

COVERED CALL INCOME COMMENTARY 3Q 2020



Covered Call Income is a separately managed account investment strategy



written by
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Mega-Caps Push Indices/Volatility Higher

U.S. markets continued to surge in July and August before selling off in September. This was somewhat predictable, as the month of September has historically been the worst performing of the year for not only the S&P 500 but also the Dow and tech-heavy Nasdaq. This year was no different - volatility returned to levels that had not been seen in quite some time. The primary drivers for the moves higher in July and August were the mega-cap internet stocks that benefitted from stay-at-home orders and increasing COVID fears. Some of the recipients of this increased business included Amazon, Netflix, Microsoft and Apple. From a technical perspective, all three major indices finished above their respective 200 day moving averages in the third quarter for the first time since January.

Taking Advantage of Volatility

From an income standpoint, the Covered Call Income (CCI) model account generated two of the top three income months of the year in the third quarter, with income from option premiums and dividends reaching over 4.50%. The option overlay was short in duration, and the trading team was able to take advantage of the increased volatility in September by resetting quite a few option positions (resulting in the impressive income numbers). While our CCI strategy recorded a strong quarterly performance, it slightly underperformed the primary benchmark (CBOE S&P 500 BuyWrite Index). This was due to the companies we could not own because of price constraints. These included many of the same names mentioned in the second quarter, such as Amazon, Google, Netflix and Facebook. In reviewing quarterly returns from different S&P sectors, the strategy had positive contributions from consumer discretionary and consumer staples, but had slight negative contributions from healthcare, technology and communication services. Several companies that performed well during the second quarter were Wal-Mart (WMT), Coca-Cola (KO), Nike (NKE), Starbucks (SBUX) and Target (TGT). The strategy also added a position in Apple (AAPL) after the company's 4-for-1 stock split. Keeping with our sector-neutral approach, we added General Motors (GM) after Target was called away and became too expensive to own. The CCI strategy also bought a position in Applied Materials (AMAT) in September. The option premiums on Apple and Applied Materials are very attractive and helped add to the increase in income for the month of September.

Fourth Quarter Volatility Expected

September has a well-earned reputation as the worst performing month of the year. However, the next three months have historically been some of the best performers. As we enter the fourth quarter, investors are facing several major issues that will most certainly bring additional volatility to the markets. Not only are there still COVID concerns and the potential for new spikes as we enter the traditional flu season, there is enormous uncertainty surrounding one of the most important elections of our lifetimes. Republicans and Democrats seem to have turned up negotiations on a stimulus package, with both sides meeting several times recently with the hopes of getting a deal done. And don't forget, corporate earnings season kicks off in just a few weeks.

The Crossmark trading team will continue to monitor volatility with the intent to strategically place option spread trades to maximize income as well as reduce as much market risk as possible. We will continue to stay short in duration with the option overlay for the time being as implied volatility is still high and the premiums being paid for short-term options are attractive.

Buckle your seatbelt, as the fourth quarter will definitely be one to remember.

Covered Call Income Top 10 Model Holdings ¹

Nike, Inc.
Abbott Labs
Medtronic PLC
Fiserv, Inc.
Microchip Technology, Inc.
Micron Technology, Inc.
DuPont de Nemours, Inc.
Emerson Electric Co.
Starbucks Corp.
Coca Cola Co.

% of Total Portfolio: 38%

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 9/30/2020.

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