

QUARTERLY UPDATE: 1Q 2022 COVERED CALL INCOME COMMENTARY



Separately Managed Account



written by **Paul Townsen**, Managing Director – Head of Trading & Investment Operations

Covered Call Income Top 10 Model Holdings¹

Apple, Inc.	5.2%
Applied Materials, Inc.	3.9%
Micron Technology, Inc.	3.8%
Electronic Arts, Inc.	3.7%
Bank of America Corp.	3.7%
Morgan Stanley	3.4%
Oracle Systems Corp.	3.3%
Medtronic PLC	3.3%
Cisco Systems, Inc.	3.3%
Merck & Company	3.2%
Total % of Portfolio	36.8%

Markets and Performance

From the beginning of 2022, investors experienced a very volatile first quarter, with violent swings in equity, bond, and commodity markets across the globe. Equities sold off as markets began to reassess the potential for the Federal Reserve (the Fed) to launch more aggressive interest-rate hikes to help curb high inflation not seen in over 40 years. The Fed raised interest rates by .25% with the potential for more tightening at the May meeting. Russia invaded Ukraine in February, sending oil and other commodity prices soaring and stocks falling into official correction territory. Bond prices dropped to levels not seen in years. Put all of this together, and you get a market ripe with volatility. The model account took advantage of the increase in volatility during the quarter to generate over 4% in income from the sale of covered call premiums and dividends paid from holdings. Fast forward to the second week of March, and the markets staged a roaring comeback, cutting much of the losses sustained in January and February.

Positive and Negative Contributors to Performance

The model portfolio slightly underperformed its primary benchmark (the CBOE S&P 500 BuyWrite Index) during the first quarter of 2022, returning -2.65% versus 0.82%, respectively. However, the option overlay helped the model portfolio outperform the S&P 500 index during the same period. The energy and utility sectors were the strongest quarterly performers, with energy being the only sector to register a positive return. The model portfolio received positive contributions to return by owning Chevron (2.2% of total net assets) and Conoco Phillips (1.4% of total net assets) in the energy sector and Exelon (2.2% of total net assets) and Nextera Energy (1.8% of total net assets) representing the utility sector. Technology, communication services, and consumer discretionary were amongst the weakest performing sectors during the first quarter. Stocks the model portfolio held that produced a negative contribution to return were Starbucks (-0.1% of total net assets), DR Horton (-0.2% of total net assets), and General Motors (0.0% of total net assets).

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 3/31/2022.

Looking Ahead

The strong rebound in March could potentially be good news for stocks. However, the aggressive Fed and the unsettled war in Ukraine will keep volatility front and center for the time being. One other development to watch is the yield curve. Rates for two-year Treasuries briefly rose above those for 10-year Treasuries during the first quarter. Such a move has preceded six of the seven recessions since 1978. The Crossmark team will continue to monitor volatility with the intent to trade the value-added option overlay to maximize income and reduce as much inherent market risk as possible. We expect the second quarter of the year will produce numerous trading opportunities for the option side of the Strategy.

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All investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results. The Covered Call Income strategy may not achieve its objective if the managers' expectations regarding particular securities or markets are not met. Equity investments generally involve two principal risks—market risk and selection risk. The value of equity securities will rise and fall in response to general market and/or economic conditions (equity market risk). The value of any individual equity security will rise and fall in response to the market's perception of the issuer's revenues, earnings, balance sheet, credit worthiness, business plan, and overall perception of the viability of the issuer's business (selection risk).

Options are not suitable for every investor. Writing call options to generate income and to potentially hedge against market declines by generating option premiums involves risk. These risks include, but are not limited to, potential losses if equity markets or an individual equity security do not move as expected, and the potential for greater losses than if these techniques had not been used. If the market price of a security increases, a call option written against that security limits the gain that can be realized. And, there are significant differences between the securities and options markets that could result in an imperfect correlation between these markets, causing a given transaction not to achieve its objectives.

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