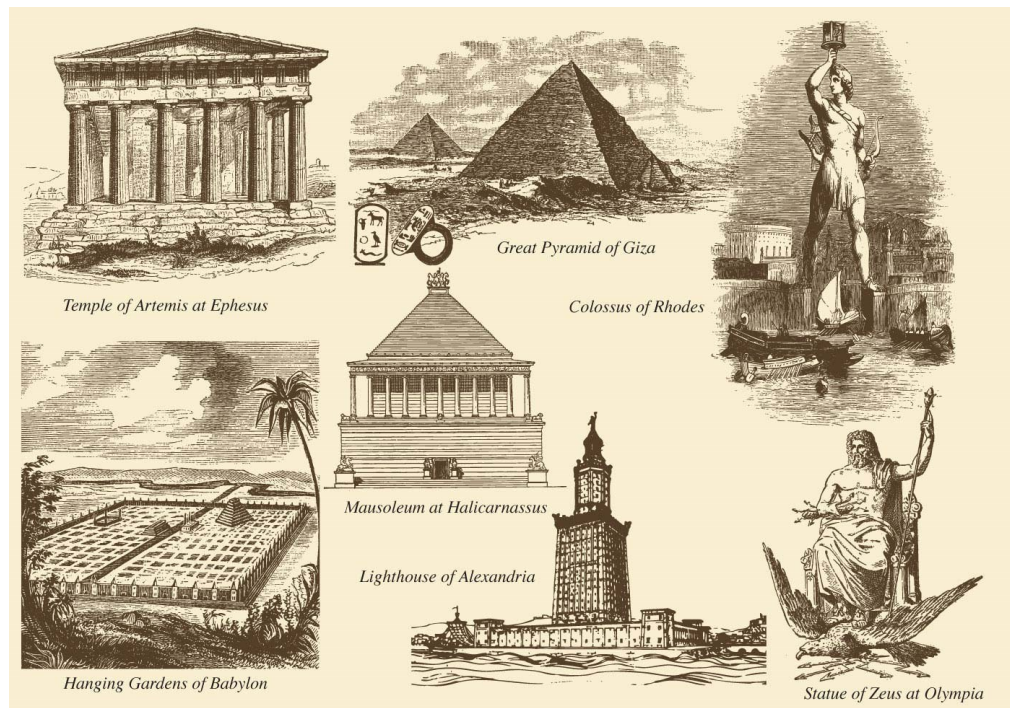


Compound Interest: The 8th Wonder of the World

The Original Seven Wonders

The first ‘seven wonders of the ancient world’ list was made more than 2000 years ago, by adventurous Hellenic travelers who marveled at the world’s most incredible man-made constructions. Although the “known” world (to Greeks) at the time was restricted to the Mediterranean and the Middle East, these original seven wonders were the quintessential “must see” list for ancient travelers. They were:

- Great Pyramids of Giza
- Hanging Gardens of Babylon
- Temple of Artemis at Ephesus
- Statue of Zeus at Olympia
- Mausoleum at Halicarnassus
- Colossus of Rhodes
- Lighthouse of Alexandria



The New Seven Wonders

Of the original seven wonders, only the Great Pyramids of Giza have survived. The others have been destroyed. So in 2001, Swiss-born, Canadian filmmaker Bernard Weber set up the New7Wonders Foundation to find a new seven wonders of the world for the modern era, asking members of the public to cast their votes. After months of deliberating, debating and shortlists, the following list made the cut.

The “New” Seven Wonders (of the Modern World)

- The Colosseum (Rome, Italy)
- The Great Wall (China)
- Taj Mahal (India)
- Christ the Redeemer (Brazil)
- Machu Picchu (Peru)
- Chichén Itzá (Mexico)
- Ancient city of Petra (Jordan)



The Eighth Wonder of the World

According to legend, Albert Einstein once called compound interest the 8th Wonder of the World and the "most powerful invention in human history". There is some debate about the veracity of this quote, but there remains some evidence to suggest the sentiment, if not the exact words.

