CROSSMARK GLOBAL INVESTMENTS

COVERED CALL INCOME

Covered Call Income is a separately managed account investment strategy

Commentary – 3/31/2019

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- U.S. stocks rebounded sharply in January after reaching lows in December as some of the worst fears hovering over the markets subsided for now.
- Brexit continues to be at the forefront from a global market perspective with a hard exit or resolution at the end of March.
- Earnings season kicked off with the financial names in mid-January to relatively mixed reviews, with the rhetoric appearing to be slow growth but with no fear of a recession.
- If the trade talks with China don't result in a solid agreement or worst case fall apart altogether, downside risk in the markets will be prevalent.
- The Covered Call Income strategy outperformed the BXM index in the 1st quarter of 2019.

First Quarter Review

U.S. stocks rebounded sharply in January after reaching lows in December as some of the worst fears hovering over the markets subsided. Stocks were oversold from a technical standpoint in December and recovered substantially as monetary policy shifted in a more dovish direction with financial conditions also easing. As investors look to the future, several headwinds still remain prevalent. The March 1st deadline loomed for additional tariffs coming into play with the U.S. and China if no agreement is in place. Brexit continues to be at the forefront from a global market perspective with a hard exit or resolution at the end of March. Let us not forget about the 180 degree turn the Fed made from their early Q4 2018 comments on rate hikes to now more of a dovish tone and likely standing pat. Earnings season kicked off with the financial names in mid-January to relatively mixed reviews, with the rhetoric appearing to be slow growth but with no fear of a recession.

Markets climbed higher for the second consecutive month in February. Investors saw the combination of positive US and China trade talks, considerably more dovish rhetoric from the Fed and the implementation of Chinese stimulus measures. US-China trade negotiations dominated the headlines for the majority of February. The areas of the deal at the forefront included tariffs, intellectual property rights and Chinese-led subsidies for the technology sector. Enough progress was made in the trade talks, which culminated with an extension of the deadline of March 1st for an agreement to be put in place before the US raised tariffs on Chinese imported products. The partial government shutdown ended at the end of January with President Trump signing a bill that would fund the government through the end of September. However, funding for the border wall with Mexico was not included in this bill thus President Trump declared a state of emergency in order to receive funds for the wall that the President based his campaign on. The minutes of the FOMC meeting in January confirmed the dovish shift in sentiment at the Fed with patience remaining the compelling word. The minutes also expanded on the Fed's decision to maintain a larger balance sheet and to put an end to quantitative tightening by the end of the year.

U.S. stocks continued trending upward in March after a short-lived bump associated with the inversion of the yield curve. The markets have now recovered much of their fourth quarter losses in 2018. Many investors see the change in tone with the Fed as a reason to remain bullish on stocks. In more ways than one, the weakness in the fourth quarter of 2018 set the stage for the recovery we have seen so far in the first quarter of 2019. The Federal Reserve reacted to the market weakness by turning more dovish and putting rate hikes on hold for the year. The next move expected by the Fed now looks to be a rate cut, as the 10 year Treasury yield continued to fall. Along with the Fed, US/China trade talks as well as the weakening global economy could potentially have negative ramifications for the markets as we head into the second quarter. The weakening global economy has been highlighted by the inversion of the U.S. yield curve. Past history shows the U.S. yield curve does a much better job of measuring global economic conditions, which can affect broad international markets. If the trade talks with China don't result in a solid agreement or worst case fall apart altogether, downside risk in the markets will be prevalent.

"In more ways than one, the weakness in the fourth quarter of 2018 set the stage for the recovery we have seen so far in the first quarter of 2019."

VIX vs S&P 500 QTD 2019

Source: Bloomberg

The Covered Call Income strategy outperformed the primary benchmark of the BXM in January and February and slightly lagged the BXM for the month of March. Overall, the Covered Call Income strategy outperformed the BXM index in the 1st quarter of 2019. The option overlay on the Covered Call Income strategy was a boost from an attribution standpoint as well for the quarter. The premiums from the call options sold plus dividends received from the underlying stocks enabled income generated to hit close to 3% for the quarter. The Covered Call Income strategy utilizes a sector neutral approach to the S&P 500 sector weights. Implementing this approach takes quite a bit of risk off the table. From an attribution standpoint, the strategy was affected in the following ways for the quarter:

- Technology, industrials, energy and consumer discretionary were sectors that produced a positive attribution to the portfolio. Stocks held in the strategy that individually performed well for the quarter within these sectors included: V, INTC, MSFT, UTX, XOM, LOW, NKE and SBUX.
- Healthcare, financials and materials were sectors that produced positive performance but lagged the other sectors in the S&P 500 index for the quarter.

Covered Call Income: Moving on to the 2nd quarter of 2019

Investor confidence so far in the first quarter of 2019 has not been shaken by trade uncertainty, weakening global growth or an inverted yield curve. In fact, consumer confidence continues to trek even higher among these issues surrounding the markets. Being prepared for volatility to make another comeback is a key aspect in regards to the Crossmark Covered Call Income strategy. The Crossmark trading team will continue to monitor volatility with the intent of strategically placing option trades in order to maximize income. Staying disciplined as we head into the second quarter is a key message for all investors.

Top 10 Model Holdings [1]

Exxon Mobil Corp.
Visa, Inc.
Intel Corp.
United Technologies Corp.
Nike, Inc.
Exelon Corp.
Abbott Labs
Microsoft Corp.
Coca Cola Co.
Starbucks Corp.

% of Total Portfolio: 36%

About Covered Call Income

Covered Call Income strategy is designed for investors who want equity market participation with enhanced income potential. This approach is appropriate for investors looking for higher yields, capital appreciation and reduced risk levels.

Writing calls on securities held in the portfolio maximizes the gains that can be realized if the price of a stock increases. Investing in equity securities involves market risk, including the possible loss of principal.

[1] Model Portfolios are based on a hypothetical account managed during the current quarter. Actual characteristics and income may differ materially from model. As of 3/31/2019.

Definitions

"Up and Out" – This occurs when the original call option is repurchased and another call option is sold. The new option is sold with a higher strike price and a later expiration date than the original option.

"Rolling Down" – This involves buying back the current call option and selling another call option with the same expiration date. The only difference between the two call options is the strike price. In this case, the new option has a lower strike price.

"At-the-Money" – Options with a strike price, or exercise price, equal to the price of the underlying asset. Theoretically, these options have a delta around 50%.

"In-the-Money" – Options with a strike price, or exercise price, lower than the price of the underlying asset. These options have a theoretical delta greater than 50%.

"Out-of-the-Money" – Options with a strike price, or exercise price, greater than the price of the underlying asset. These options have a theoretical delta less than 50%.

"Delta" – One of the "Greeks" derived from the Black-Scholes model for option pricing. Theoretically, it states how much the price of the option will change given a $1 change in the price of the underlying asset. It is also commonly referred to as the "hedge ratio."

Our Firm

Crossmark Global Investments is an innovative investment management firm. We provide a full suite of investment management solutions to institutional investors, financial advisors and the clients they serve. We have a multi-decade legacy of specializing in values based investment strategies for clients. Founded in 1987, the firm is headquartered in Houston, Texas and manages approximately $4.9 billion in AUA.

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