Van Hulzen Asset Management

Van Hulzen Covered Call Strategy

A brief overview of covered calls and how to use the strategy in client portfolios

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Overview of Covered Calls

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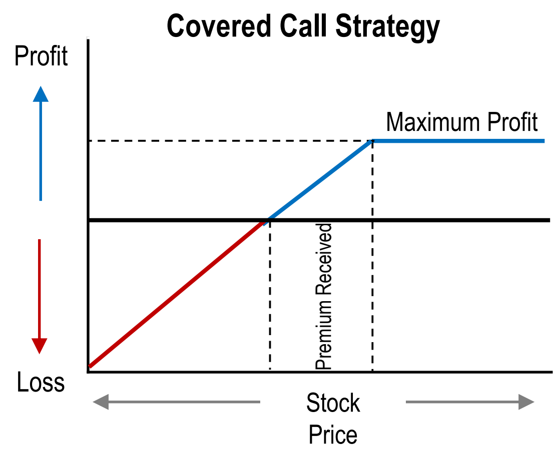
A covered call is an options strategy whereby an investor holds a long position in an asset (for example Johnson & Johnson "JNJ") and writes (sells) call options on that same asset in an attempt to generate increased income from the asset. A covered call is also known as a "buy-write".

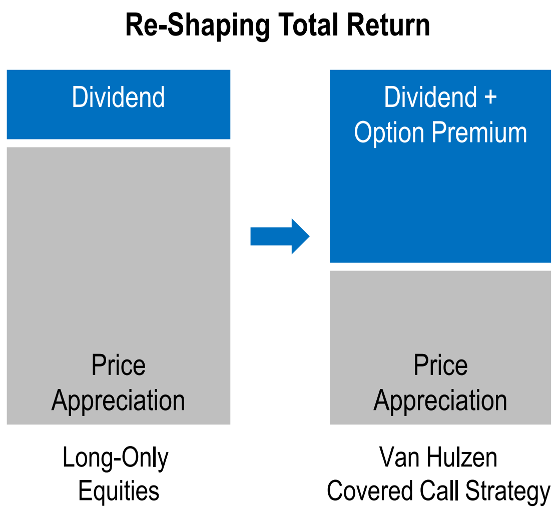
An investor who buys or owns stock and writes call options in the equivalent amount can potentially earn income without taking on additional risk. The premium received is income to the investor, received up front and deposited into the investor's cash account. It also may offer some downside "cushion" in the event the stock slides downward and has the potential to boost returns on the upside.



Key Traits of Covered Calls

Potentially, the primary advantage of a covered call strategy is to earn premium income, which may have the effect of boosting overall returns on the stock and seeking a measure of downside protection. The covered call writer is looking for a steady or slightly rising stock price for at least the duration of the option.

What a covered call position does is exchange unknown price appreciation potential for a known income component (option premium). The best candidates for covered calls are stocks that the portfolio managers are willing to sell if the stock rises and the calls are assigned. That would mean that the optimum total return has been achieved over a certain time period. This passage of time (time decay) has a positive impact on this strategy, all other things being equal. Some refer to this as a "get paid for waking up" investment. If the options expired worthless, the portfolio manager can collect another option premium. Collecting option premium can be seen as extra "dividend" payment on top of regular dividends.



Covered Calls: How to Use the Strategy in Client Portfolios

What type of investors invest in Covered Calls?

Covered call investing has been around for over 40 years and a broad range of investors use covered calls as an allocation within a larger portfolio. Pensions are using covered calls to replace both U.S. large-cap equity allocations and also fixed income allocations. Family office, foundations and non-profit organizations are using covered calls to generate income and steadier returns. Ultra-high-net worth individuals and certain trusts are using covered calls to generate income and offset inflation.

Portfolio Positioning

Three primary positions: Investors seeking equity returns with less risk than stock-only allocations use covered calls. Investors who seek income similar to high yield bonds use covered calls as a fixed income alternatives. Investors seeking an allocation to alternatives may consider covered calls, because of the positioning on the security market line.

Possible Outcomes for a Covered Call Position

1. Stock rises ↑ and the option gets called away (maximum possible profit);
2. Stock remains unchanged (results in a profit from the call income received);
3. Stock drops ↓ (results in a loss just as with long only stocks, except the loss will be partially offset by the call income received).

