Sheaff Brock

Innovative Portfolios for Intelligent Investors™

MARKET UPDATE

May 2019

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, and the S&P Mid-cap 400 is the next largest 400 stocks. These are not managed portfolios and do 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. 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, 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)

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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. 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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SheaffBriefs

Go to sheaffbriefs.com. Check out our blog.

> "I don't care what the newspapers say about me as long as they spell my name right."
> P.T. Barnum

<u>Just because you say it, doesn't mean it's true or complete.</u>

There are many things we hear and take as gospel. Maybe we hear a statistic so often that we assume it must be true, or we hear a saying that has been repeated for centuries and assume it's complete or accurate.

One such saying is, "There's a sucker born every minute." This phrase is attributed to P.T. Barnum, as a statement of his cynicism about his own work, the way he could dupe people into paying for his circus. But it was *never said by Barnum*. In reality one of Barnum's *competitors* used it to describe the famous showman's exhibits, and the people he "suckered" into paying to see them.

Another quote is, "Let them eat cake." The full quote goes: "If they have no bread, let them eat cake." However, neither of them are right – because *Marie Antoinette never said it*. It's fake news! The quote was used by anti-monarchists in propaganda to protest the decadence of Versailles, King Louis, and Marie; to show they were out of touch with "the people." The protestors "cake" reference was taken from Rosseau's book *Confessions*, which was published a full 10 years before Antoinette met her maker at the guillotine. You think the protestors had to wear yellow vests back then?

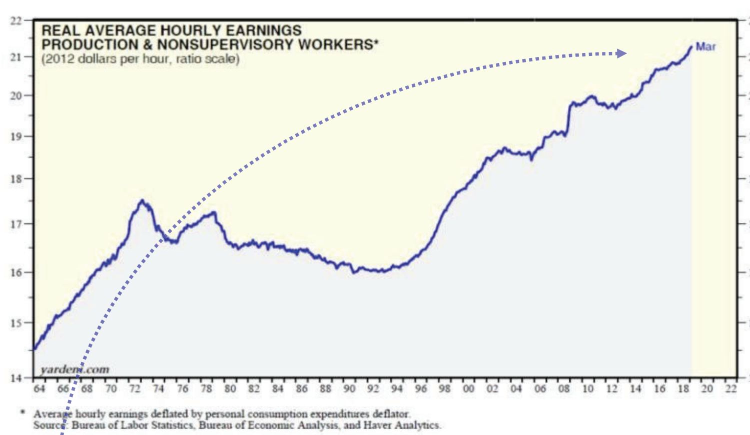
Marie Antoinette at the age of 13, when she married. Sacre' bleu, scandaleux!! *(sweet up-do though)*
Source: Wikipedia

And, one of the more misquoted texts is, "Money is the root of all evil." This comes from the Apostle Paul's writing in the Bible's New Testament, 1 Timothy 6:10, and the real text is, "The love of money is a root of all sorts of evil." Big difference in meaning. It's not money (a morally neutral medium of exchange), it's the <u>love of</u> money (greed). And, it's not <u>the</u> root <u>of all</u> evil, but <u>a</u> root <u>of all kinds</u> of evil. There are a lot of evil roots, greed is just one of them.

All three of these sayings might be used by candidates in the upcoming Presidential election. During the coming political year, you will hear all kinds of rhetoric about the wealth divide, much of which is hogwash. Louis Navellier recently wrote:

In the April 19th New York Times, Nobel Prize winner Joseph Stiglitz wrote in his opening paragraph on the editorial page that "90% have seen their incomes stagnate or decline in the past 30 years" since "the United States has the highest level of inequality among the advanced countries and one of the lowest levels of opportunity." How can the nation's GDP more than double (+110% since 1989) if 90% of us are no better off?

Dr. Yardeni, (we've often written that Ed Yardeni is our favorite economist) *once a student of Stiglitz at Yale, said Stiglitz is using "the worst data series ever," real median income, compiled annually by the Census Bureau – "an extremely flawed measure of income, yet it is widely used by Progressives to prove their claim of widespread and prolonged income stagnation." The main reason it's flawed? The data is based on surveys that rely on respondents' honesty. Even the Census Bureau warns that "for many different reasons there is a tendency in household surveys for respondents to underreport their income." Bottom line, people lie to census workers about income. Stagnation? More realistic data shows that over the past 30 years, inflation-adjusted average hourly earnings of nonsupervisory workers is at an all-time high.*



Source: Yardeni Research

This uses a measure of wages that covers the vast majority of payroll employment, in other words, regular workers. Yardeni concludes: "Income stagnation is a myth. Income <u>inequality</u> isn't a myth but an inherent characteristic of free-market capitalism, an economic system

Tiffany's Tips! Tiffany VanHook serves our clients as a financial planner and estate specialist. Tiffany is a graduate of Baylor Law School and has many years of experience providing ultra-high-net-worth families financial and estate planning services. Her expertise and planning services are available for Sheaff Brock clients. Every month we share a planning tip or two:

√ *High school students should have received college acceptance and financial aid packages last month! There's no standard format for financial aid letters, so comparing offers can be a challenge. Start by subtracting any free aid (grants and scholarships) from the cost of attendance. From there, develop a plan for the balance. Your financial aid letter will offer information about the types of federal loans for which you qualify. Remember, you can negotiate an offer through an appeal, particularly if you have a better offer from another comparable school, or if your financial circumstances have substantially changed since filling out your FAFSA.*

√ *If you are making quarterly estimated tax payments, head's up for your second installment, due June 15th! With summer vacations upon us, schedules may become hectic. It's a good idea to make note of all payments due in the upcoming summer months to make sure nothing gets missed! You might also consider setting up automatic payments for regular expenses.*

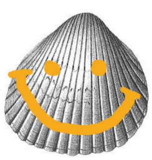
that awards the biggest prizes to those capitalists who benefit the most consumers with their goods and services. Perversely, inequality tends to be greatest during periods of widespread prosperity. Many households are prospering, even if a few are doing so more than the rest of us."

Listen skeptically to both sides in the next election cycle since what is said may not be true or complete.

(Thanks Trudy M. for the inspiration for this newsletter)

Markets and Economy

- According to Strategas Research, a recession is probably not in the cards (another saying we repeat that alludes to cards used in fortune-telling) this year or next.
- First quarter earnings for all S&P 500 companies have come in +4.5%; better than expected and 90% of all companies beat expectations. So much for the much-hyped and feared "earnings recession."



- Our portfolios performed pretty good (some really good) through April.
- An equity investor was "happy as a clam" at the end of April. This is an example of another incomplete saying. Are clams happy, and how would you know? Do they even have emotions? The complete saying is, "happy as a clam at high tide," which makes sense due to the fact they are underwater and hidden from the human clamdiggers.

OK, enough semi-worthless trivia.

Warren Buffett, 5/2/19: "Stocks are ridiculously cheap if interest rates stay at current levels."

Portfolio Updates

Dividend Growth & Income

Dividend paying stocks performed admirably in the first four months of 2019. Through April, our portfolio composite gained 15.4% net-of-fees vs. the Dow Jones Select Dividend Index benchmark's 14.4%. All but one of the twenty-five stocks in the portfolio raised their dividends in the trailing 12 months. This month after earnings reports were in, we made one change in the portfolio by selling a stock we had patiently waited three years for anticipated appreciation and swapping it for Kohls (KSS). Several years ago, this Wisconsin based mid-market retailer was chastised for not having a mall-based store strategy. The strategy looks OK now. The stock pays a dividend of just under 4%, dividends have been increased eight years in a row (most recently a solid 10% increase), and forward P/E ratio is only 9. According to our Panaray research tool, KSS has traded at an average P/E of 13 over the last seven years, which implies nice potential appreciation. For well over a year, Kohls and Amazon (unlikely bedfellows) have been testing an Amazon return counter inside Kohls' stores, letting Amazon customers return their purchase at a Kohls store. This Amazon partnership will be expanded to all Kohls stores this summer. Early this month, Kohls revealed Amazon bought six-year warrants on 1.7 million shares of Kohls stock at $69 per share. We bought the shares at a bit under $68.

Bulls of the Dow

The Bulls of the Dow had a tough April due to three stocks, Walgreens, UnitedHealth, and Boeing dragging down the rest of the team. Year-to-date, our composite gained 13.3% net-of-fees vs. 14.8% for the Dow Jones Industrial Average (DJIA). Boo. In the trailing 12 months ending April, the Bulls are leading 17.3% vs. 12.6% for the DJIA. Yay! We have received some pushback on owning Boeing but remember, the Bulls methodology is a 100% quantitative system, and we don't override it. There is significant proof that human bias can screw up...well...just about anything. We leave the system alone.

IntelliBuilD Growth™

Two of *Investors Business Daily's* stock lists are sorted by their "downside risk" characteristics and the portfolio buys the 33 best scoring American domiciled stocks. Through April, year-to-date performance was 21.4% net-of-fees vs. 18.2% for the S&P 500. Growth stocks are generally all about earnings growth. According to Panaray, our 33 companies have median estimated earnings growth this year of 11% vs. only 6% for the S&P 500. Our portfolio carries an average forward P/E of 17, exactly the same as the S&P 500; nearly twice the expected earnings growth for the same valuation. In 2019, seven stocks have turned over and been sold to reinvest in new names with average expected earnings growth of 24% and an average P/E of only 10. It's like card game; discard a weak holding and replace with a better one.

Twenty Under Thirty-Five

After a rough March, April was kind to this fully invested, twenty-stock portfolio of American companies priced under $35 (at least when first purchased). It went from our best performing equity portfolio at the end of February to the bottom of the barrel at quarter's end, and up to fairly competitive by the end of April. Similar to the Bulls of the Dow, this is a rules-based quant portfolio which humans can't monkey with and we have confidence in. But, the portfolio has been moody, probably due to only having twenty positions and that it is made up of 90% small and mid-cap stocks.

