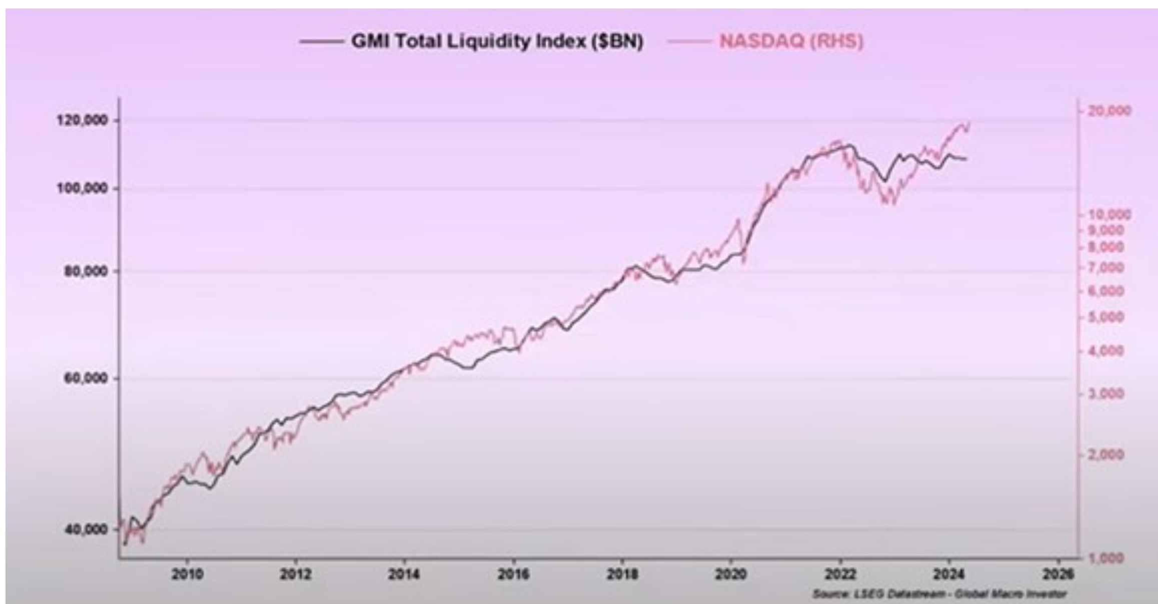
Covered Call Commentary May | 2024

Walls of Money

Liquidity Driven Market

Ever since 2008, the Treasury department and the Federal Reserve have been focused on one thing: Preventing another financial crisis and market meltdown. They have managed to achieve this, primarily by keeping the liquidity flowing. The 2022 sell-off was not fun, but it was not nearly as nasty as 2009-09.

Consider the following chart, which plots the Federal Reserve balance sheet (liquidity index) and the Nasdaq 100 index. Since the market lows of 2009, there has been a 97.5% correlation between the two. David Tepper of Appaloosa Management famously predicted in 2010 that low rates and quantitative easing would propel markets much higher (the famous "Don't fight the Fed" adage). He was right about this.



This correlation between the Fed balance sheet and the stock market is a huge eye opener for most people. Walls of money have been pushing this market higher for well over a decade. All this liquidity served as fuel for economic growth and outsized market returns, catching many investors who were expecting Great Depression 2.0 completely flat footed. Of course, the byproduct of all this money printing is the current sovereign debt crisis we find ourselves in.

