## Covered Call Commentary

June | 2024

### Big Tech Dominance Continues

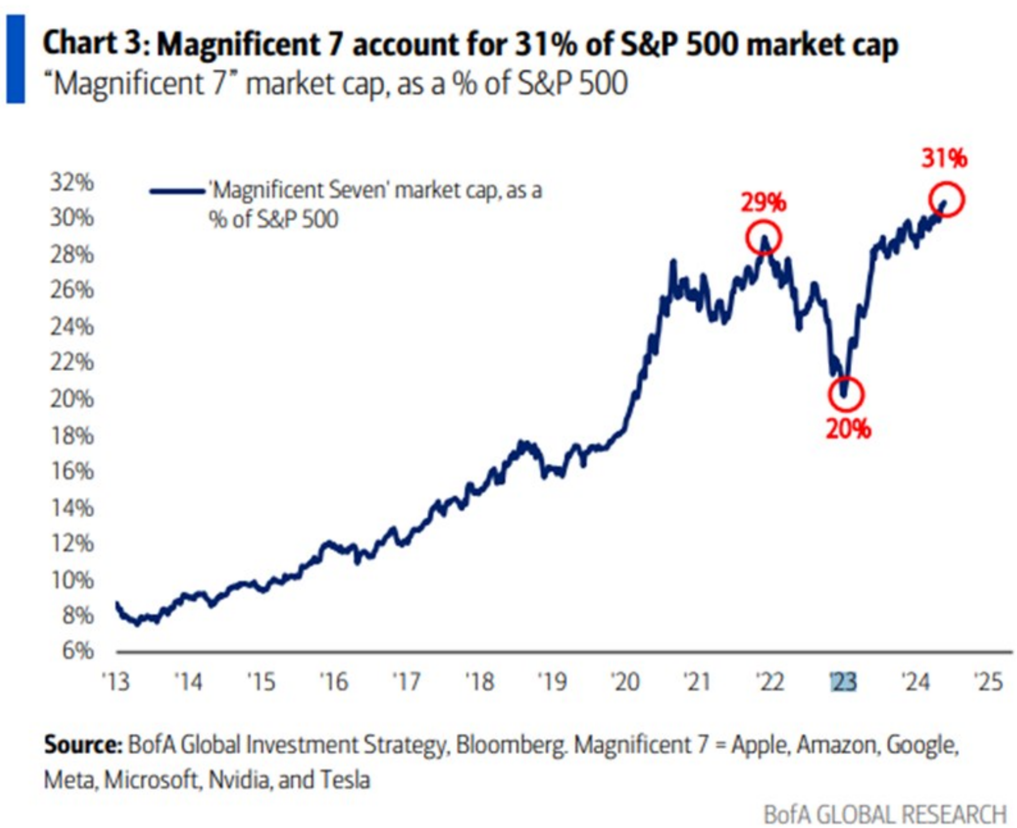
**Bloomberg Headline**
July 10, 2024

# Market Strategists Abandon S&P 500 Targets, calling them "no longer useful"

Market commentators love to make predictions. But Piper Sandler & Co recently eliminated its price target for the S&P 500, saying the index is being driven by just a handful of heavily weighted stocks and targets are therefore no longer very useful. And Bloomberg analyst Jonathan Levin hopes more firms follow suit.

We are not market timers, but headlines like this are a little concerning…and tend not to bode well for markets. Let's take a deeper look…

