Covered Call Commentary

February | 2023

Focus on Dividend *Growth*!

Income is king in markets like these. We are an income strategy, so we know a thing or two about this topic. But there are different types of dividend-paying companies, and understanding the difference can be critical to picking the right stocks.

There are of course well-known value traps in the dividend space. For example, companies that have seen a deterioration in fundamentals but have not yet cut their dividend will typically see their dividend yield spike to levels that at first glance look very attractive. Until they cut their dividend, that is.

Another warning sign is the payout ratio. Companies that pay a high dividend but are not growing the business often end up with very high payout ratios (the percentage of earnings that gets paid out in dividends). Tobacco companies are great examples of this. A high payout ratio typically means there is not much capacity to grow the dividend going forward. But it also means there is not much capital available to grow the business. And in an inflationary environment like today's, a company may need to grow just to survive.

Dividend Growth: A Strong Signal Of Quality & Confidence

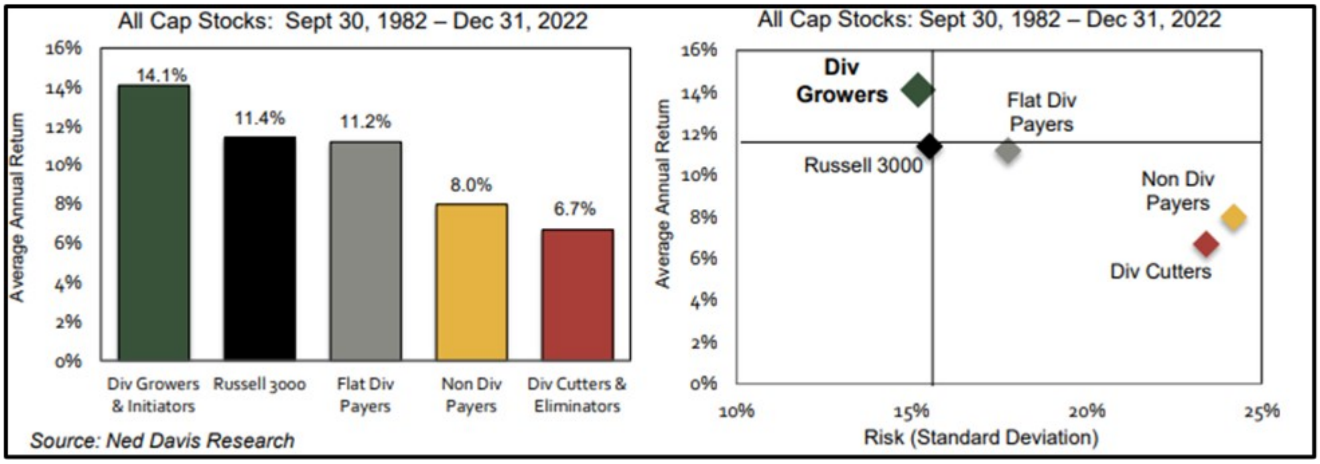
There is a big difference between dividend yield and dividend growth. Having a dividend yield signals the existence of financial health and a profit-sharing mindset. It does not necessarily tell you if those things exist ***today***…just that they did at some point in the recent past. But a track record of consistent dividend growth, year after year, signals that the company is in good standing today and is ***confident about its future***.

Studying The Dividend Landscape

Ned Davis recently published a study that broke down the dividend universe into the following four categories to compare shareholder returns over the past 40 years.

- Dividend growers & initiators (within the last 12 months)
- Flat dividend payers (no growth)
- Dividend cutters
- Non-dividend payers

The results are meaningful, even enlightening. Dividend growers had an average shareholder return of 14.1% over the past 40 years, by far the highest in the group. Dividend cutters had the lowest performance, and the other categories lined up in between. See below.