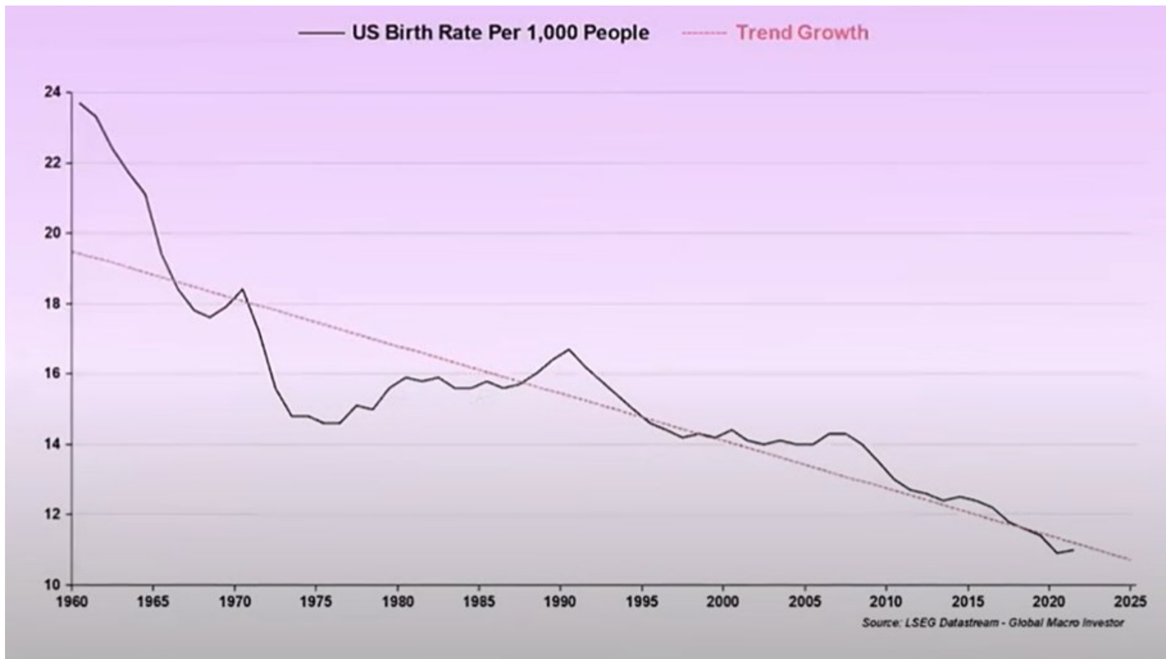
Ral Pal, another well-known hedge fund manager and macro investor, has a very simple definition of GDP growth.

GDP growth = population growth + productivity growth + debt growth

Let's consider each of these components.

