# Sheaff Brock

Innovative Portfolios for Intelligent Investors™

# MARKET UPDATE
## May 2017

Benchmarks: The S&P 500 Index is a market capitalization-weighted index comprised of the 500 stocks with the largest market capitalizations trading in the United States. This is not a managed portfolio and does not reflect the deduction of fees or expenses; returns include dividends. The Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market in the United States, including Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and CMBS (agency and non-agency). The CBOE S&P 500 Buy-Write Index (BXM) is a passive total return index based on buying an S&P 500 stock index portfolio, and selling the near-term S&P 500 Index (SPX) covered call option, generally on the third Friday of each month. The SPX call will have about a one month expiration, with an exercise price just above the prevailing index level, slightly out of the money. The BXM Index does not take into account significant factors such as transaction costs and taxes and, because of factors such as these, investors should be expected to underperform passive indexes. The BXM Index represents a hypothetical buy-write strategy. DB Commodity Index Tracking Fund (DBC) The PowerShares DB Commodity Index Tracking Fund seeks to track changes in the level of the DBIQ Optimum Yield Diversified Commodity Index Excess Return™ plus the interest income from the Fund's holdings less the Fund's expenses. The Fund is designed for those who want a convenient way to invest in commodities. The Index is composed of futures contracts on 14 of the most heavily traded and important physical commodities in the world. The Fund and the Index are rebalanced and reconstituted annually in November. The Alternative portfolio is a commodity centric portfolio of ETFs and mutual funds whose constituents' profits are highly sensitive to general commodity prices. It may perform differently than DBC since the composite does not hold futures contracts. Indexes are unmanaged and unavailable for direct investment. Benchmark returns include reinvestment of income, but do not reflect taxes, or other fees that would reduce performance. Performance information of benchmark indexes is included for comparison purposes only. Two general types of benchmarks are provided.. The first type is a well-known and widely-recognized index, such as the S&P 500 Index (described previously), and the Barclays US Aggregate Bond Index (described previously). These types of indices are not selected to represent an appropriate benchmark, but rather to allow for comparison of a composite's performance to that of a well-known and widely recognized index. The second type of index is a narrowly-focused (NF) index selected on one or more characteristics, continued from page 4) such as asset class, style or strategy, geographic area, or sector, for example, similar to characteristics of a composite. Although a NF index may have characteristics similar to those of a composite, actual composite holdings will differ significantly from the securities that comprise an index. Consequently, use of a NF index does not indicate that a composite will achieve returns, volatility or other results similar to those of the index. The composition of a NF index will not reflect the manner in which a composite is constructed in relation to investment holdings, Portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility or tracking error targets, all of which are subject to change over time. Comparison of a narrowly-focused index to a composite must be limited to the similar characteristics. Clients should NOT expect performance comparable to a narrowly-focused index in an actual account. (continued below)