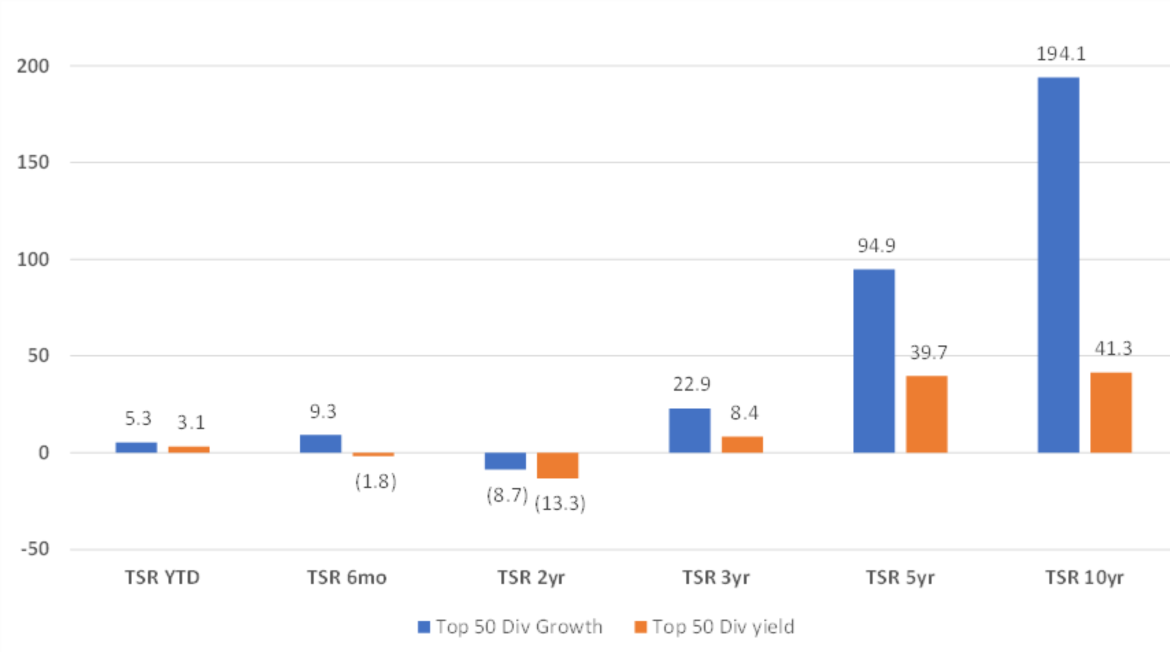
The table below shows the percentage of time Dividend Growth stocks have outperformed their respective benchmarks over rolling periods

Data as of 12/31/2022	Initiation Date	Index	One Year Rolling	Three Year Rolling	Five Year Rolling	Ten Year Rolling
All Cap Dividend Growers	9/30/1982	Russell 3000®	**61%**	**63%**	**75%**	**84%**
All Cap Flat Dividend Payers	9/30/1982	Russell 3000®	46%	33%	31%	43%
All Cap Non-Dividend Payers	9/30/1982	Russell 3000®	38%	30%	32%	30%
All Cap Dividend Cutters	9/30/1982	Russell 3000®	31%	23%	24%	25%

Dividend Growth vs Dividend Yield

We were particularly interested in how the top dividend growers compared to the top dividend payers, so we ran our own study. Using the HOLT™ database, we compared the top 50 dividend growers in the S&P 500, using an average 5yr dividend growth figure, to the top 50 dividend yielders in the index. We found similar results.

The top dividend growers outperformed the top yielders in every time-period studied: YTD, 6mo, 2yr, 3yr, 5yr & 10yr. And the performance spread is meaningful. See below.



Digging A Level Deeper

The dominance doesn't stop at stock price performance. The fundamentals of the top dividend growers are significantly better than the top dividend yielders. On average, the growers have Cash Flow ROIs almost 2x higher (15.4% vs 8.1%), sales growth more than 2x higher (10.9% vs 5.3%), dividend growth more than 4x higher, and payout ratios much lower (31% versus 53%), meaning they have more capacity to keep growing their payouts. The dividend growers also present less leverage risk. On average, the top growers have less than half the financial leverage (including debt and off-balance sheet leases obligations) than the top yielders (14.5% vs 33.1%).

