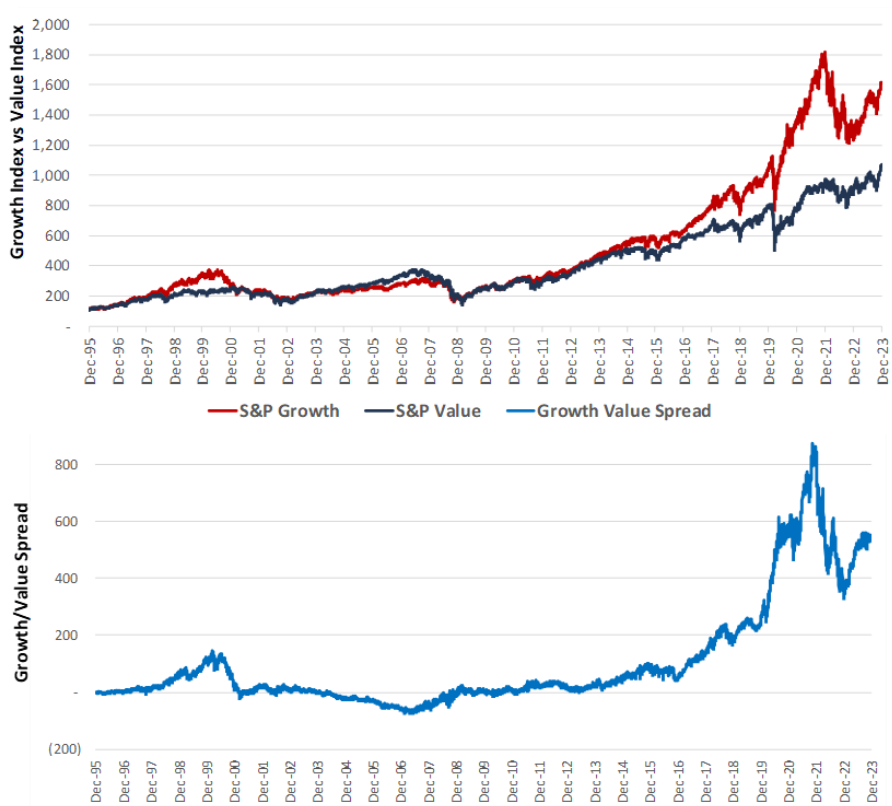
Covered Call Commentary December | 2023

Quality & Discipline Bring Strong Results in 2023

Stocks finished the year in epic fashion, with the S&P 500 following up the third quarter's -3.3% return with +11.7% in Q4. The fourth quarter also differentiated itself from the rest of the year with its wider market breadth. The fourth quarter saw a rebound in big tech (Broadcom, Amazon and Microsoft were among our top performers), but the rally was broader than just tech. For example, Northern Trust, Costco and Waste Management each gained more than 17% for us in Q4. This expanded participation could potentially bode well for the overall market.