Sheaff Brock

8801 River Crossing Blvd.
Suite 100
Indianapolis, Indiana 46240

317-705-5700 or 866-575-5700
sheaffbrock.com

Any portfolio returns mentioned are composite returns, and are net of fees and commissions. There is the chance that market conditions or portfolio performance may deteriorate in the future, and clients may experience real capital losses in their managed accounts. Portfolios are compared to the performance of various indices although the portfolio, which contains much fewer positions, may not reflect the securities making up these indices. None of the indices may be an appropriate comparison index as our managed accounts may own companies not represented in the benchmarks. All clients of SBIA who desire to participate in option transactions receive the option disclosure document, titled Characteristics and Risks of Standardized Options, which outlines the purposes and risks of option transactions. Despite their many benefits, options are not suitable for all investors. Individuals should not enter into option transactions until they have read and understood the risk disclosure document which can be obtained from their broker, any of the options exchanges, or OCC. All investment strategies carry risk, and transactions in options may carry a high degree of risk. Options derive their value from underlying equities or indices, and the derivative value is directly related to the underlying security, thus they carry many, if not more, of the same risks as the underlying equity or index. Sellers of options should familiarize themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs. Selling ("writing" ) an option generally entails greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavorably. Standstill option yield is calculated by dividing the aggregate annual option time decay by the aggregate account values. The yield is reflected gross of management fees. There were no other strategies employed to obtain the results portrayed other than those strategies disclosed in the SBIA ADV or other disclosure brochure. SBIA provides this Newsletter for general informational and educational purposes, and where appropriate, to assist in explaining the portfolios and composites. It is not investment advice for any person. Information is obtained from sources SBIA believes are reliable, however, SBIA does not audit, verify, or guarantee the accuracy or completeness of any material contained therein. The statements and opinions reflect the judgment of the firm, and along with the information from third-party sources and calculations, are made on the date hereof and are subject to change without notice. SBIA does not assume liability for any loss that may result from reliance by any person upon any material in this Newsletter. Clients or prospective clients are directed to SBIA's Form ADV Part 2A and to one or SBIA's representatives for individualized information prior to deciding to participate in any portfolio or making any investment decision. SBIA does not provide tax advice. Clients are strongly urged to consult their tax advisors regarding any potential investment. **Past performance does not guarantee future results, there is always a possibility of loss.**

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**Monthly Update**

Publication date: 5/15/2017

Check out sheaffbrock/in-the-news for our latest column at abcnews.com,

and at CNBC.com.

**Don't wait to buy real estate, buy real estate and wait.**

**Will Rogers**

## **Real** (estate) **Income**

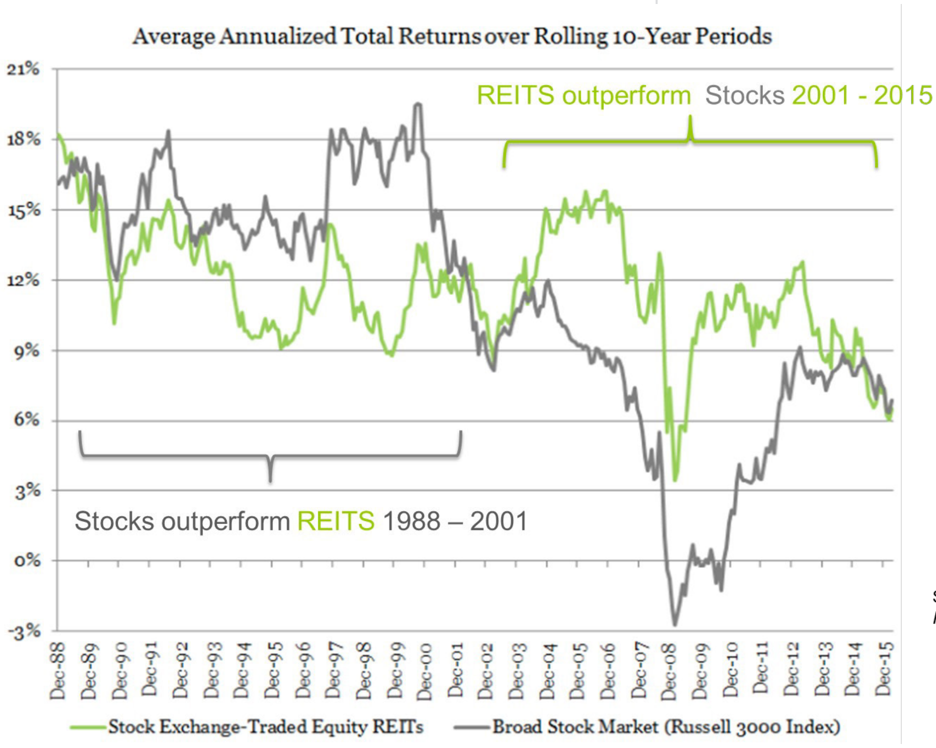
Investment income is scarce today, and as you saw in this letter a couple of months ago, history suggests interest rates could stay relatively low for many years. Most of our clients desire income, but do not want to "tie up" funds in long-term bonds or bank CDs, especially at today's low rates.

