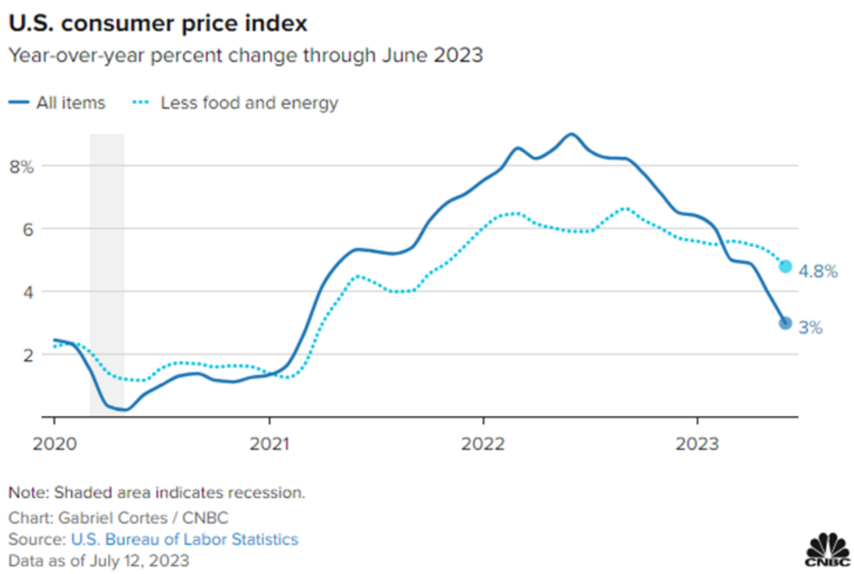
Covered Call Commentary: Q2 2023

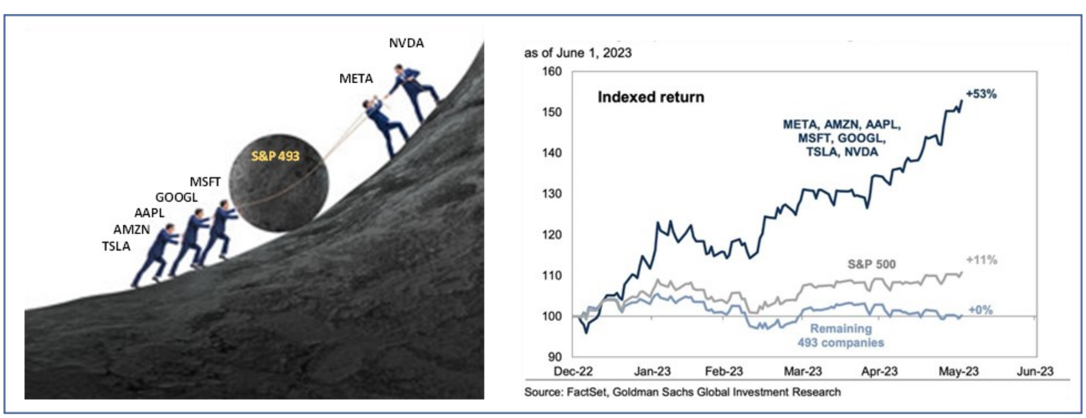
Recovery Continues

Stock markets turned in a strong Q2. Inflation has now declined for 12 straight months, which has fueled returns for the largest technology stocks that underperformed in 2022. At first blush, it would appear the Fed's aggressive monetary policy has helped tame the beast. The final verdict is still to come, of course. Fed policy will continue to have a huge bearing on future stock returns, as studies show that markets tend to do well when 10-year treasuries are below 5% but struggle when they are above 5%. The 10-year Treasury bond is current yielding 4%, while the Federal Funds rate is already over 5%.



