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COVERED CALL INCOME COMMENTARY

Fourth Quarter Review

October turned out to be downright scary for the markets as stocks had their worst month of performance since September of 2011. Volatility came back with a vengeance, which should not have come as that big of a surprise given the fact that interest rates continued to rise, Fed uncertainty was still high, trade negotiations with China continue to persist and mid-term elections were rapidly approaching. The higher volatility that investors are experiencing seemed likely to persist and did it ever. Sounds pretty unnerving. However, the markets entered what has been a historically strong seasonal period. The months of November and December of mid-term election years have been quite strong as history has shown. The broader fundamentals of the markets still remained favorable in October with Corporate earnings up again over 20%, profit margins remained close to historical highs, and sales growth continued to run at a pace not seen in several years. All of those factors seemed to indicate healthy tailwinds for the markets.

Geopolitical events continued to move the markets over most of the month of November. The U.S. mid-term elections produced an outcome that most everyone expected as the Democrats took control of the House of Representatives with the Republicans increasing their hold on the senate. Risk off sentiment within the markets prevailed through most of the month as the U.S. administrations approach to global trade continued to be quite hostile. The most important meeting at the G-20 event turned out to be a dinner between President Xi of China and President Trump as the two world leaders sat down to discuss quite a few topics but none more important than the issues surrounding trade. Any whisper of good news coming out of that dinner meeting would have the markets off to the races again. All one had to do was look at S&P futures on Sunday night to determine how global equity investors thought of how the meeting went between the leaders of the world's two largest economies. As far as the Fed goes, the markets did not have to wait until the December meeting to receive some good news from Fed Chair Powell. Chairman Powell's comments indicated a more meaningful dovish tone which was drastically different than anything he had stated publically in the past several months. As with the Trump/Xi dinner, the markets again reacted favorably.

The final month of 2018 was not a December to remember from a market standpoint. Investors had to contend with rising U.S. central bank rates, the ongoing trade conflict between the U.S. and China, weaker Chinese growth and continued rising geopolitical concerns. Also, the Treasury yield curve inverted, a further sign investors are worried the economy is slowing. The yield curve doesn't cause a recession, but it expresses concerns the Fed has raised rates too high and too fast and will have to cut in the near future. After a few near misses, the S&P 500 finally entered into a correction in the middle of the month,

- Risk off sentiment within the markets prevailed as the U.S. administrations approach to global trade continued to be quite hostile.
- The last week of the month saw wild swings in the global stock markets as shifts in sentiment pushed the markets sharply higher and lower without much rationale.
- Overall, the Covered Call Income strategy outperformed both the BXM and S&P 500 index for the 4th quarter.

meaning the index closed more than 10% below its previous all-time high. The S&P 500 index played chicken with these levels earlier but had always rallied enough at the close to stay above the 10% threshold. Global markets continued to decline as the Fed raised rates and lowered expectations for future rate hikes but investors expressed dismay with the rhetoric coming from the Fed. The last week of the month saw wild swings in the global stock markets as shifts in sentiment pushed the markets sharply higher and lower without much rationale.

Consider these records for the market during the last week of trading:

- Investors experienced the worst Christmas Eve on record and the markets were only open half of the day.
- The day after Christmas saw the Dow set a record for the largest single-day point gain.
- On Thursday the 27th, the Dow moved from 600pts down to 250pts up making it the largest single-day rally in the Index's history.

Can you imagine what the markets would have done on Christmas Day had they been open?

VIX vs S&P 500 YTD

Source: Bloomberg

The Covered Call Income strategy outperformed the primary benchmark of the BXM in October and December and slightly lagged the BXM for the month of November. Overall, the Covered Call Income strategy outperformed both the BXM and S&P 500 index for the 4th quarter. 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 over 3% for the quarter. The Covered Call Income strategy utilizes a sector neutral approach to the S&P 500 sector weights. Taking 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:

- Consumer staples, healthcare and utilities were sectors that produced a positive attribution to the strategy. Stocks held in the strategy that individually performed well for the quarter within these sectors included: WMT, KO, ABT and EXC.
- Consumer discretionary, technology, financials and energy were the sectors that lagged from an attribution standpoint. Stocks held in the strategy that contributed to negative attributions included: HAL, TXT and ATVI.

Covered Call Income: Looking ahead to 2019

We have no reason to expect markets to become less volatile over the near term. The fact the markets ended the year on a positive note might add some momentum heading into the New Year. The core issues of slowing growth, what actions the Fed will take in 2019, U.S. and China trade and Brexit will continue to produce a high level of uncertainty in the markets which will in turn provide for more volatility. Look for the Crossmark Covered Call Income team to strategically place trades in order to generate additional income while using volatility to the strategies advantage. Bucket your seatbelts as we head into 2019.

Chairman Powell's comments indicated a more meaningful dovish tone which was drastically different than anything he had stated publically in the past several months.

Top 10 Model Holdings [1]

Abbott Labs
Exxon Mobil Corp.
Visa, Inc.
Coca Cola Co.
Intel Corp.
Oracle Systems Corp.
Exelon Corp.
Nike, Inc.
Cisco Systems, Inc.
United Technologies Corp.

% of Total Portfolio: 36%

[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 12/31/2018.

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.

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."

About Crossmark's 30 Year History
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 we 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 $4.5 billion in AUM.

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