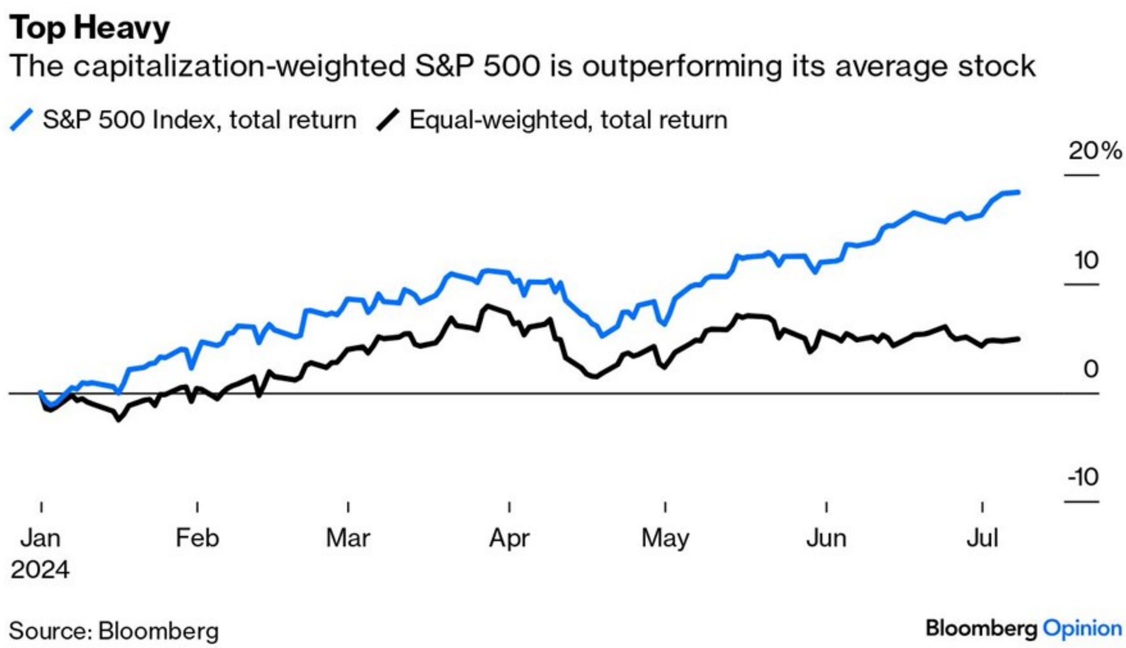
**Big Tech Dominance**



Big Tech continues its dominance, with the Top 7 stocks now accounting for 31% of the market cap of the S&P 500. That's an average weighting of 4.4% for these top 7 names, versus 0.1% for the other 493 stocks in the index. NVDA is a huge driver of this trend, of course, with its 150% YTD return and 7% S&P weighting.

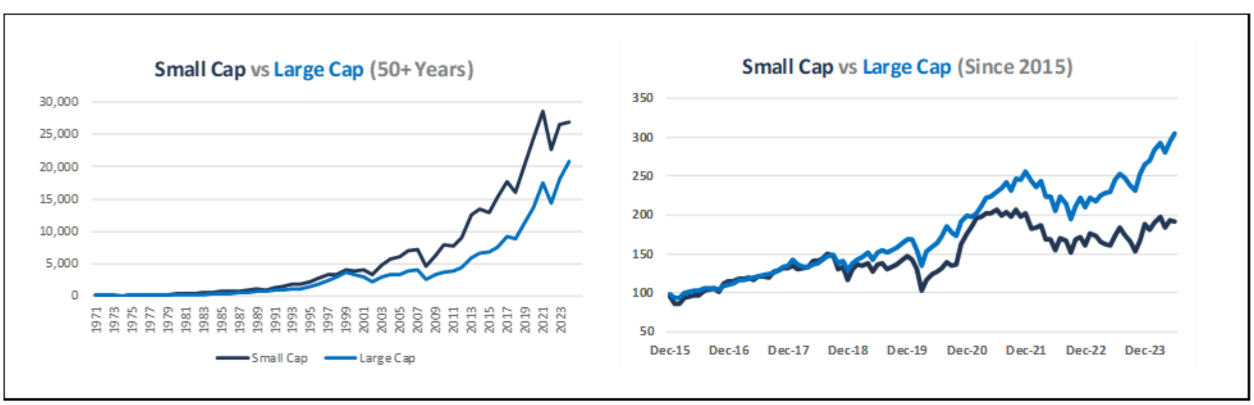
**Market Cap Weighted vs Equal Weighted**

Based on the above, you would expect the market cap weighted S&P 500 index would outperform the equal weighted index. And it has…to the tune of 10.2% through June 30 (15.3% vs 5.1%).