Wide dispersion continued in Q2, with growth stocks dominating value stocks

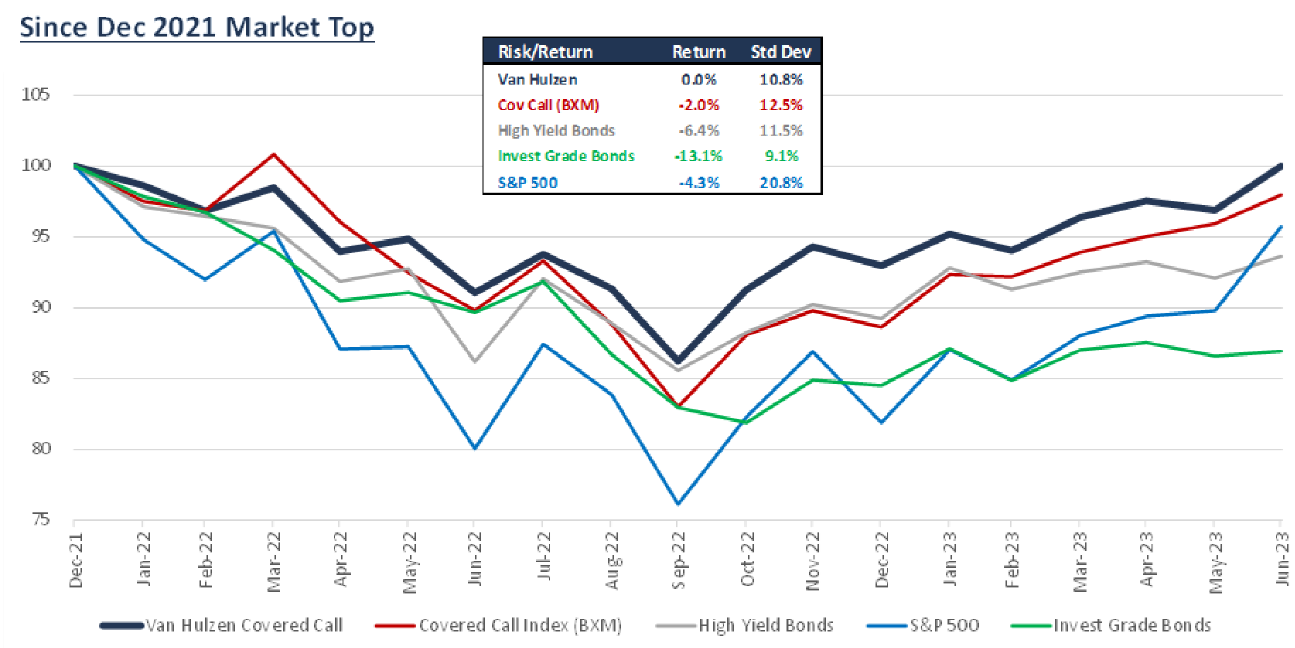
Growth stocks dominated value stocks in the first half of 2023, with the Russell 1000 Growth beating the Russell 1000 Value by 13.4% in Q1 and then *another* 8.7% in Q2. Big Tech once again led the way. Although market breadth improved somewhat in the month of June, as of June 1 the top seven stocks (coined the Magnificent 7) were up 53% while the other 493 S&P constituents were flat. See below. The energy, utilities and staples sectors turned in negative returns for the first half. For the most part, income strategies have not worked this year.



Strategy Performance

Our income strategy, however, returned **+3.7%** for the quarter, bringing its first half return to a very healthy **7.5%**. We own high quality large cap stocks and sell covered calls on these positions in order to add incremental income and downside protection.

And we are pleased to report that as of June 30 our strategy has clawed back all of its 2022 losses. This compares very favorably to the broad stock and bond indices, which are still 4-13% below their 2021 high water marks. See below.



Portfolio Highlights

We have often discussed how covered calls tend to behave in different market environments. Given the continued dispersion of Q2, we will once again illustrate this using the YTD performance of our actual holdings.

- **Sideways & Declining Markets**. Covered calls tend to outperform in sideways moving, as well as declining, markets. This has certainly been true in 2023, with our covered call positions outperforming by 4-6% relative to just owning the underlying stocks. See top two sections below.

