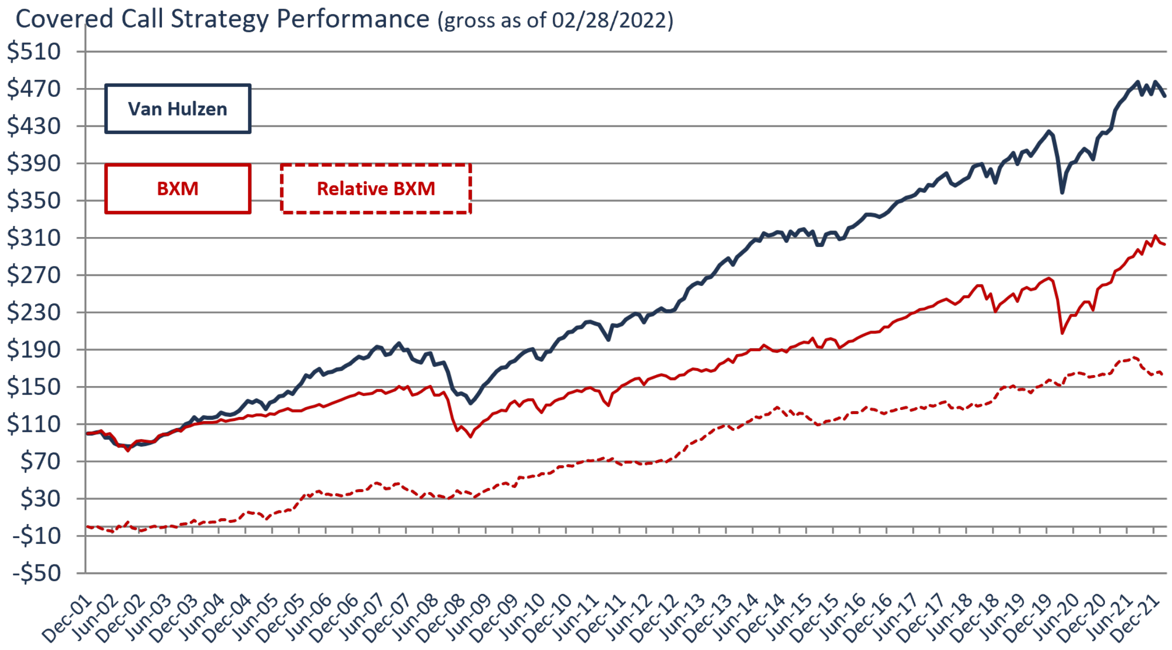


Risk/Return Statistics	Cumulative Return	Annual Return	Standard Deviation
Van Hulzen	**86.0%**	**7.1%**	**11.4%**
S&P 500	**15.1%**	**1.6%**	**16.4%**
High Yield Bonds	67.8%	5.9%	11.5%
Cov Call (BXM)	**27.4%**	**2.7%**	**12.5%**

Note: We launched our covered call strategy in January 2002, one year after the beginning of the "Lost Decade." In order to present a comparable period, we have assumed we would have performed in-line with our benchmark (the BXM) during that first year. Considering we have out-performed the BXM by 2.7% annually over our 20-year track record, we believe this is a conservative assumptions. Return presented are gross.

Takeaway

The record breaking "growth bet" of the past 5 years appears to be over. With inflation on the rise and the Fed printing money faster ever year, we recommend you focus on quality, income and protection. Did we already say that income matters? We truly believe that Option Income is the new frontier!



Returns (annualized)*	Feb 2022	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	-1.8%	-0.4%	-3.2%	-3.2%	8.2%	5.7%	5.8%	5.5%	7.4%	7.9%
Van Hulzen (Net)	-1.8%	-0.5%	-3.4%	-3.3%	7.6%	5.1%	5.2%	5.0%	6.7%	7.0%
BXM	-0.7%	0.5%	1.8%	-3.2%	15.3%	7.8%	6.4%	6.7%	6.8%	5.6%
Difference (Gross-BXM)	-1.1%	-0.9%	-5.0%	0.0%	-7.2%	-2.1%	-0.6%	-1.1%	0.6%	2.2%

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

For more information of this unique aspect of our strategy, please vaminstitutional.com

RISK CONSIDERATIONS: Review Code FPAC-0103-22:

Past performance is not a guarantee of future results. Dividends are not guaranteed and must be declared by a company's board of directors

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The Strategy involves risk including the possible loss of principal. There is no assurance that the Strategy will achieve its investment objectives. The use of leverage embedded in written options will limit the Strategy's gains because the Strategy may lose more than the option premium received. Selling covered call options will limit the Strategy's gain, if any, on its underlying securities and the Strategy continues to bear the risk of a decline in the value of its underlying stocks. It is not possible to invest directly in an index