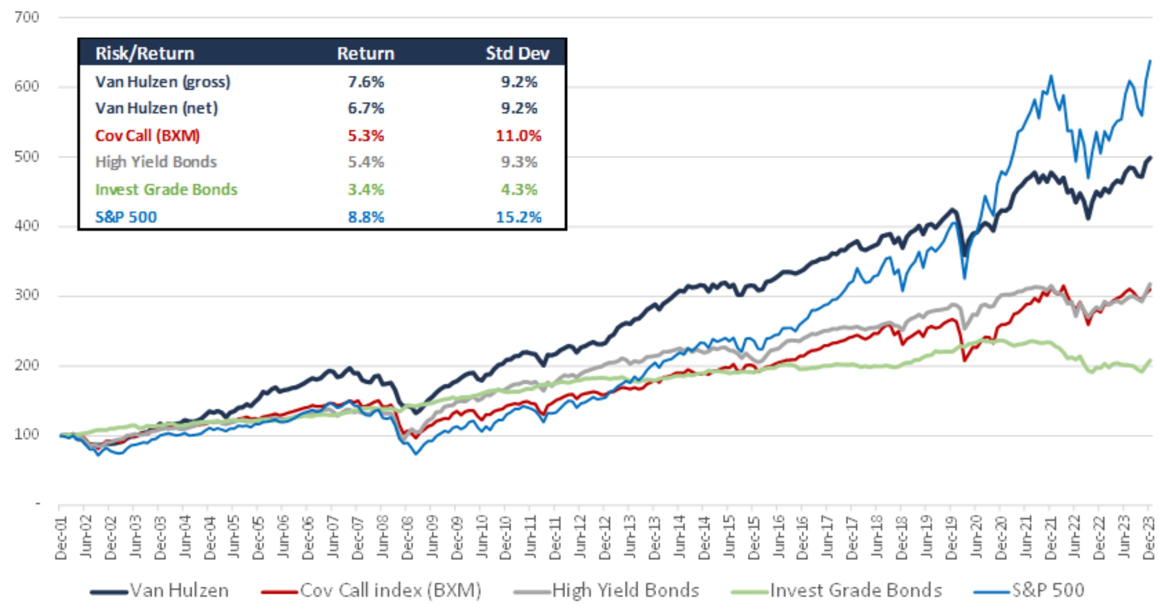
Updated Growth/Value Spread

While the S&P growth index outperformed the value index by 9.4% in the first half of 2023, the value index actually outperformed slightly (by 1.3%) in the second half. We track the spread between these indices closely. The strength of growth stocks has been well documented over the past decade. But the value index made a new all time high in 2023, whereas the growth index is still clawing its way back from the 2022 declines. See below. This trend should continue to benefit our strategy, being an income strategy, we naturally lean towards high quality, dividend paying, value stocks.



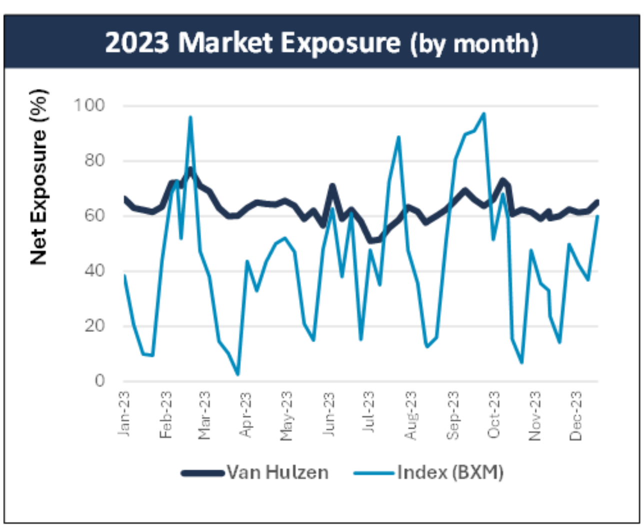
Performance

Our strategy gained **+5.5%** in Q4, versus 4.2% for our benchmark (the CBOE covered call index, ticker BXM). For the full year, we gained **+12.4%** versus 11.8% for the BXM. The index benefited from owning the entire S&P 500, which had a gangbuster year due to its large “Magnificent 7” weighting (the Mag 7 gained 75.9% in 2023, while the S&P 500 ex Mag 7 gained only 12.5%). But the BXM’s inconsistent market exposure (see next section) dragged on performance in 2023. Our strategy owns just four of the Mag 7 stocks (Apple, Alphabet, Amazon & Microsoft) but maintains a very consistent level of market exposure throughout the year.



Discipline & Consistency

Many consultants have studied covered calls and concluded that they are a great way to get near-market returns at 30-35% less risk. That implies net market exposure of roughly 65-70%. So when investors decide to invest in a covered call strategy, they expect their investment to be 65-70% net long. Our market exposure has been slightly lower than that over time, as we choose to invest in only the highest quality stocks with strong balance sheets (which tend to be lower beta), but we pride ourselves on our discipline and consistency. ***Our benchmark, however, is incredibly inconsistent***. Just take 2023 as an example.