In order to help clients with income diversification we decided to bring out an income-centric portfolio based on real estate. We all know that real estate can be income producing, and we all know that real estate often appreciates. However, most of us don't want to manage our own rental properties or deal with the headaches of direct income producing real estate ownership. Sheaff Brock's solution to this need is a portfolio of income generating, publicly traded companies with real estate exposure. Most of the portfolio holdings are, and will be, REITs (real estate investment trusts). REITs have a long history of producing good returns. The below chart shows nearly four decades of rolling 10-year returns of the REIT index in **green** and a broad stock market index (Russell 3000) in **gray**. It starts with a 10-year period from 1978 to 1988, and ends with 2016 .

Interesting observations between REITs and stocks, both in the chart, and in the box to the right of it:

- Over the entire 38 year comparison, both the REITs and the stock market returned about 12% annually, give-or-take.
- REITs had about half of the volatility (standard deviation).
- In the years leading up to the dot-com bust, stocks were the winners, returning about 12 to 18% annually vs. 9 to 15% for REITs.
- From 2001 on, REITs have been the winner, out-earning stocks by about 3 to 5% annually.
- Even during the 10-years ending in the great recession, REITs still mustered up positive returns vs. stocks, which had a few instances of negative 10-year returns.

REITs must payout 90% of their income as a dividend, which is why dividend yields are high, at almost 4%, but generally dividends are taxed as ordinary income. Like Will Rogers' quote, they are best used as a long-term investment, because short-term performance can be volatile. For example, the Dow Jones Wilshire REIT Index lost over half its value in 2007-2008.




**REITs** returned between 3% and 15% annually, with a standard deviation of 7.9%

Ave return1978-2016 12.8%

**Stocks** returned between (3%) and 20% annually, with a standard deviation of 16.9%

Ave return 1978-2016 11.6%

Source: REIT.com, *Comparing Average REIT Returns and Stocks Over Long Periods*, 4/20/16

The main reason to diversify into REITs is not to improve an equity portfolio's return, since returns are similar, but instead to reduce overall volatility, increase diversification, and provide an additional source of income.

How do REITs reduce volatility? By turning in performance that is often quite different from that of other major equity asset classes. They often zig while the stock market zags. In approximately one out of every four calendar years since 1975, REITs' returns differed by 25% or more from those of the S&P 500 Index. In most of those years, REITs' returns were higher.

There are about 170 domestic REITs that trade with enough volume that you can actually buy them. REIT Index funds, such as Vanguard's REIT ETF (VNQ) own them all, and weight the holdings by size. Big companies outweigh little. Currently, the biggest REIT is Simon Property Group (SPG-shopping malls), which pushes the weighting of retail REITs to over 20% of the index. In fact, most mutual funds and ETFs in this space have similar top holdings of very large REITs. Diversifying among funds does you little good, because they mostly own similar positions.

***Sheaff Brock's portfolio difference***, and advantage in our opinion, is the ability to equally own both larger and smaller REITs, plus own companies in the real estate space that are not REITs, but are connected closely to real estate. Also, if we want to purposely avoid, or reduce exposure to an industry (like shopping malls or government reimbursed nursing homes), we can while most of the large funds cannot. The portfolio's 20 positions currently yield a bit over 4%, are all REITs, and are spread among many sectors such as hotels, billboards, medical properties, data-storage, self-storage, senior living, etc. We own no retail mall REITs.

We are excited about our Real Estate Income & Growth portfolio offering. The name says it all; real estate holdings with income first, and growth second. Buy it, enjoy the income, and like Will Rogers said, wait.

By the way,

This property is NOT in our portfolio.