	Top 50 Div Growers	Top 50 Div Yield
CFROI (2023E)	15.4	8.1
Sales growth (5yr)	10.9	5.3
Dividend Yield	1.8	5.0
Dividend Growth (5yr)	24.6	5.7
Dividend Payout Ratio	31.1	53.1
P/E	16.0	12.0
Leverage %	14.5	33.1
Default Probability	-	0.8

The only argument one could make against this analysis is that the dividend growers have a lower current yield than the top yielders. That's true. But it's a more diversified group. And of course, we sell call options on all our holdings, so we win the yield argument either way. In our view, it's total shareholder return that matters most.

Key Takeaway

There are always exceptions, and individual company analysis is critical. But generally speaking, our findings suggest that investors should be more focused on dividend growth than dividend yield. We have summarized this in a simple stylized equation:

Choosing Dividend Growth Over Yield

Higher ROI businesses
+ Higher sales growth
+ Higher dividend growth
+ Low payout ratios (capacity to keep growing)
+ Less leverage

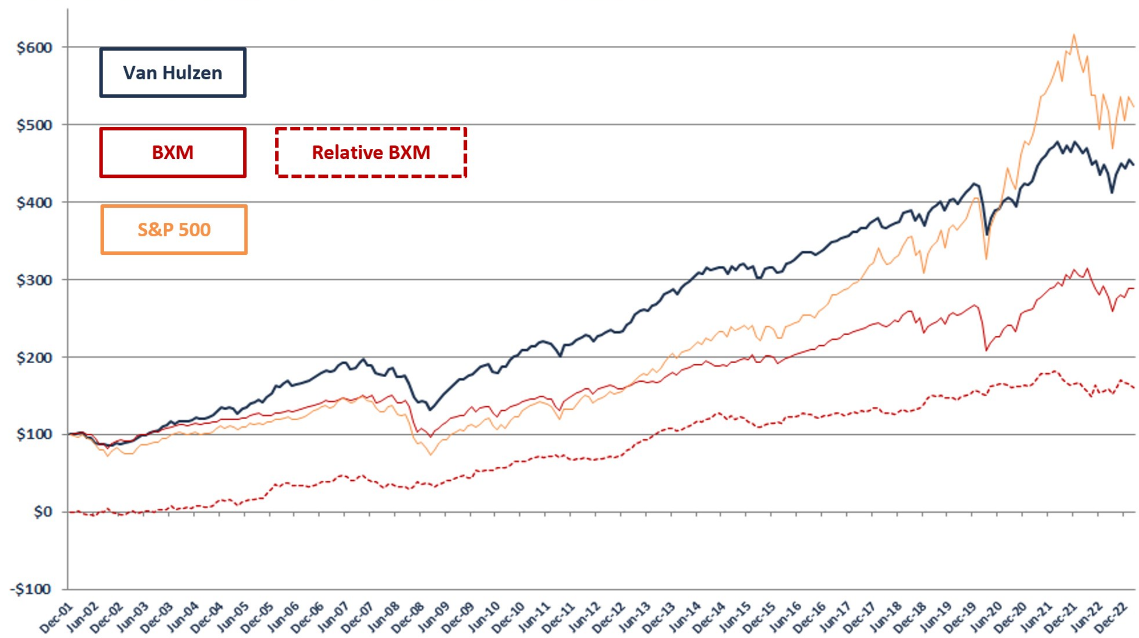
= Significantly higher shareholder returns

We will present some of our portfolio holdings thru this lens next month.

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.

Covered Call Strategy Performance (gross as of 02/28/2023)



Returns (annualized)*	Feb 2023	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	-1.2%	-0.3%	3.0%	1.1%	-2.9%	4.3%	4.0%	5.4%	6.2%	7.4%
Van Hulzen (Net)	-1.3%	-0.4%	2.7%	1.0%	-3.4%	3.7%	3.5%	4.8%	5.6%	6.5%
BXM	-0.2%	2.7%	3.8%	4.0%	-4.8%	5.7%	3.6%	5.8%	5.9%	5.1%
Difference (Gross-BXM)	-1.1%	-3.0%	-0.8%	-2.9%	1.9%	-1.5%	0.4%	-0.3%	0.4%	2.2%

*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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