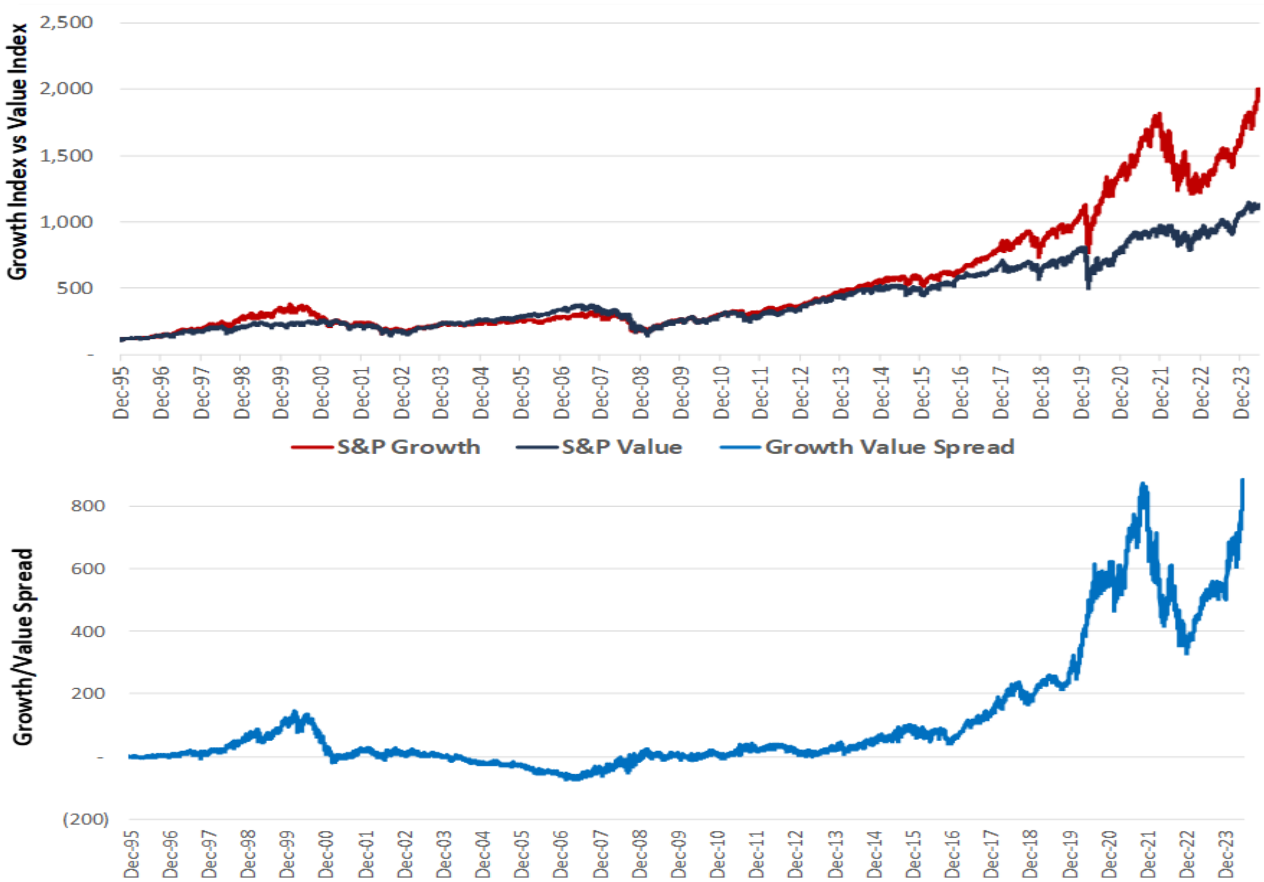

**Large Caps Continue To Dominate Small Caps**

This same theme applies as you go down cap as well. The Russell 2000 index turned in a paltry 1.7% return in the first half, compared to 15.3% for large caps. And, while small caps have traditionally outperformed large caps over the long run (see below, left), it has been a very different story over the past 6-7 years (below, right).