(Cheetos probably sell like mad)

## Portfolio Updates

The Producer Price Index (PPI released on 5/11/17) and Consumer Price Index (CPI released on 5/12/17) have increased 2.5% and 2.2% respectively in the last 12 months, the largest year-over-year increases in 5 years, meaning inflation seems to be heating up. Unemployment is very low and wage pressure is building as well. Government leaders worldwide want some inflation since it allows them to pay off future bond obligations with cheaper currency. If inflation is just 2.5% per year, that means a dollar borrowed today in a 30-year bond offering can be paid back at less than 50 cents on the dollar.

Here's an overview plus updates on some of our portfolios.

The first four months of 2017 were:

| | |
|---|---|
| Great for large-cap stocks, S&P 500 | +7.1% |
| Decent for mid-cap stocks, S&P 400 | +4.6% |
| Not as hot for small-cap stocks, S&P 600 | +1.8% |
| Good for bonds, Barclays Aggregate Bond | +1.6% |

The best and worst sectors were:

| | |
|---|---|
| Technology (XLK) | +13% |
| Consumer Discretionary (XLY) | +11% |
| Financials (XLF) | +2% |
| Energy (XLE) | - 9% |

### Dividend Growth & Income

Dividend Growth & Income was very competitive in the first third of the year. The portfolio composite total return beat 8 out of the 10 largest dividend-driven ETFs. The two ETFs that beat us have low (sub 2%) dividend yields. In April we sold two non-performing stocks and bought JP Morgan and Texas Instruments with the funds. Unlike some of the ETFs with "Dividend" in their name, we take the "Income" in our strategy's title seriously. The portfolio's dividend yield is a bit over 3%, and of the 25 stocks currently in the portfolio, 22 have raised their dividend in the last year. Currently we have a position in all but one S&P sector; no telecom position.

**Announcement repeat:** In the next few weeks, new management agreements will arrive in your mailbox. *They will need to be signed and returned.* The update is mostly due to the changes in the Department of Labor's language requirement regarding fiduciaries. We are a fiduciary already, but the language update is needed. Thank-you regulators!! Woo-hoo, busy work!

**Knowledge Builder** webinars are offered monthly. They are less than an hour (or a glass-and-a-half of wine) long and are on various subjects. You can also view the recording of previous Knowledge Builders on our website. Invites come by email.
Wine comes from your cabinet.

### IntelliBuilD Growth™

This is the growth equity portfolio based on *Investors Business Daily's* stock lists, and it has enjoyed a nice start to the year by gaining almost three-times more than the average of the mid and small-cap indices. Fairly volatile, but this year it's our shining star.

### Covered Call

A low VIX + short-dated calls = less yield, but the rising market has allowed more positions to be called away, providing total return. The composite's theta yield* (if the underlying stocks sit there, the option premium time decay) on the entire composite is about 7% net of fees, plus a dividend yield of about 2%, which gives a high single-digit static yield. **A theoretical, Black-Scholes derived statistic calculated by thinkpipes*.

### Bulls of the Dow

Two stocks were replaced at the beginning of the second quarter. New additions were Apple (AAPL) and American Express (AXP). The ten (some would say stodgy) stocks are beating the youngsters so far this year.

### Preferred Income

A big April has graced preferreds with the best start to a year since 2014. A repeat of that year would be great, but don't bet on it.

### Alternative

A great start to 2017 driven by emerging market exposure, which haven't been this hot since 2012.

*The following option overlay products are intended to be additive in return to other investments held in an account, and are not appropriate for all investors. Historically, the cash-flow from overlays has been positive from year-to-year. However, realized gains and losses are very inconsistent. These are long-term strategies and may not produce capital gains over the short-term.*

### Put Income Overlay

We are continuing to add index put spreads on the SPDR S&P 500 ETF (SPY) in all accounts with notional exposure wiggle room. The goal is to put half of an account's risk on the index, and the other half of risk on individual stocks. Currently, across the entire book we are over halfway to the SPY exposure goal. We are still working through the legacy problem children positions, exchanging puts to new names with higher probabilities of expiring at a gain. Remaining are a handful of stocks in the energy, commodity, retail, and medical sectors to work through. Half-dozen down, half-dozen to go.