Here is the formula for compound interest:

$$A = P \left(1 + \frac{r}{n}\right)^{nt}$$

A = Total amount

P = Principal amount

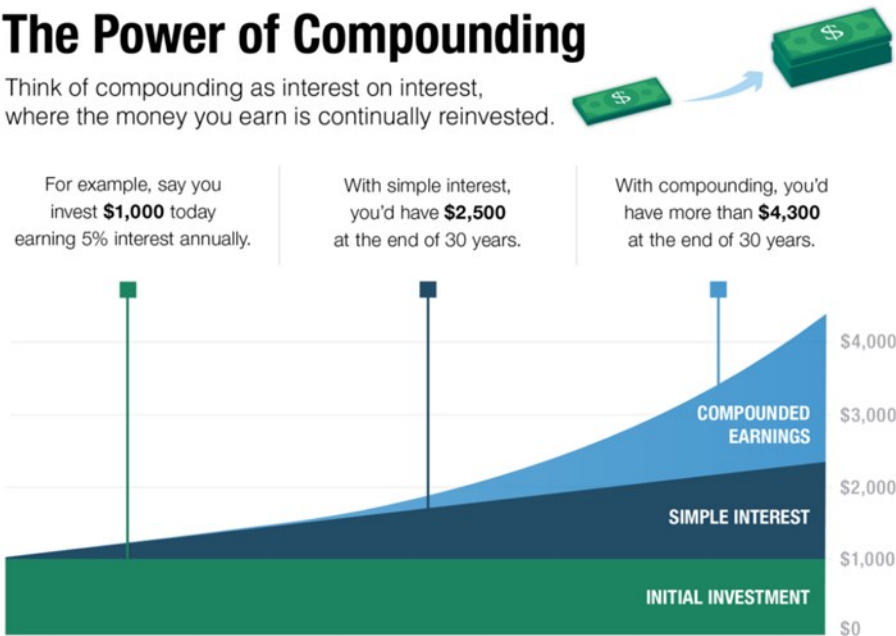
r = Annual rate of interest, expressed as a decimal

n = How many times interest is compounded per year

t = How long the money is deposited or borrowed, expressed in years

BUSINESS INSIDER

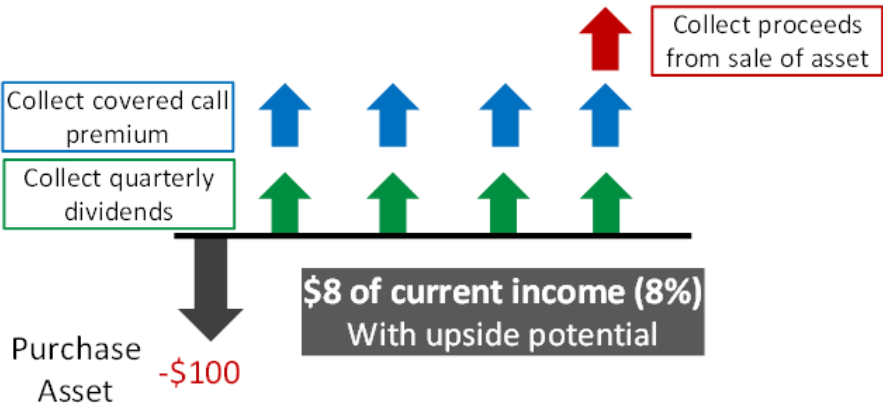
Einstein liked equations. But for those of us who don't, a more simplistic way of demonstrating this concept follows. This example shows that \$1,500 of "simple interest" can be increased to more than \$3,300 if, instead of spending this income, it is left to compound over time. It's a simple but incredibly powerful concept.



As covered call managers, we are big fans of dividends (the interest-equivalent for public stocks). And we are even bigger fans of option premiums, which can create a valuable income stream even on stocks that do not pay a dividend.

Stylized Example of a Covered Call position

In this example, a stock is purchased for \$100. A dollar in dividends is collected each quarter, and an additional dollar is collected each quarter from call option premiums. In total, this equates to \$8 of income per year (an annual yield of 8%). If left to compound, this income can have a very significant impact on future wealth. Remember, the above compound interest illustration only assumed 5%.



What about taxes?