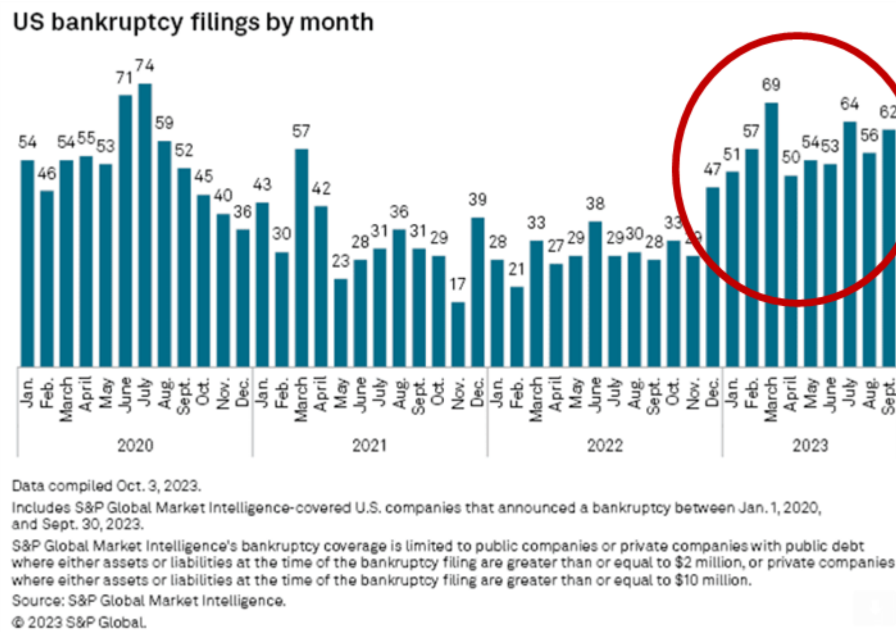
The net exposure of our benchmark (BXM) ranged from 3% to 97% during 2023.

But our strategy holds higher quality stocks and has the flexibility to go longer in duration, resulting in a more stable net exposure (which ranged from 52% to 72% in 2023).

Clients expect consistency and stability from covered calls, not a market timing vehicle.

The Lag Effect: Bankruptcy Filings On The Rise

We have discussed the infamous "lag effect" in previous commentaries, and specifically how there has typically been an 11 month lag between the Fed's last rate hike and the onset of recession. Based on this math, many economists are expecting a recession sometime in mid-2024. A key component of this is corporate bankruptcies, and bankruptcy filings (just through Q3) were already approaching peak levels from the COVID pandemic of 2020 when the world shut down. See below.



We believe quality is going to matter more than ever in the upcoming years, as the economy slows and investors shy away from companies that have speculative business models or are over-stretched from a leverage standpoint. As you know by now, we do not speculate and insist on rock solid balance sheets in our holdings, with no tolerance for credit risk.

Portfolio Highlights

Each quarter, we review the portfolio in the context of different market environments. As a reminder, here are the four categories:

- **Sideways & Declining Markets**. Covered calls tend to outperform in sideways moving, as well as declining, markets. Our covered call positions in these categories all outperformed in Q4, by an average of 3.3% 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 also held true in Q4, as our hedged positions showed no drag relative to the performance of the underlying stocks. These names actually outperformed by 0.5% in Q4. See bottom, left.
- **Exploding Markets**. Covered calls tend to underperform when stocks rocket higher in a short period of time. This was true again in Q4. However, by actively rolling our options positions, we were able to capture approximately 65% of the upside in this category (13.1% divided by 20.2%). We are pleased with this result. See bottom, right.

Sideways Moving

Name	Stock	Options	Net
LNG	3.1%	1.6%	4.7%
JNJ	1.4%	1.0%	2.4%
ORCL	1.1%	2.2%	3.3%
CMCSA	-0.7%	1.1%	0.4%
Median	**1.3%**	**1.3%**	**2.6%**

Covered Call Better

Declining

Name	Stock	Options	Net
XOM	-14.2%	5.2%	-9.0%
AJG	-10.7%	7.7%	-3.0%
HSY	-7.1%	0.8%	-6.3%
PXD	-0.6%	3.0%	2.3%
Median	**-8.9%**	**4.1%**	**-4.9%**

Covered Call Better

Rising

Name	Stock	Options	Net
MRK	6.6%	0.4%	7.0%
DHR	5.8%	1.3%	7.0%
ABBV	5.0%	-2.4%	2.6%
UNH	4.8%	0.6%	5.4%
Median	**5.4%**	**0.5%**	**5.9%**