- **Rising Markets**. When market gains are gradual and moderate, covered calls can typically keep up with long-only stocks. This has also held true in 2023, as our hedged positions showed no drag relative to the performance of the underlying stocks. They have actually outperformed by 2.8% relative just owning the underlying stocks. See bottom, left.

- **Exploding Markets**. Covered calls tend to underperform when stocks rocket higher in a short period of time, like tech stocks have in 2023. However, by actively rolling our options positions, we were able to capture approximately 63% of the upside in this category (23.5% divided by 37.3%). We are pleased with this result. See bottom, right.

Sideways Moving

Name	Stock	Options	Net
XOM	-1.1%	5.8%	4.7%
KMI	-1.7%	2.6%	0.9%
DRI	-2.4%	3.6%	1.2%
IBM	-2.7%	5.0%	2.3%
Median	**-2.0%**	**4.3%**	**2.3%**

Covered call better

Declining

Name	Stock	Options	Net
MMM	-18.8%	5.8%	-13.0%
ABBV	-15.1%	7.1%	-7.9%
TMUS	-8.7%	5.1%	-3.6%
WMT	-8.0%	8.8%	0.8%
Median	**-11.9%**	**6.5%**	**-5.4%**

Covered call better

Rising

Name	Stock	Options	Net
ANET	8.8%	4.1%	12.9%
MRK	5.4%	3.1%	8.5%
GLD	5.1%	2.5%	7.6%
DHR	3.9%	0.5%	4.4%
Median	**5.2%**	**2.8%**	**8.0%**

Covered call better

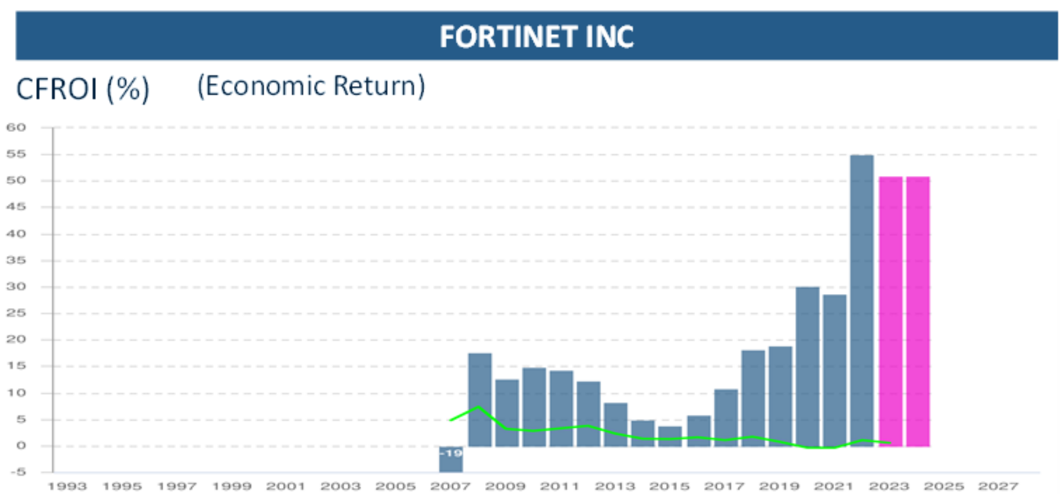
Exploding

Name	Stock	Options	Net
AAPL	49.6%	-17.2%	32.4%
MSFT	42.6%	-28.0%	14.6%
GOOGL	32.0%	-10.3%	21.6%
ORCL	23.3%	-2.6%	20.7%
Median	**37.3%**	**-13.8%**	**23.5%**

Long-Only Better

We have included some individual example trades from the first half below.