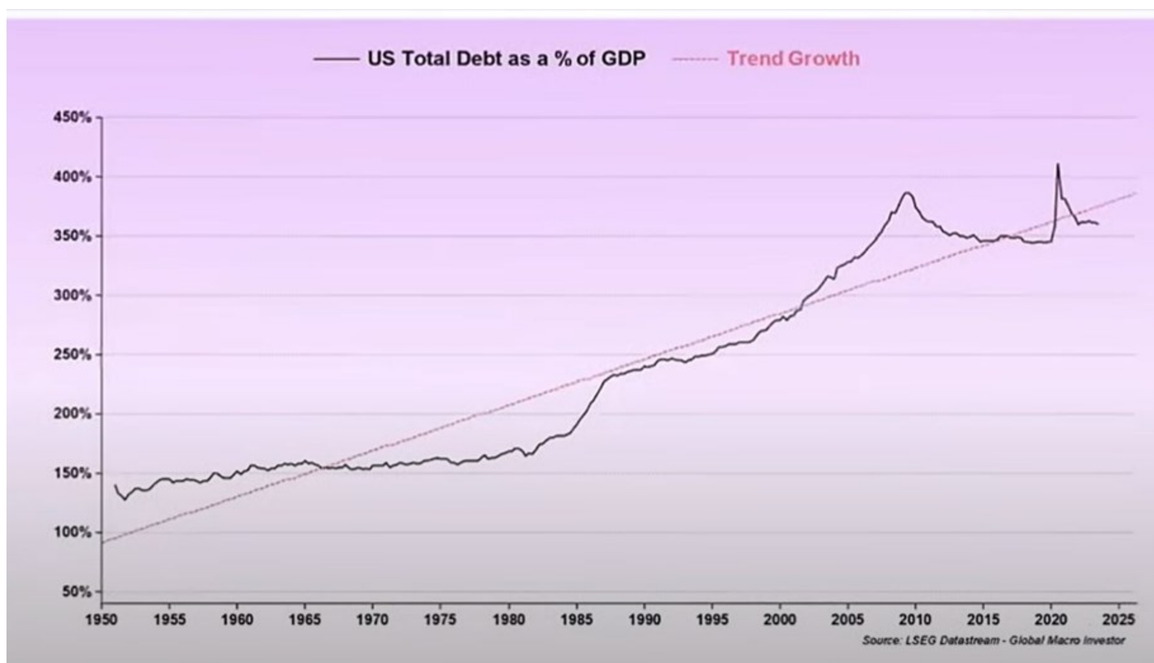
Population Growth

The US birth rate has **halved** since the peak of the Baby Boomer generation. When the Boomers entered their adult years, they began building cars and houses, having kids, and going on vacations. This certainly drove economic growth during the 1980s-90s. But that generation is almost entirely retired at this point, and declining birthrates means they will not be easily replaced. Clearly future GDP growth is not going to come from population growth.



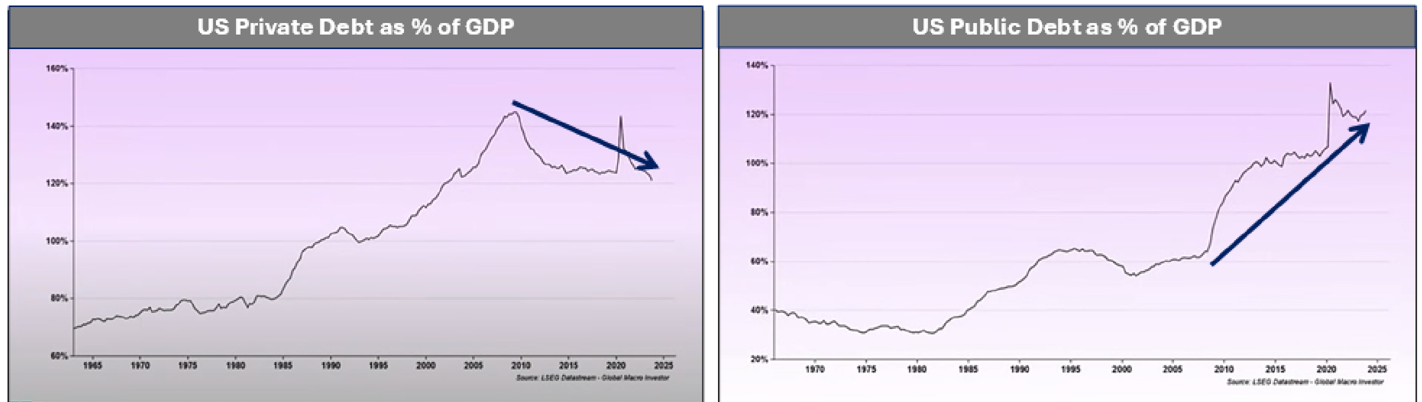
Debt Growth

Debt as a percentage of GDP has exploded, from ~160% in 1980 to more than 350% today. This certainly helps explain the strong stock market performance. Just take another look at the earlier chart of liquidity and the Nasdaq.



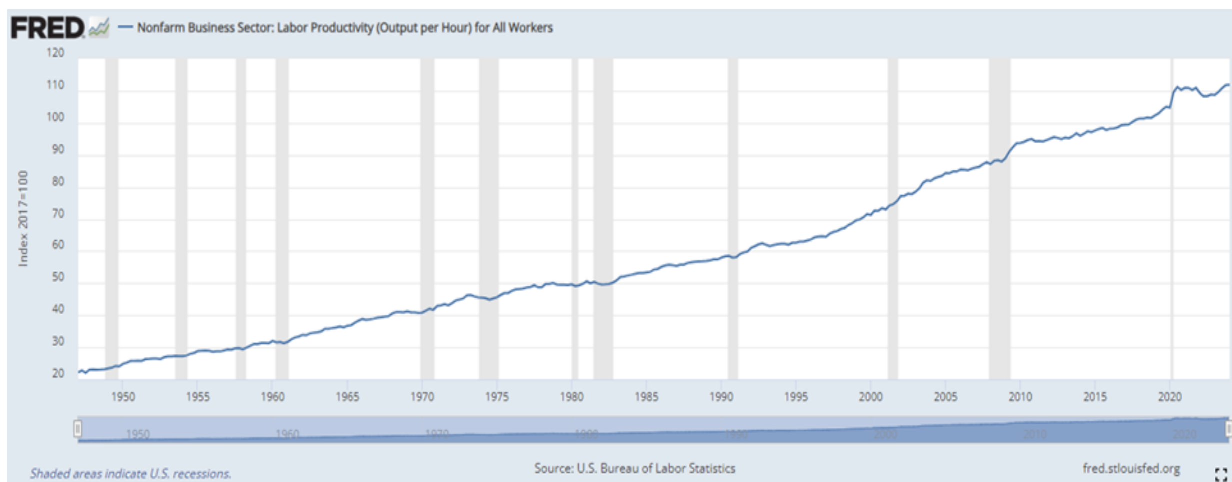
But there are two distinct components to Total Debt. Private debt actually peaked during the global financial crisis of 2008 and has pulled back as companies tightened their screws and consumer lending standards were also tightened. But that debt didn't go away. It simply shifted to the government. Public debt as a percentage of GDP has doubled over the same period (2008-2024). The US government "had our backs," as they say, and now has its own crisis to deal with. Governments around the world have been battling to service all this new debt, and higher rates are not helping. Of course, it's been easier for the US because of its currency reserve status. There is much analysis around interest rate policy, but the Fed's primary monetary tools seem to have been liquidity and currency debasement in recent years.