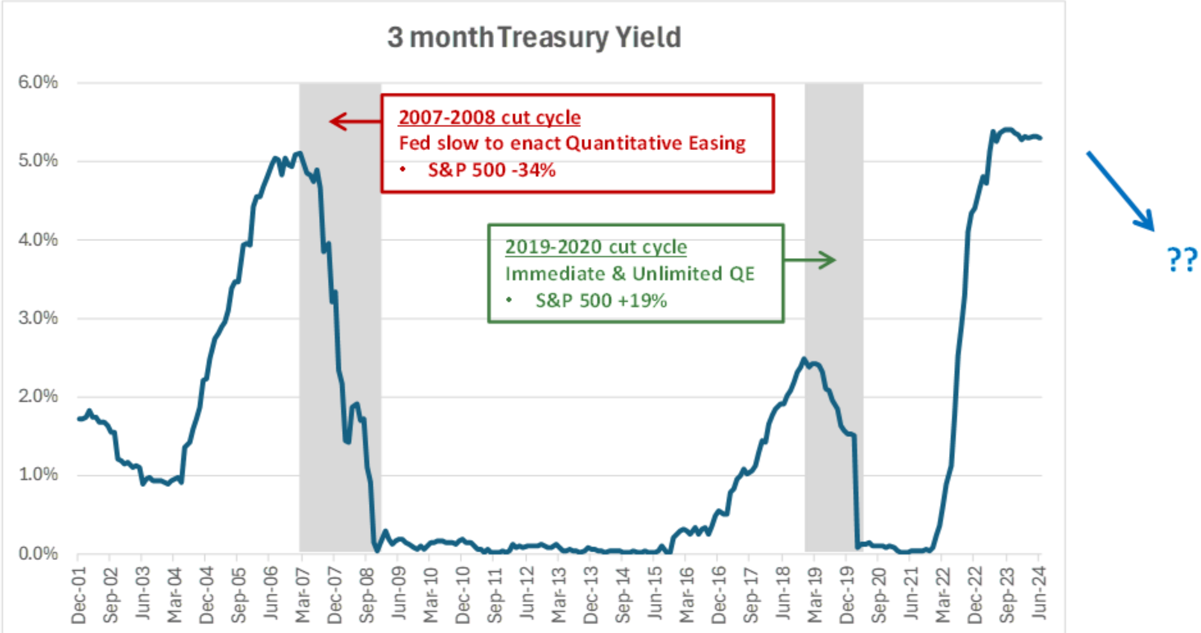
### Growth vs Value

We track the S&P growth and value indices on a cumulative basis. Growth has now fully recovered from its 2022 selloff, and the growth-value spread (royal blue line in bottom chart) is back to its all-time highs. Interestingly, the value index (dark blue line in top chart) continues its steady climb and is at all-time highs as well. As income-oriented covered call managers, we are happy to see this. Our composite is also at all-time highs, but we are positioned very well to outperform if/when the next correction arrives.




### Outlook: Rate Cuts On The Horizon

There's no doubt that much of the current rally can be attributed to the expectation of rate cuts and potential quantitative easing. Inflation came in at 3.0% this month, very close to achieving the 2 handle the Fed wants to see. And the jobs market is slowing, strengthening the case for cuts. After the inflation reading, the probability of a rate cut by September soared to 87%. There is still much debate about how this will affect markets, however. Some analysts say cuts only arrive in response to economic weakness/recession, and that's bad for markets. Others say it's a signal that the Fed is willing to step in and save the day. Both have been true in recent years (see chart below). In our view, it's all about how the Fed responds to the slowing economy. And by this we mean QE, not the actual rates themselves. In contrast, the Fed turned the spigots on immediately when the economy shut down in 2020 and the market rallied 19% as a result. See below.




- It's still all about the Fed
- Liquidity (QE) actually matters more than rates
- Slow QE in 2008 crushed stocks, while immediate QE in 2020 fueled rally
- Moderate inflation is typically good for stocks and bad for bonds

**Q2 Performance**

Our strategy turned in a 1.7% return in Q2, versus 1.5% for the covered call index (BXM). The S&P 500 (market cap weighted) index was up 4.3% in Q2, but NVDA accounted for 2.7% of that (meaning the other 499 stocks turned in a 1.6% return). The equal weight S&P was -2.6% for the quarter. Our strategy was up 6.7% for the first half of the year, a solid result considering our value tilt and disparity amongst stocks.

**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 Q2, by an average of 3.5% 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 held true in Q2, as our hedged positions showed only limited drag relative to the performance of the underlying stocks. These stocks had a 5.6% quarter (22.4% annualized), and our covered call positions turned in 4.9% (19.6% annualized). 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 Q2. However, by actively rolling our options positions, we were able to capture approximately 60% of the upside in this category. We are pleased with this result, considering two of these names were up more than 20% (80% annualized). See bottom, right.

**Sideways Moving**

| Name | Stock | Options | Net |
|---|---|---|---|
| ETN | 0.6% | 0.4% | 1.0% |
| DHR | 0.2% | 2.4% | 2.6% |
| XOM | -0.1% | 1.3% | 1.2% |
| ABBV | -5.0% | 1.4% | -4.8% |
| **Median** | **0.0%** | **1.4%** | **1.4%** |

Covered Call Better

**Declining**

| Name | Stock | Options | Net |
|---|---|---|---|
| DIS | -18.9% | 8.8% | -10.0% |
| LOW | -13.0% | 7.9% | -5.1% |
| AON | -11.8% | 3.1% | -8.7% |
| CMCSA | -10.6% | 2.4% | -8.2% |
| **Median** | **-12.4%** | **5.5%** | **-6.9%** |

Covered Call Better

**Rising**

| Name | Stock | Options | Net |
|---|---|---|---|
| MS | 7.9% | -4.2% | 3.7% |
| MSFT | 6.4% | -0.6% | 5.8% |
| KO | 4.8% | -0.4% | 4.4% |
| AJG | 3.9% | -0.8% | 3.2% |
| **Median** | **5.6%** | **-0.7%** | **4.9%** |