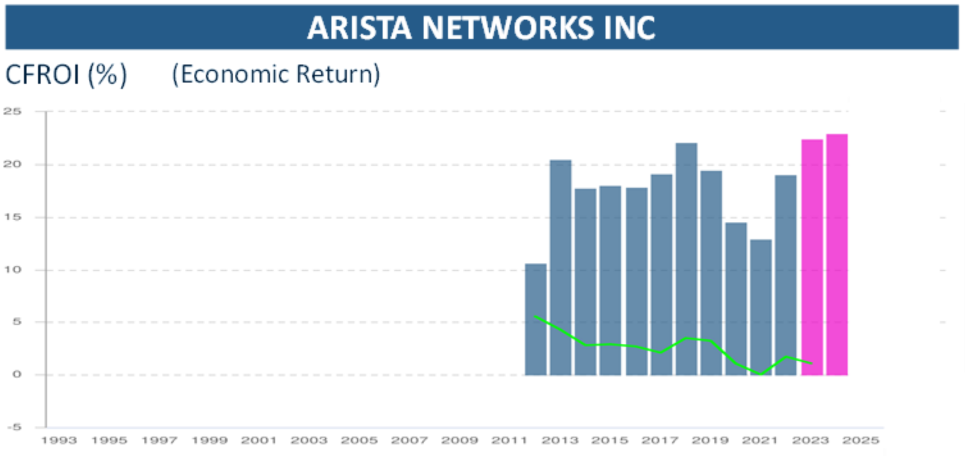
Fortinet (FTNT)



Source: Credit Suisse HOLT TM

- Fortinet is a leading cybersecurity & networking provider
- Strong, improving Cash Flow ROIs (see chart above)
- Over the last 18 months, have had seven positive earnings revisions (none were negative) and have beaten estimates every quarter.
- No dividend, but of course covered calls give us an option premium of 8-10% on this stock
- Near zero debt. $2.2 billion of cash on hand.
- Significant share-repurchase program (approx. $2 billion last year)

Arista (ANET)



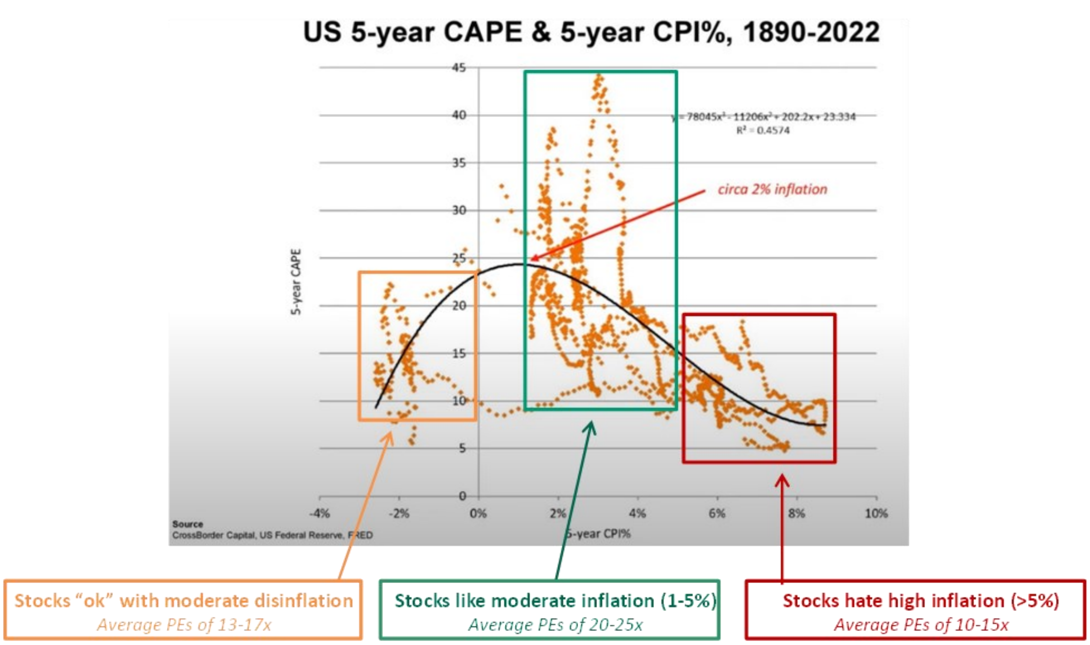
Source: Credit Suisse HOLT TM

- Arista is a leader in cloud networking solutions, with 5yr sales growth > 20%
- Over the last 18 months, have had nine positive earnings revisions (none were negative) and have beaten estimates every quarter.
- No dividend, but of course covered calls give us an option premium of 8-10% on this stock
- Significant share-repurchase program ($700 million last year)
- Zero debt. $3 billion of cash on hand.

