Van Hulzen Asset Management

Volatility: Welcome Back!

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3 Reasons Why Covered Call Investors Welcome Back Volatility

Covered call strategies have historically out-paced the market during volatile periods. After three years of record low volatility, covered call strategies might once again be poised for out-performance. Here are the reasons why.

1. **Possible higher yields:** During periods of heightened volatility, option premiums have a tendency to increase in price, as more investors are willing to pay for a hedge in their portfolios. Because covered call strategies are designed to sell options for income purposes, these higher premiums can result in a higher yield to the investor. For example, the Iron Horse Covered Call fund typically yields 6-8% annually, but we are currently clipping annualized yields in the range of 12-15% due to higher overall market volatility.

2. **May provide protection:** Because covered call portfolios are designed to potentially provide a higher income stream than most long-only equity strategies, they tend to do a particularly good job of protecting portfolios when the market declines. Call premiums can provide an income buffer that helps mitigate downside exposure, and this buffer potentially expands as volatility rises.

3. **Research:** Numerous studies published on the CBOE website have concluded that covered call strategies can provide roughly the same return as the stock market over the long term, but with less overall market exposure.

Van Hulzen Covered Call Strategy:
The Strategy invests in large cap companies that the portfolio managers expect to produce strong returns on investment, pay regular dividends, have below-average leverage, attractive valuations, and a consistent shareholder value-oriented track record. The Strategy predominantly invests in dividend-paying companies and uses call options in an attempt to create incremental income and reduce portfolio volatility. The Strategy seeks to make income a more significant component of the total investment return and targets long term risk-adjusted returns versus long-only equities. The goal is a portfolio that generates a higher than average annual income with a target of 6-8% annual income.

Van Hulzen Asset Management offers its covered call capabilities in separately managed account format, as well as through a mutual fund.

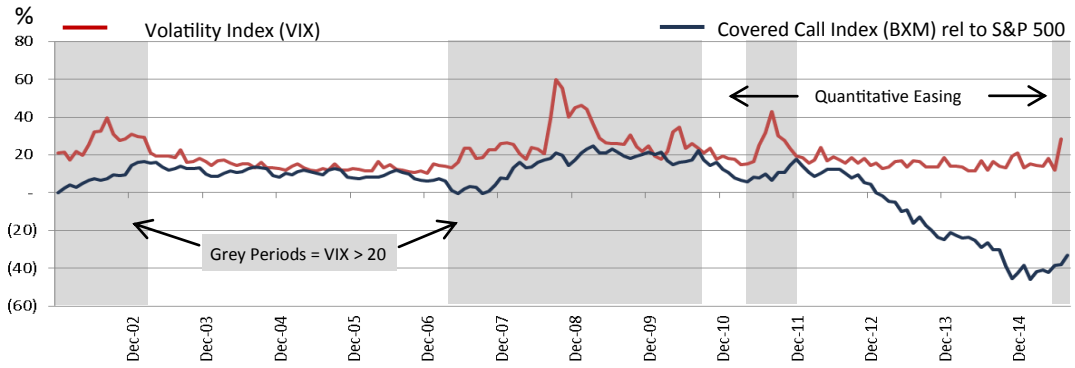
More information on the fund:
www.ironhorsefund.com

Market Look-Back: Covered Calls Out-Perform During Volatile Periods

The CBOE volatility index (ticker VIX) has averaged ~20 over the long term, meaning the market typically expects future volatility to be around 20%. The VIX is often referred to as the market's "fear gauge" since it spikes during periods of uncertainty. A quick look at the data, since Van Hulzen has been managing covered calls, shows investors that utilized covered calls generally outperformed during periods of volatility.

In the chart below, the grey periods represent stretches when VIX traded above its long term average of 20, while the white periods represent below average stretches. There are two long periods of low volatility displayed here: 2003-2007 and 2012-2015. In the teams view, the difference between the two periods of low volatility is simple: **quantitative easing**.