Similar return

**Exploding**

| Name | Stock | Options | Net |
|---|---|---|---|
| AAPL | 23.0% | -10.2% | 12.8% |
| GOOGL | 20.8% | -8.9% | 12.0% |
| ORCL | 12.7% | -5.3% | 7.4% |
| KMI | 9.9% | -2.4% | 7.5% |
| **Median** | **16.8%** | **-7.1%** | **9.7%** |

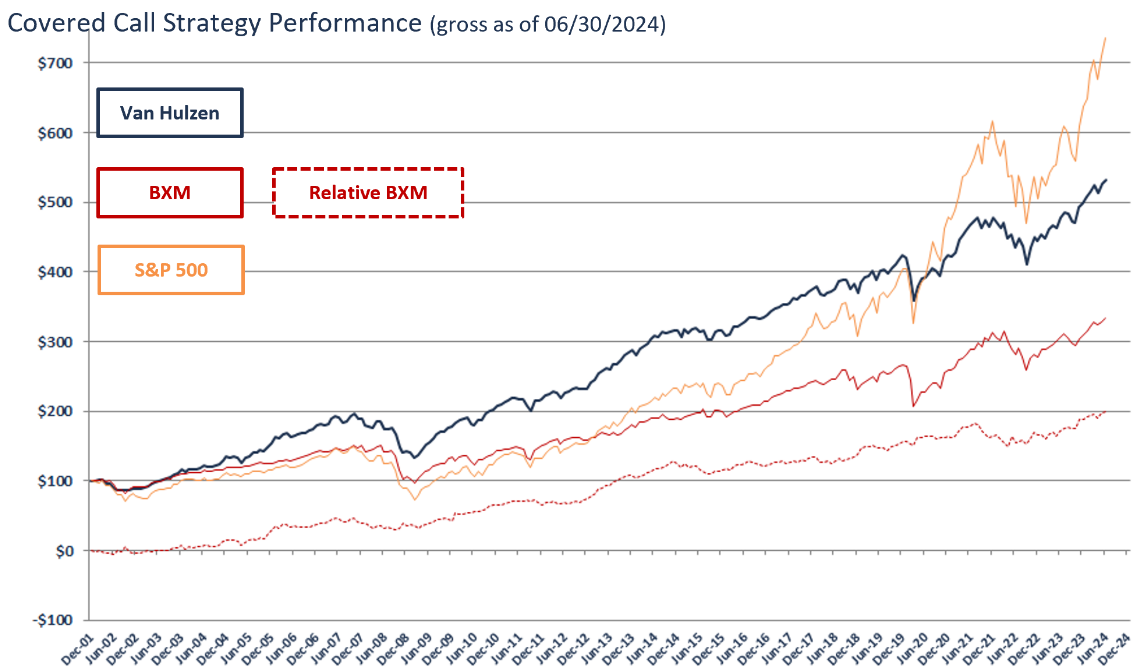
Long-Only Better

## Key Takeaways

- We turned in a strong second quarter in 2024, outpacing our benchmark at lower risk.
- Although volatility is below average at the moment, this remains 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 to-day'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 cred-it 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 in-come and appreciation. This approach has created strong alpha for us in the past.
- Our track record suggests that we tend to participate in 83% of the market's gains over the long run (7.7% annualized return over 23+ years, vs 9.2% for the S&P 500) but take significantly less risk (approx. 65%) 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.




| Returns (annualized)* | Jun 2024 | 3M | 6M | YTD | 1 Year | 3 Years | 5 Years | 7 Years | 10 Years | Inception |
|---|---|---|---|---|---|---|---|---|---|---|
| Van Hulzen (Gross) | 1.3% | 1.7% | 6.7% | 6.7% | 11.5% | 4.4% | 5.8% | 5.9% | 5.6% | 7.7% |
| Van Hulzen (Net) | 1.2% | 1.5% | 6.4% | 6.4% | 10.9% | 3.9% | 5.2% | 5.3% | 5.0% | 6.9% |
| BXM | 1.8% | 1.5% | 7.6% | 7.6% | 8.9% | 5.0% | 5.6% | 5.5% | 5.8% | 5.5% |
| Difference (Gross-BXM) | -0.5% | 0.2% | -0.9% | -0.9% | 2.6% | -0.5% | 0.2% | 0.5% | -0.1% | 2.2% |
| S&P 500 | 3.6% | 4.3% | 15.3% | 15.3% | 24.6% | 10.0% | 15.0% | 14.3% | 12.9% | 9.3% |

*Inception date : 12/31/2001. Figures greater than one year are annualized. Van Hulzen returns represent actual returns from composite of accounts