Thoughts on Inflation & Interest Rates

Inflation & Stock Market Multiples

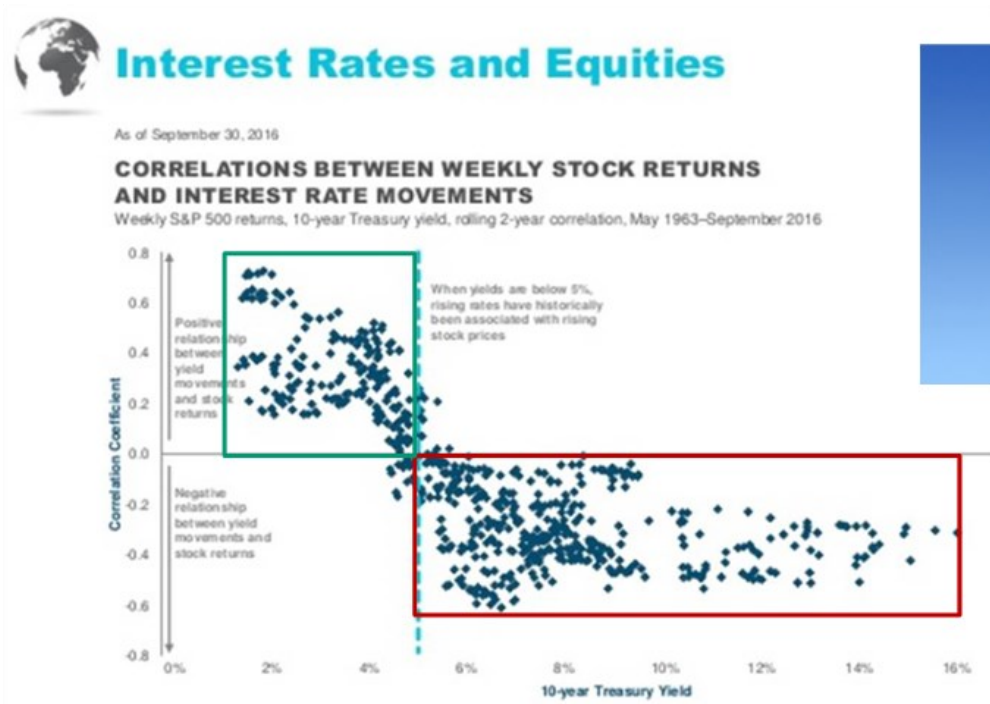
The following chart plots 5yr PE multiples (y axis) against 5yr CPI (x axis). Low single digit inflation (1-5%) corresponds to the highest historical PEs. We are currently in this range, but not by much.



Lookback: *November 2022 Commentary ("Between A Hawk & A Hard Place")*

"The prevailing wisdom is that higher rates will weigh on stock returns, as they did in the 1970s. But we had run-away (double digit) inflation in the 1970s, whereas inflation appears to be slowing and rolling over today. We found a T. Rowe Price study that shows that when Treasuries are below 5% (as they are now, barely), rising rates have actually been associated with rising stock prices. It's when rates rise above this 5% threshold that additional increases start to negatively impact the stock market. See below."

The 10-year Treasury bond is current yielding 4%, while the one-month T-Bill rate is slightly above 5%. We are right there, at the "Hard Place." There's no question the future outlook for inflation, and the Fed's response, will continue to be critical.