Hypothetical Covered Call Example

An investor purchases shares of the hypothetical TSJ Sports Conglomerate (TSJ) for $50. The investor then sells a call option on TSJ with a strike price of $55, the investor receives the premium ($5/share) from the option sale and has agreed to sell his shares of TSJ at $55 no matter how high the shares may rise in value.

One of three scenarios is going to play out:

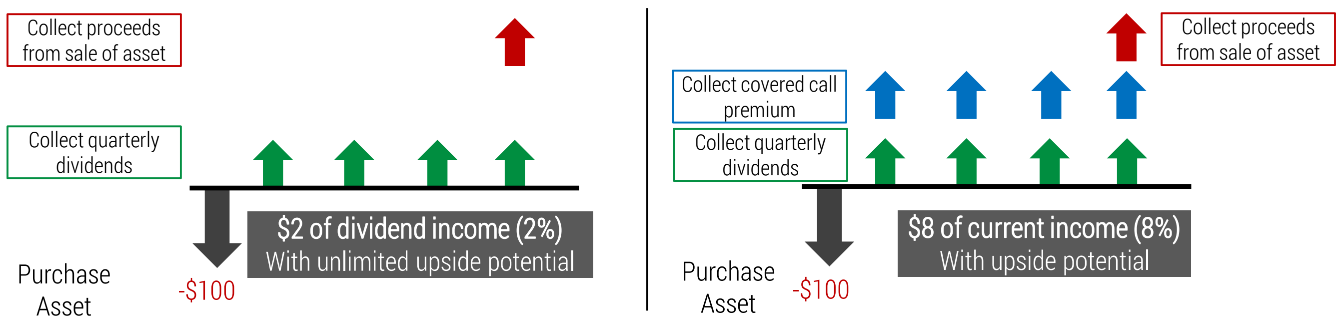
1. TSJ shares trade flat (below the $55 strike price) - the option expires worthless and the investor keeps the premium from the option.
2. TSJ shares fall - the option expires worthless and the investor keeps the stock.
3. TSJ shares rise above $55 - the option is exercised, and the upside is capped at $55 ($5 price gain), plus the option premium ($5 income gain). In this case, the maximum total return is achieved.

Hypothetical examples do not represent or imply performance of any strategy and are provided for Illustrative purposes only.

Summary of Covered Calls

The Van Hulzen Covered Call Strategy has roughly 35-50% less risk than a stock portfolio and produces more income than a high yield bond strategy. As the research published on the CBOE website indicates, covered calls are able to produce equity-style results but do so with less risk and higher levels of income. Below is an illustration that compares Covered calls vs Long Only Equity.

Long-Only Equity vs. Covered Call Equity Strategy



Typical long-only strategies rely on price appreciation for most of their return.

A covered call strategy seeks to capture a portion of return at inception. Potentially creating a steady income component.

Van Hulzen Covered Call Strategy

The Strategy invests in large cap companies that the portfolio managers expects to produce strong return 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, has an over 15 year track record in managing covered calls.
For more information on Van Hulzen Asset Management: vaminstitutional.com
For more information on the Rational Iron Horse Fund: rationalmf.com/funds/iron-horse-fund

RISK CONSIDERATIONS:

Past performance is not a guarantee of future results.

Van Hulzen Asset Management (VAM) is a SEC registered investment advisor located in El Dorado Hills, CA. VAM and its representatives are in compliance with the current registration requirements imposed upon registered investment advisors by those states in which VAM maintains clients. VAM may only transact business in those states in which it is registered or qualifies for an exemption or exclusion from registration requirements. Past performance is not a guarantee of future results. The results achieved by individual clients will vary and will depend on a number of factors including the particular underlying stock and its dividend yield, option market liquidity, interest rate levels, implied volatilities, and the client's expressed return and risk parameters at the time the service is initiated and during the term. Investing in options involves risk that must be considered and reviewed with a professional prior to investing. This presentation is not intended for the giving of investment advice to any single investor or group of investors and no investor should rely upon or make any investment decisions based solely upon its contents. 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. The BXM is a passive total return index based on (1) buying an S&P 500 stock index portfolio, and (2) "writing" (or selling) the near-term S&P 500 Index (SPXSM) "covered" call option, generally on the third Friday of each month. Performance shown in above graphs is gross of fees. The overall Morningstar Rating is based on risk-adjusted gross returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics. Relative performance represents the difference between a $100 hypothetical investment in Van Hulzen's covered call strategy versus a $100 hypothetical investment in each respective benchmark.

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 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-0069-17

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