Components of total Debt: 1965-Present



Productivity Growth

This brings us to productivity. There's no question that technology has been a boon to productivity, particularly since the 1960s (see the chart from the US Bureau of Labor Statistics below). And Artificial Intelligence (AI) promises to super-charge productivity even further, most likely at the expense of unemployment.



Looking Forward

Productivity has been a major driver of stock returns over the past decades and will likely continue to be. But it also seems clear that much of our economic growth has been fueled by debt. And it's getting to the point where the US government can no longer afford its interest payments.

There are basically two options:

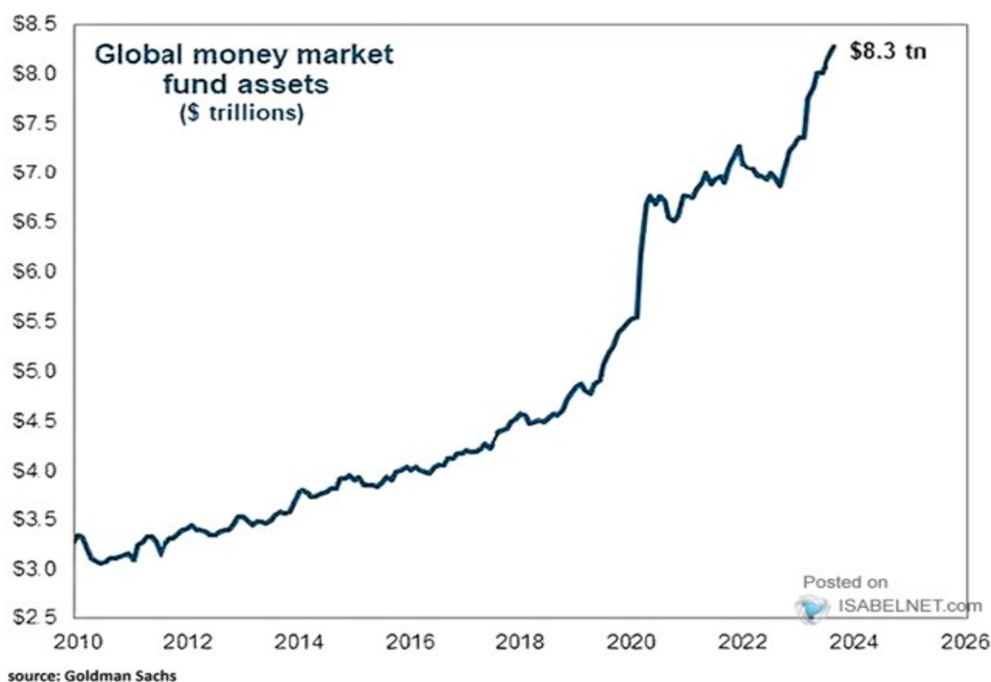
1. Continue to borrow/spend and hope that economic growth and inflation outpace the debt growth, as it did in the late 1940s

2. Tighten the screws and take a sizeable hit to GDP, which would potentially spiral into unforeseen problems in our debt-based, inter-dependent economy.

