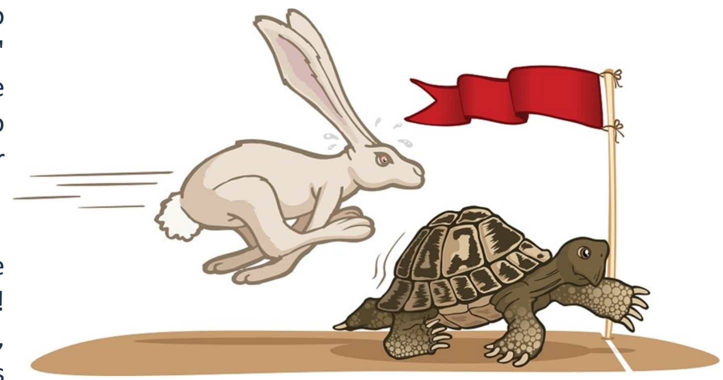
INVESTMENT COMMENTARY: Q2 2017

July | 2017

The Importance of the Business Cycle: "The Tortoise and the Hare"

Everyone knows the story about the Tortoise and the Hare: One day a hare was bragging about how fast he could run. He bragged and bragged and even laughed at the tortoise, who was so slow. The tortoise stretched out his long neck and challenged the hare to a race, which, of course, made the hare laugh. "My, my, what a joke!" thought the hare. "A race, indeed, a race. Oh! what fun! My, my! a race, of course, Mr. Tortoise, we shall race!" said the hare.

The forest animals met and mapped out the course. The race begun, and the hare, being such a swift runner, soon left the tortoise far behind. About halfway through the course, it occurred to the hare that he had plenty of time to beat the slow trodden tortoise. "Oh, my!" thought the hare, "I have plenty of time to play in the meadow here." And so he did.

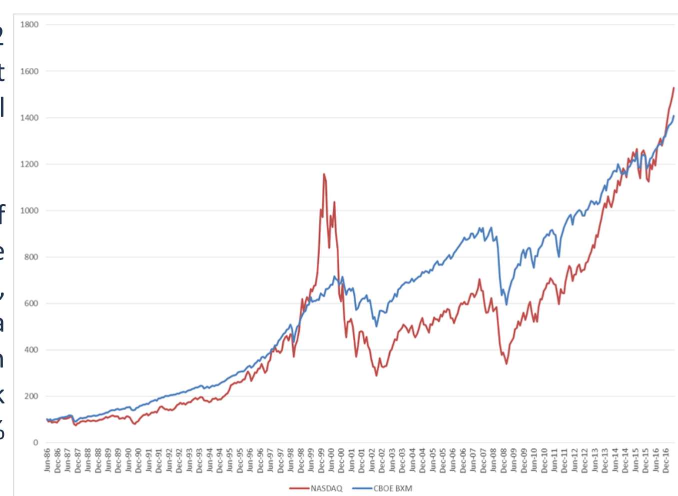


After the hare finished playing, he decided that he had time to take a little nap. "I have plenty of time to beat that tortoise," he thought. And he cuddled up against a tree and dozed. The tortoise, in the meantime, continued to plod on, albeit, ever so slowly. He never stopped, but took one good step after another.

The hare finally woke from his nap. "Time to get going," he thought. And off he went faster than he had ever run before! He dashed as quickly as anyone ever could up to the finish line, where he met the tortoise, who was patiently awaiting his arrival.

Our point about this fable is not so much who wins but which road you choose to take to your finish line. Some people like the excitement of the NASDAQ, for example. They enjoy the ride in up markets, despite the possibility of huge losses during market weakness. This is not our game.

Since the creation of the covered call index (ticker BXM) in June 1986, the index has had an annual return of 9.0%, compared to 9.2% for the NASDAQ. The standard deviation (risk) of the BXM was 10.7%, compared to 21.9% for the NASDAQ. That’s less than half the risk for virtually the same return.



The path of the NASDAQ included deep holes to dig out of in 2002 and 2008. And although this hare has finally caught up, we are not worried. He will venture off his path once again. And we will continue down ours.

Turning to the business cycle. During the end of the first half of this year, the bull market in U.S. stocks celebrated a rare milestone by turning eight years old. The current bull market, defined by prices rising without a 20% decline that would signify a bear market, began for the S&P 500 just over eight years ago, in the depths of the recession in 2009. Since then, the benchmark index has gained 249% over 96 months. That translates into a 17% annualized performance.

The rally represents the second longest bull market since WWII, second only to the dot com bubble of the 1990s. According to Fortune, the average age of a bull market is 57 months.