Covered Call

A jolly good show through April: 12.7% net-of-fees vs. 8.4% for the CBOE Buy/Write index. Currently the largest positions in the composite portfolios are Texas Instruments, AT&T, Abbvie, TJX, Union Pacific, Apple, Marriott, and American Express. Across the entire book of accounts, the covered calls are generating time value "theta" of $6000 per day, about 7.2% if the stocks just sit and twiddle their thumbs.

Real Estate Income and Growth

The REIT portfolio followed the strong first quarter with a good April. In 2019 through April, our composite gained 16.1% vs. 15.5% for the S&P U.S. Real Estate Index. According to Panaray, our portfolio sports a dividend yield of 4.1%, a historically rising dividend stream, and upside potential. Industry group NAREIT says commercial real estate is the third largest asset class. Don't own any? Allocate $ here.

Preferred Income

Our portfolio composite is a blend of retail $25-par preferreds and institutional $1000-par preferreds. The U.S. Preferred Stock Index yields about 6%, which is even a bit sweeter than high-yield corporate bonds. The bonus for preferred stock buyers is some of the dividends are taxed at capital gains rate. The sector is a good value, in our opinion.

Option overlay products are additive in return to other investments held in an account, and are not appropriate for all investors. Realized gains and losses can be very inconsistent. These are long-term strategies and may not produce capital gains over the short-term.

Put Income and Index Income Overlay

Both option overlays are back on track after the SPY index option restructure required after the December swoon. Through April of 2019, Put Income (index credit-spreads on SPY plus puts on individual stocks) delivered a solid 3.11% net-of-maximum-fee return from realized gains. And so far, May's spike in volatility has been a cash-flow benefit.

Through April, Index Income (credit-spreads on SPY only) earned 1.37% in net cash flow. The strong stock market caused a big improvement in the short option values making the composite net total return 6.33%. The recent pick up in volatility generally makes premiums bigger, which is good for option sellers, like us. Both of these strategies offer an *additive return* to a client's underlying portfolio (which might be invested in a strategy previously discussed) and can't be compared to any appropriate index. But, as a comparison the S&P 500 gained 18.2% through April. Here's a happy/warm thought: The next newsletter will come in summertime!

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 Portfolio	2019*	2018	2017	2016	2015	2014	2013	2012	2011
Fixed Income	**Preferred Income** - Preferred stocks	7.37	-5.66	7.44	1.58	5.47	14.29	-4.65	9.42	
Growth and Income	**Covered Call Income** - Quality stocks & covered calls	12.72	-10.38	12.96	6.16	-1.11	6.33	22.28	10.23	-11.09
	Dividend Growth & Income - Dividend paying stocks	15.40	-8.95	21.99	11.07	-7.27	5.04	36.23	12.17	5.62
	Real Estate Income & Growth - REITs/real estate stocks	16.12	-5.34	2.99*	*5/1/17 inception					
Growth	**IntelliBuildTM Growth** - IBD growth stocks	21.40	-11.30	25.40	-2.85	2.53	7.47	11.56*	*10/1/13 Inception	
	Bulls of the Dow - 10 stocks of the Dow Jones 30 Indus.	13.31	4.51	33.76	9.35	0.96	11.41	24.35*	*2/1/13 Inception	
	Twenty Under $35 - 20 best scoring stocks under $35	13.82	-18.74	5.72*	*10/1/17 Inception					
Option Overlay	**Put Income** - Realized gains return	3.11	0.58	*5.66*	*0.21*	*-8.86*	0.55	4.04		
	Index Income - Cash-flow yield	1.37	1.67	2.48	3.35*	*6/1/16 inception date				
	Index Income - Total return mark-to-market^	5.86	-3.59	2.46	2.49*					
	Index									
Large-Cap Stocks	S&P 500	18.24	-4.38	21.83	11.96	1.38	13.69	32.39	16.0	2.1
Mid-Cap Stocks	S&P Mid-Cap 400	19.09	-11.10	14.45	18.73	-3.71	8.19	31.57	16.07	-3.10
Covered Index	CBOE S&P 500 Buy/Write	8.43	-5.26	13.00	7.06	5.24	5.64	13.26	5.20	5.72
Fixed Income	Barclays Aggregate Bond	2.97	0.02	3.54	2.65	0.55	5.97	-2.15	4.2	7.8

*Returns are through previous month-end. Composites include all fully discretionary accounts and consist of all client accounts that are at least 80% invested in the strategy. Returns are presented net of maximum management fees and all trading expenses, and the reinvestment of all income. Put Income results are only realized gains. Index Income total return reflects the realized and unrealized gain/loss including the reinvestment of cash-flow income from the options divided by the prior period ending composite value. Cash flow yield represents the cash received from the sale of index option premium divided by the average composite value. ^Returns have been restated to reflect the change in unrealized gain/loss on the option premiums. Returns are calculated using the highest fee to reduce the composite gross of fee return to obtain the composite net of fee return. An analysis is performed on a quarterly basis to determine the highest fee paid in the portfolio as the highest fee paid may change over time . (continued on opposite page)