Austrian economists see austerity as the answer. But there is zero appetite for that in Washington, by either party, particularly in an election year. So we shall see.

Wall of Money

This just in: Scott Rubner of Goldman Sachs believes a "wall of money" (as much as $7-8 trillion) is headed for the stock market this summer, as investors prepare for the Fed to cut rates buy liquidation a portion of the record money market funds and look for better opportunities.



How All This Relates To Our Strategy

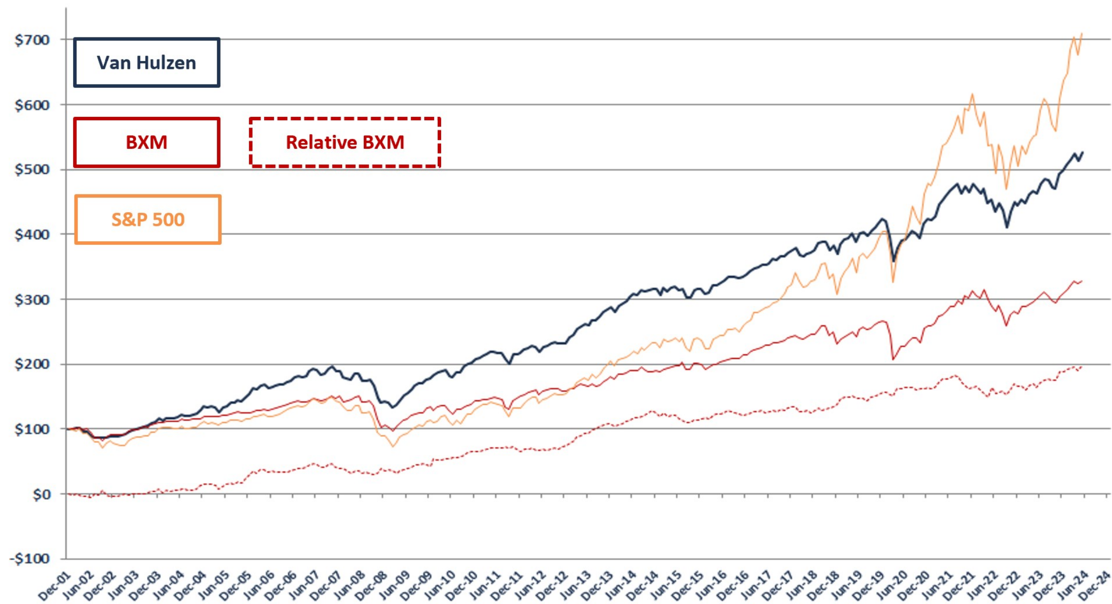
We believe it's important to understand the current market environment as well as how we got here. So much depends on the Federal Reserve these days, and their actions are very difficult to predict. Stocks are historically expensive, on a relative basis. But the Fed has also demonstrated its determination to prevent a financial collapse, which could lower the odds of another meltdown like we saw in 2008. Either way, we pride ourselves on the consistency and discipline in our investment approach. And our approach has brought us successfully through many a crisis and has served us well over 22+ years.

We have a targeted yield of 6-8%, significantly lower volatility than the S&P 500 and comparable volatility to high yield bonds (without the credit risk). We are ready for any market environment.

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 05/31/2024)



Returns (annualized)*	May 2024	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	2.3%	2.1%	6.8%	5.4%	13.6%	4.6%	6.2%	5.8%	5.6%	7.7%
Van Hulzen (Net)	2.3%	2.0%	6.6%	5.1%	13.0%	4.0%	5.6%	5.2%	5.1%	6.8%
BXM	1.1%	1.9%	7.8%	5.7%	9.3%	5.1%	6.2%	5.2%	5.6%	5.4%
Difference (Gross-BXM)	1.2%	0.2%	-0.9%	-0.3%	4.3%	-0.6%	0.0%	0.6%	0.0%	2.2%
S&P 500	5.0%	3.9%	16.4%	11.3%	28.2%	9.6%	15.8%	13.8%	12.7%	9.1%

*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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