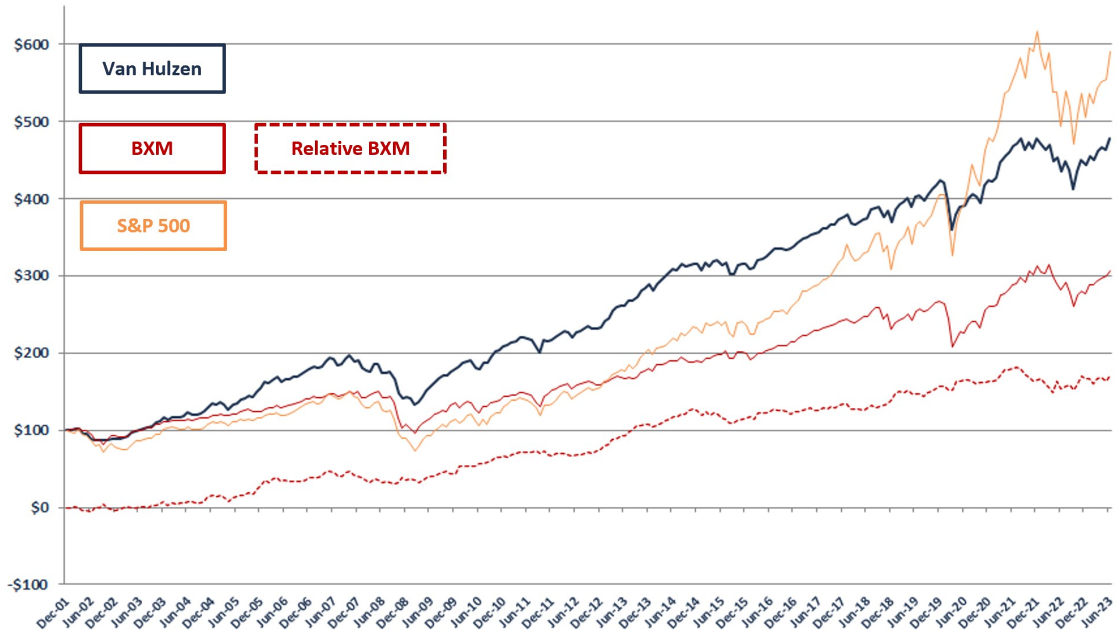
Key Takeaways

- This is a great market for covered calls. The outlook for the economy is very uncertain, and most economists are projecting mid-single digits for equity returns over the next 7-10 years.
- The stock market has not been this concentrated at the top since the 1960s. This typically doesn't bode well for markets (the lost decade of the 1970s followed the concentration of the 1960s).
- After this rebound run in Big Tech, we believe value stocks will perform better in the next decade than they did in the past decade. Perhaps better than growth, perhaps in-line with growth. We are indifferent about this.
- We will continue to stick to our knitting. We don't chase trends. Of the "Magnificent Seven," we own the three that meet our investment criteria. We earn an attractive yield on them and have valuable downside protection in place. This approach has created strong Alpha for us in the past.
- When the next significant pullback occurs (be it months or years away), our 21-year track record suggests that our strategy will lose much less than the market and "break-even" in about half the time. There's no guarantee of this, but it's been true in 5 of the 6 significant selloffs over the past 20 years.
- Our track record also suggests that we tend to participate in 87% of the market's gains over the long run (7.5% average return over 21+ years, vs 8.6% for the S&P 500) but take significantly less risk in the journey.
- We are ready for whatever the market throws at us.

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 06/30/2023)



Returns (annualized)*	Jun 2023	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	3.2%	3.7%	7.6%	7.6%	9.8%	6.9%	4.9%	5.4%	6.3%	7.5%
Van Hulzen (Net)	3.1%	3.5%	7.3%	7.3%	9.3%	6.3%	4.4%	4.8%	5.6%	6.7%
BXM	2.1%	4.3%	10.5%	10.5%	9.0%	10.6%	4.4%	5.9%	6.3%	5.3%
Difference (Gross-BXM)	1.0%	-0.6%	-2.9%	-2.9%	0.8%	-3.7%	0.5%	-0.5%	0.0%	2.2%

*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-0333-23