Covered Call Better

Exploding

Name	Stock	Options	Net
AVGO	35.0%	-19.3%	15.7%
NTRS	20.8%	-8.6%	12.2%
AMZN	19.5%	0.1%	19.6%
MSFT	19.3%	-5.6%	13.7%
Median	**20.2%**	**-7.1%**	**13.1%**

Long-Only Better

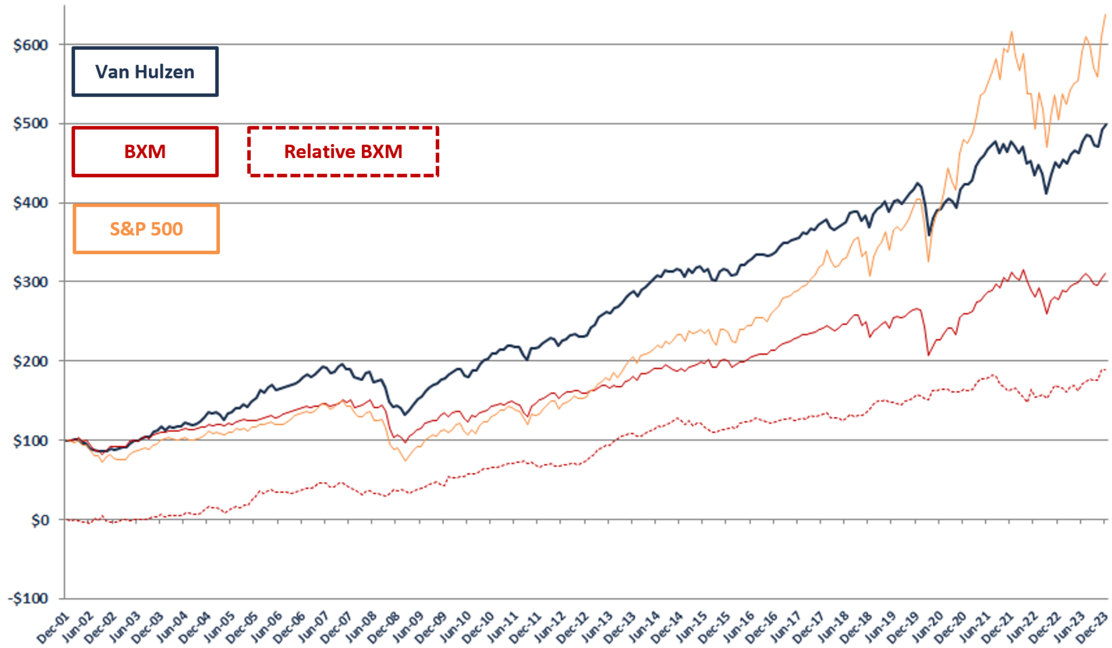
Key Takeaways

- We saw strong performance in 2023, outpacing our benchmark at lower risk.
- This is a great market for covered calls. Most economists are projecting mid-single digits for equity returns over the next 7-10 years.
- Our continued focus on quality and disciplined approach to management put us in a great position to succeed in today’s uncertain environment.
- After the recent rebound 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.
- Bankruptcies are trending up and expected to continue to rise as companies are forced to refinance their debts into higher rate debt. Many businesses will struggle in the coming years, but our insistence on quality and aversion to credit risk positions us well.
- We will continue to stick to our knitting. All of our positions are high quality and designed to deliver equal parts income and appreciation. This approach has created strong alpha for us in the past.
- Our track record suggests that we tend to participate in 87% of the market’s gains over the long run (7.6% average return over 22+ years, vs 8.8% 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 12/31/2023)



Returns (annualized)*	Dec 2023	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	1.4%	5.5%	4.5%	12.4%	12.4%	5.6%	6.2%	5.7%	5.6%	7.6%
Van Hulzen (Net)	1.4%	5.3%	4.2%	11.8%	11.8%	5.1%	5.6%	5.1%	5.0%	6.7%
BXM	1.9%	4.2%	1.2%	11.8%	11.8%	6.1%	6.1%	5.4%	5.6%	5.3%
Difference (Gross-BXM)	-0.6%	1.3%	3.2%	0.6%	0.6%	-0.5%	0.1%	0.3%	0.1%	2.3%
S&P 500	4.5%	11.7%	8.0%	26.3%	26.3%	10.0%	15.7%	13.4%	12.0%	8.8%

*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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