And why does the above matter? As of today, Warren Buffetts favorite valuation metric, the Total Market Index is at $ 25067.4 billion, which is about 131.7% of the last reported GDP. In order for the market to return to its long-term average, stocks would need to return -1% annually for then next 10 years. This includes the returns from the dividends, currently yielding 1.9%.

The graph to the right is also an another interesting chart, showing durable goods orders relative to the S&P 500. The chart tells us that either durable goods orders are, for the first time, irrelevant to the US economy…or that the "Hare" is about to take a "nap" again.

Van Hulzen Covered Call Strategy in Review and Outlook

Our strategy gained 1.9% in Q2, compared to 3.1% for the S&P 500. The energy and telco sectors were down 7% to 8%. The best performing sector was Health Care at 6.7%. The volatility index (VIX) was down 10%. This index is a key determinant of the level of option premium received when writing call options. Since the creation of the index in the nineties, the index has only closed below 10.0 on 14 days. Eight of those 14 days have been in 2017, with an emphasis on Q2 2017 (which saw a total of six). This is an extraordinary phenomena.

Our investment process is focused on finding undervalued high quality stocks and selling call options to potentially enhance the total return and risk profile on each position. We believe that equity markets are likely to experience heightened volatility in the coming years. As covered call investors, we welcome back this higher volatility as it makes the total return performance less dependent on price appreciation.

Van Hulzen Asset Management

Investment Committee

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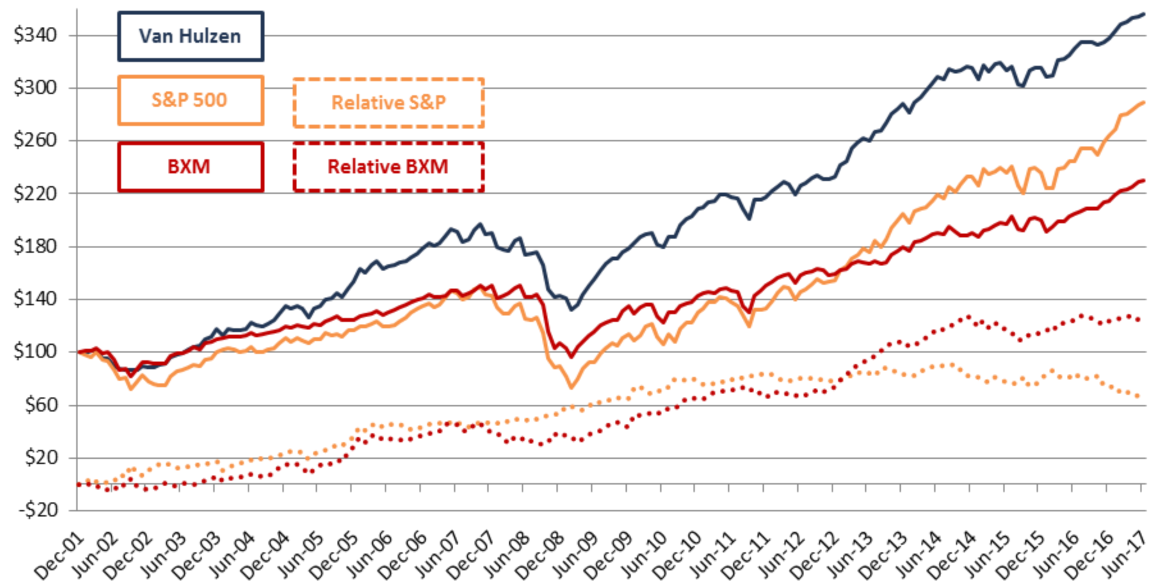
Covered Call Strategy Performance (gross as of 06/30/2017)



Returns (annualized)*	Jun 2017	3M	6M	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Inception
Van Hulzen (Gross)	0.5%	1.7%	5.3%	5.3%	8.0%	4.9%	9.5%	10.3%	6.4%	8.5%
Van Hulzen (Net)	0.5%	1.6%	5.0%	5.0%	7.3%	4.3%	8.6%	9.4%	5.5%	7.6%
BXM	0.4%	3.1%	7.2%	7.2%	12.1%	6.5%	7.7%	9.4%	4.6%	5.5%
Difference (Gross-BXM)	0.2%	-1.3%	-1.9%	-1.9%	-4.1%	-1.6%	1.7%	0.9%	1.8%	3.0%

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

Note: There is no assurance that the Strategy will achieve its investment objectives. Writing call options can result in an option exercise and may cause shares to be "called away" and sold. The use of covered call strategies does not ensure profits or guarantee against losses. Past performance may not be indicative of future results.

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