Covered Call Commentary April | 2022

Do Hedge Funds Have A Different Definition of "Hedge"?

Per Investopedia: What Is a Hedge?

"A hedge is an investment that is made with the intention of reducing the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting or opposite position in a related security"

There is an old investment wisdom: "Stocks go up the escalator and down the elevator". This month's commentary gives you the answer on how "hedge funds" perform vs our covered call strategy.

Tiger Global, one of the best performing hedge funds in the recent past, turned in a -15% month in April, bringing its YTD loss to a whopping -44%. That's its **hedge** fund -- the firm's long-only fund was -52% through April. How is this possible, when the S&P 500 and Nasdaq indices were down "only" 12.9% and 21.0%, respectively? Clearly, the answer is leverage. Using leverage can magnify gains in good years but can destroy you in down years. When asked about their performance, Tiger's spokesperson said "We do not believe in excuses and so will not offer any."

Tiger isn't alone. Based on the 1,100 hedge funds that have reported so far, the Barclay's Hedge Fund Index is -6.3% year to date. **Our strategy is not a hedge fund. But through April, we were down only 4.8% YTD.**

All this raises an important question. Why aren't hedge funds better at **hedging**? That was certainly the original intention when Alfred Winslow Jones launched the first hedge fund in 1949. It was a long/short equity fund and was designed to deliver consistent returns at lower risk. This idea gradually caught on and by the mid-1960s, hedge funds had gained broader popularity. Since then, the industry has been through two boom/bust cycles as some managers strayed from their original objectives, took on took much risk and ultimately blew up during the bear markets of 1973-74 and then 2000-2002. "Chasing the S&P" is often cited as the primary cause of such implosions.

What gives? These are smart people, and some of the best trained in the industry. The typical 2&20 incentive structure (2% management fee and 20% performance fee) is certainly one of the reasons, rewarding managers for high returns but not penalizing them much in down years. In any case, many of these funds are not doing their job.

So What is a "Reliable Hedge?"

We're in a treacherous environment, and investors are 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 have been destroyed this year, 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 create equal

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.

Protection When You Most Need It

Below you will see all S&P 500 pullbacks greater than 10% since our inception 20 years ago, comparing our performance (VAM) to that of the S&P, the BXM, and the Barclay's Hedge Fund Index (which we've labeled HFI). As you'll see, in 4 of the 6 downdrafts we did better than the hedge funds. But we have delivered an annual return of 1.8% higher (7.7% versus 5.9%).

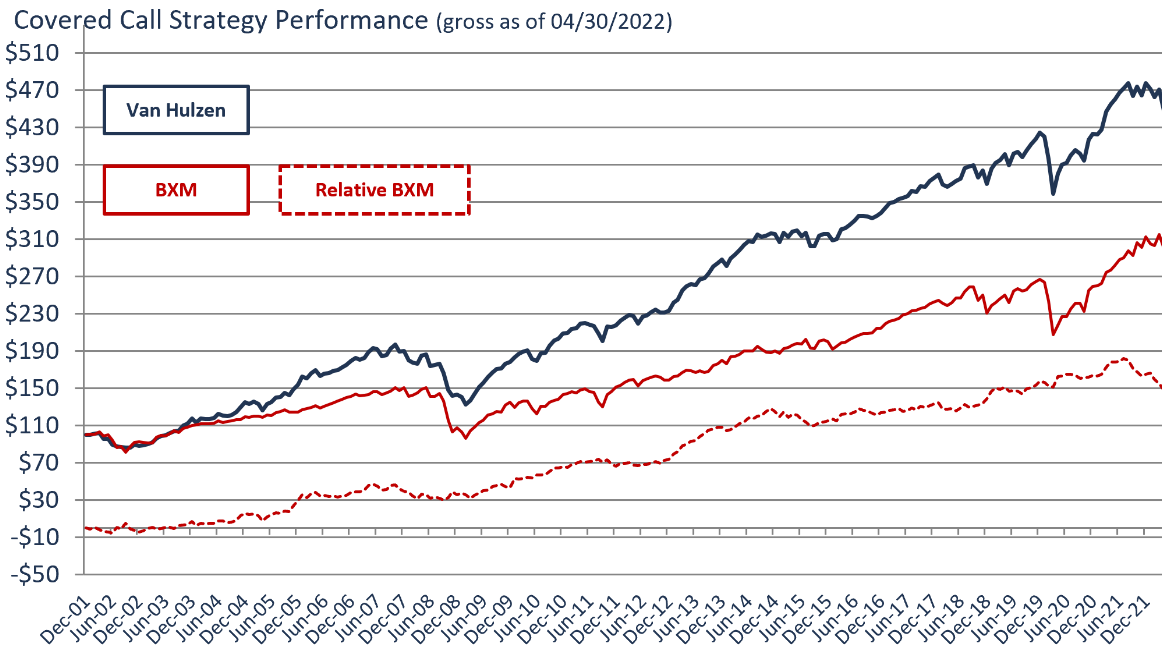
	ABSOLUTE RETURN				DOWNSIDE CAPTURE		
Time Period	S&P 500	BXM	HFI	VAM	BXM	HFI	VAM
A) October 2007 - February 2009	-50.9%	-35.8%	-24.1%	-33.7%	70%	47%	66%
B) April 2010 - August 2010	-10.9%	-4.3%	-2.8%	-1.8%	39%	26%	16%
C) April 2011 - September 2011	-16.3%	-12.2%	-9.6%	-8.7%	75%	59%	54%
D) September 2018 - December 2018	-13.5%	-10.8%	-6.3%	-5.1%	80%	47%	38%
E) February 2020 - March 2020	-19.6%	-21.3%	-11.7%	-14.6%	109%	60%	74%
F) January 2022 - April 2022	-12.9%	-2.3%	-6.3%	-4.8%	18%	49%	37%
AVERAGE	**-20.7%**	**-14.4%**	**-10.2%**	**-11.4%**	**65.2%**	**48.0%**	**47.6%**

Our covered call strategy invests in "escalator" stocks and has a great track record of avoiding the elevator down. This has been a great recipe for compounding long term returns. Per Albert Einstein: **"Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it."**

If you are in the market for a "hedge," we suggest you make sure you are getting what is advertised to you. The bumper-sticker on your 1960 pick-up truck may say "turbo," but that doesn't make it a turbo. Stick with our covered call strategy. We don't sell "bumper-stickers".

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)*	Apr 2022	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	-4.6%	-4.7%	-5.2%	-6.0%	-1.3%	3.8%	4.9%	5.0%	7.0%	7.7%
Van Hulzen (Net)	-4.7%	-4.9%	-5.5%	-6.2%	-1.8%	3.2%	4.3%	4.4%	6.3%	6.8%
BXM	-4.7%	-1.5%	-1.8%	-3.9%	8.6%	6.3%	5.9%	6.3%	6.5%	5.6%
Difference (Gross-BXM)	0.1%	-3.2%	-3.4%	-2.1%	-9.9%	-2.5%	-1.0%	-1.2%	0.5%	2.1%

*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-0133-22