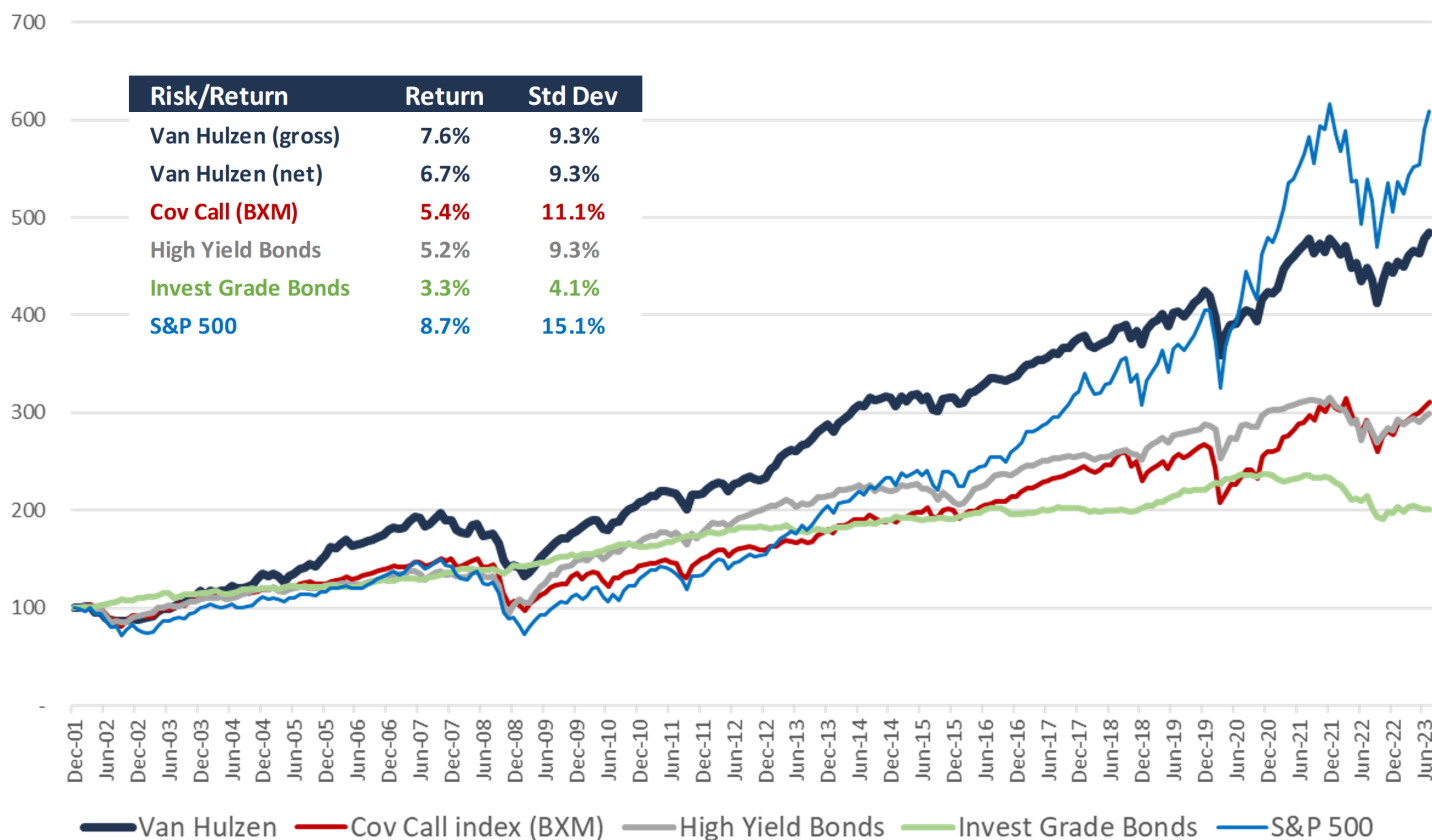
Tax treatment of covered calls is complex but can be used to your advantage in many situations. Option premiums are typically treated as short term capital gains, but there are exceptions to this. One exception is when shares get called away, the option premium reduces the cost basis of the underlying shares, effectively categorizing the gain as a long-term capital gain if the shares have been held for more than a year. Another exception is index options, which carry a preferential tax treatment of 60% LTCG and 40% STCG.

Our strategy does also have more flexibility than long-only strategies from a year-end tax planning standpoint, in that we have unrealized gains and losses in our stock positions *as well as our option positions*. So at year end, we can be strategic about which gains/losses we realize versus carry over to the next year for tax purposes. There are more “levers to pull,” which affords us more flexibility in tax planning. We ran a study in 2019 that looked at actual taxable gains in our client base over the most recent five-year period. We found that, on average, taxable gains have been roughly 2% per year. So even in the highest tax bracket, investors have only had about a 1% tax bite.

This compares favorably to fixed income accounts, which often had interest income of about twice that amount. In fact, we believe our covered call strategy is a great replacement for fixed income allocations in today’s environment, as they tend to do better during periods of inflation and/or rising rates, carry near-zero default risk (according to the Merton model), and have lower taxable gains despite our higher yields. Our average total annual return since inception is approximately 7.6%, less than 100bp less than that of the S&P 500 despite taking ~37% less risk. And our strategy has significantly outperformed all our yield-generating benchmarks (Covered call index: 5.4%; high yield bonds: 5.2%; investment grade bonds: 3.3%). See below.