### Index Income Overlay

The simple overlay using put option spreads on the SPDR S&P 500 ETF (SPY) staggered monthly, one spread expiring month, after month, after month. Since inception of this overlay, results have been a textbook example of the strategy. Every month the spreads have expired for gains, and clients have received a low-single-digit *addition* in cash-flow and realized gains to their account, which was also invested in one of our strategies, or self-directed by the client. For example in the last 12 months, Bulls of the Dow gained 19.6%, and this overlay *added* a few percentage points to that. Do the math: A few + a few + a few = many!

If you have any questions or comments regarding this letter, including any portfolio or composite, please contact our Chief Compliance Officer, Audrey Kurzawa at audreyk@sheaffbrock.com; you can also reach her, or any other Sheaff Brock representative, at 317-705-5700.

| Style | Performance Update<br>Portfolio | 2017 Thru April | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| Fixed Income | **Preferred Income** - Preferred stocks | 5.08 | 1.66 | 5.22 | 14.02 | -4.57 | 9.11 | | |
| | **High Yield Bond** | 2.41 | 11.63 | -7.32 | -1.93 | 8.78 | 15.38 | 3.99 | 15.93 |
| Growth and Income | **Covered Call Income** - Quality stocks & covered calls | 4.61 | 6.24 | -1.20 | 6.39 | 22.04 | 10.14 | -11.57 | |
| | **Dividend Growth & Income** - Dividend paying stocks | 4.52 | 11.22 | -7.17 | 5.20 | 36.47 | 12.46 | 5.80 | 16.94 |
| Growth | **IntelliBuilD Growth** - IBD growth stocks | 9.03 | -2.71 | 2.52 | 7.63 | 11.18* | *10/1/13 inception date | | |
| | **Bulls of the Dow** - 10 strongest of the Dow 30 | 8.73 | 9.65 | 1.14 | 12.42 | 30.05 | 7.83 | | |
| | **Mid-Cap 10** - Mid-cap growth momentum stocks | 0.09 | -7.90 | -12.68 | | | | | |
| Alternative | **Alternative** - Metals, foreign currencies, commodities | 9.00 | 4.37 | -8.25 | -4.23 | -0.70 | 9.02 | -7.74 | |
| Option Overlay | **Put Income** - Overlay of short equity puts | *-1.23* | *0.25* | *-9.17* | 0.56 | 5.92 | | | |
| | **Index Income** - Overlay of unleveraged put credit spreads | 1.28 | 3.20* | *4/30/16 inception date | | | | | |
| | **Index** | | | | | | | | |
| | **S&P 500** | 7.16 | 11.96 | 1.38 | 13.69 | 32.39 | 16.0 | 2.1 | 15.1 |
| | **CBOE S&P 500 Buy/Write** | 4.96 | 7.06 | 5.24 | 5.64 | 13.26 | 5.20 | 5.72 | |
| | **Barclays Aggregate Bond** | 1.59 | 2.65 | 0.55 | 5.97 | -2.15 | 4.2 | 7.8 | 6.5 |
| | **DB Commodity Index Tracking Fund (NAV Total Rtn.)** | -6.57 | 18.50 | -27.41 | -28.18 | -7.57 | 3.31 | -2.71 | |

Composites include all fully discretionary, management fee-paying and non-management fee-paying accounts, including those accounts no longer with the firm of reasonable size that are substantially invested in accordance with the composite strategy or style. Returns are presented net of management fees and all trading expenses, and the reinvestment of all income. Put income results are only realized gains and Index Income reflects the total return of only the option overlay. Net-of-fee results were calculated using actual management fees. Actual advisory fees and transaction fees will vary depending on, among other things, the portfolio, account size, and activity. Fees are described in SBIA's ADV Part 2A. *Denotes partial year, with note reference. Prior to October 1, 2015 Preferred Income was sub-advised by Trust Investment Advisors, Indianapolis, IN. Please see additional disclaimers on the next page.