The Federal Reserve Banks "easy money" policy has fueled stocks and depressed volatility over the past three years, creating headwinds for risk managed strategies like covered calls. But the Fed completed its last QE program late last year and is unlikely in our opinion to continue these policies going forward.



Source: Bloomberg. Past performance is no guarantee of future results. Indexes are not available for direct investment. All investing involves risk including the potential for loss of principal. There is no guarantee that any strategy will be successful.

Periods with VIX > 20

Time Period	S&P	BXM
Jan 2002 - April 2003	-18.3%	-2.3%
July 2007 - Nov 2010	-15.2%	-5.5%
July 2011 - Dec 2011	-3.7%	3.2%
Average monthly return	***-0.5%***	***0.0%***
Annualized	*-5.6%*	*0.4%*

Periods with VIX < 20

Time Period	S&P	BXM
May 2003 - June 2007	76.9%	49.8%
Dec 2010 - June 2011	13.1%	5.9%
Jan 2012 - July 2015	80.4%	34.1%
Average monthly return	***1.3%***	***0.8%***
Annualized	*15.9%*	*9.2%*

At Van Hulzen Asset Management the Investment Committee believes the market has entered a new (potentially lengthy) period of above average volatility. Covered call strategies have historically been well suited for this environment. If the team is right, then now may be an ideal time to reallocate some capital from long-only equities into covered calls.

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Important Definitions: Business Cycle*: The recurring and fluctuating levels of economic activity that an economy experiences over a long period of time.* ***Call Option****: An agreement that gives an investor the right (but not the obligation) to buy a security at a specified price within a specific time period.* ***Covered Call****: An options strategy whereby an investor holds a long position in an asset and writes (sells) call options on that same asset in an attempt to generate increased income from the asset.* ***Return on Investment****: rate of return annualized over a given period, expressed on an annual basis or as a return per year.* ***Volatility****: A statistical measure of the dispersion of returns for a given security or market index. Volatility is often measured by using the standard deviation between a security's returns and a market index. Typically, the higher the volatility, the riskier the security.* ***Standard Deviation:*** *a measure of daily volatility of returns. Typically, the higher the volatility, the riskier the security****. Beta:*** *a measure of the volatility of a portfolio relative to the overall market.* ***Sharpe Ratio:*** *A risk-adjusted measure used to determine reward per unit of risk.* ***R-Squared:*** *The percentage of a portfolio movement that can be explained by movements in its benchmark index.* ***Jensen Alpha****: A market risk balanced measure of performance, based on CAPM. It is calculated as the difference between security average return vs. risk free rate and beta times benchmark excess return. 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. IBOXX HY Index: The index is a rules-based index consisting of liquid U.S. dollar-denominated, high yield corporate bonds for sale in the United Sates. The index is designed to provide a broad representation of the U.S. dollar-denominated high yield liquid corporate bond market. There is no limit to the number of issues in the index. The Morningstar Short-Term Corporate Bond Index includes US corporate bonds with maturities of between one and four years. The Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-through), ABS, and CMBS. Index is updated on the 15th or the next business day for the previous month. The Dow Jones Credit Suisse Hedge Fund Index is an asset-weighted hedge fund index derived from the TASS database of more than 5000 funds. The Index consists of funds with a minimum of US $10 million under management and a current audited financial statement. Funds are separated into primary subcategories based on investment style. The Index in all cases represents at least 85% of the assets under management in the universe. The index is rebalanced monthly, and funds are reselected on a quarterly basis. Index NAVs are updated on the 15th of each month. Methodology and additional information are available at www.hedgeindex.com.*

The Strategy involves risk including the possible loss of principal. There is no assurance that the Strategy will achieve its investment objectives. The use of leverage embedded in written options will limit the Strategy's gains because the Strategy may lose more than the option premium received. Selling covered call options will limit the Strategy's gain, if any, on its underlying securities and the Strategy continues to bear the risk of a decline in the value of its underlying stocks. 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. **Review Code:** FPAC-0028-15

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