Long Term Track Record

21+ Years, Dec 2001 – July 2023 (gross)



Note: 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 and net of fees.

Key Takeaway

Big Tech and growth stocks have provided incredible returns over the past decade. If you haven't already, we believe it's time to either bank some of those gains or add downside protection to your positions. Adding call options can not only add incremental income (typically to the tune of 5%+) but also provide valuable downside protection. Most economists believe equity returns will be in the ballpark of 5-6% over the coming decade. At 100% market exposure. There is certainly a place for growth stocks, in any market. But the reality is global growth is slowing. The world economy is over-levered and needs to cool off. As global stocks consolidate, we think there's a strong case for (1) short term treasuries: why not bank 5%+ risk free returns with a portion of your portfolio while stocks chop sideways?, and (2) covered calls: we are getting 7-8% yield at ~35% less risk than the stock market.

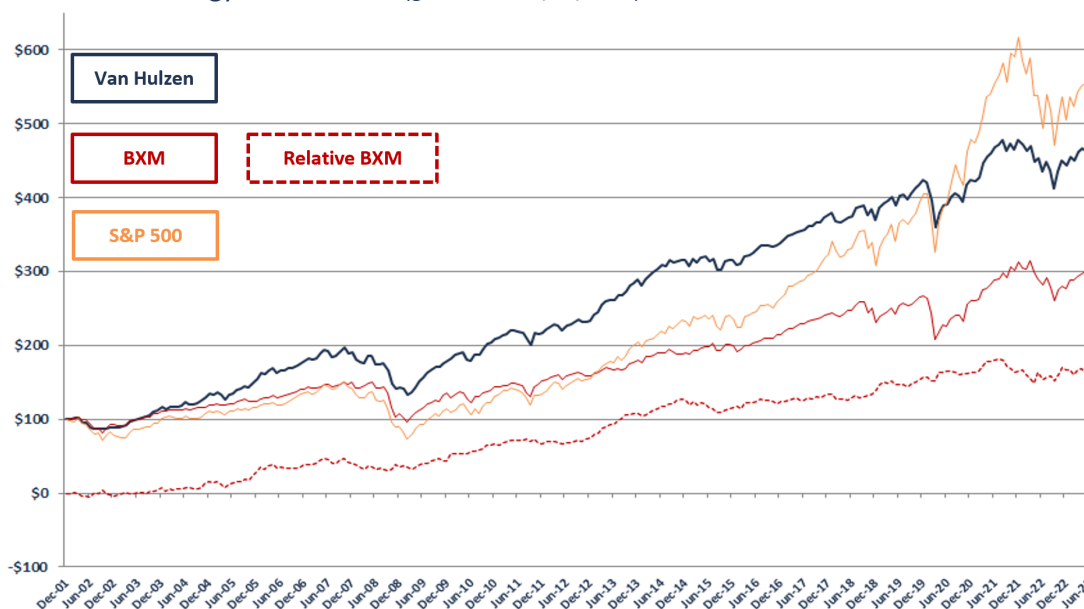
Consider the following potential allocation, which leans into shorts term treasuries and covered calls but also maintains a solid allocation of growth stocks. We believe this type of combination could yield more than 5%, while limiting market exposure to less than 50% (in case of major pullbacks) and allowing for 12%+ upside if markets continue to move significantly higher. This approach locks in the 5-6% that economists are expecting, but as income instead of potential total return. We believe Einstein would approve. Consider the below illustrative exercise to demonstrate the potential power.

	Weight	Yield	Risk	Upside Potential
Short term Treasuries	40%	5.3%	0%	6%
Covered calls	40%	7.5%	65%	15%
Growth stocks	20%	0.5%	100%	20%
Blend	100%	5.2%	46%	12%

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 07/31/2023)



Returns (annualized)*	Jul 2023	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	1.5%	4.0%	6.6%	9.2%	8.3%	6.6%	4.6%	5.4%	6.2%	7.6%
Van Hulzen (Net)	1.4%	3.9%	6.4%	8.9%	7.7%	6.1%	4.1%	4.9%	5.5%	6.7%
BXM	1.4%	4.6%	7.6%	12.1%	6.4%	9.7%	4.1%	6.0%	6.3%	5.4%
Difference (Gross-BXM)	0.1%	-0.5%	-0.9%	-2.8%	1.8%	-3.1%	0.5%	-0.5%	-0.1%	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. Review code: FPAC-0371-23