# Sheaff Brock

**Innovative Portfolios for Intelligent Investors™**

# MARKET UPDATE

June 2020

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. The Dow Jones Industrial Average is a price-weighted index of 30 giant American companies. 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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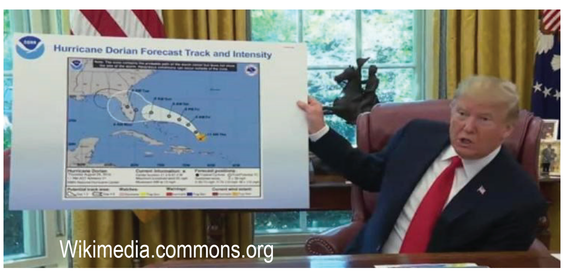
> "The truth is like poetry. Everyone says they like it, but no one really wants to hear it."
> Anonymous

## 2020

There is a podcast called *The Argument* of which the co-host, Michelle Goldberg, said something that put the first five months of this year into stark perspective. She said that 2020, "started off like 1974 (an impeachment crisis), quickly became 1918 (a pandemic), turned into 1929 (economic crash), and is now 1968 (massive urban unrest)." By anybody's measure this year has been unbelievable. And now add to the list the deepest recession, the shortest recession, the fastest stock market sell-off, and the most violent stock market bounce back. We're not even halfway through the year! What's next?

Why not hurricane season and a for-sure contentious election to cap it all off?



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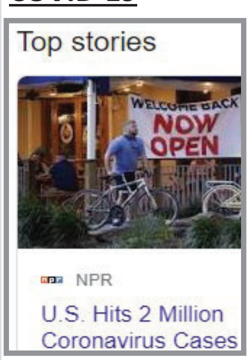
## COVID-19

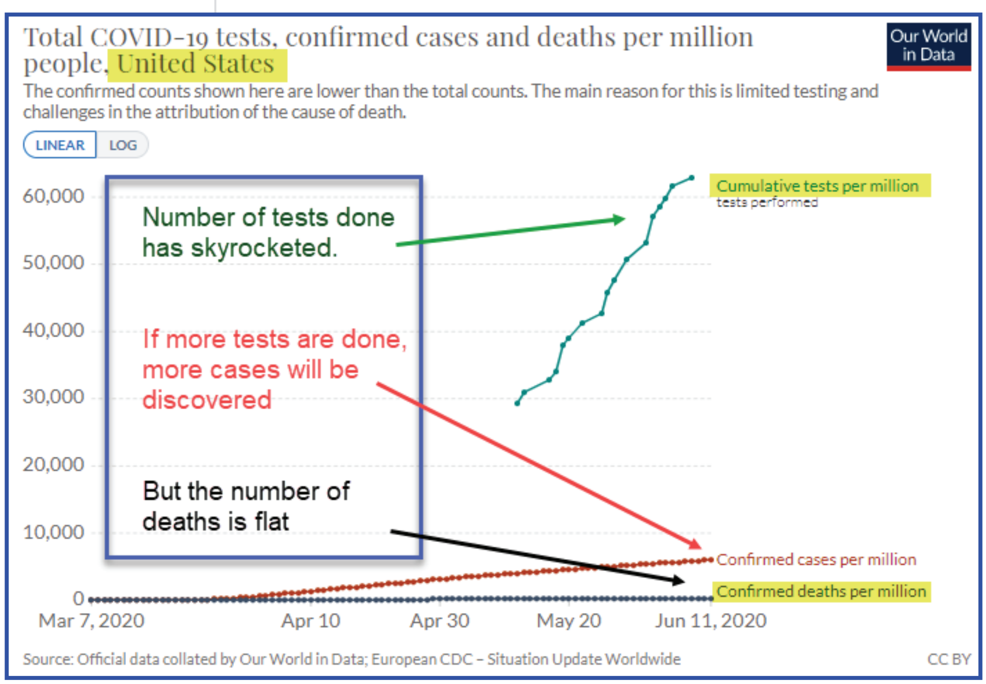



Sorry, I know you are sick of reading about this. States are opening up and the news is focused on the number of COVID-19 cases going back up. Headlines like the one to the left are common. The "case number" is nearly irrelevant, in my opinion. The number of cases is directly influenced by the number of tests done. The more tests done means the more cases will be discovered, which is logic a kindergartener understands. As you can see in the chart the rate of testing is skyrocketing, so naturally the confirmed cases are increasing. The death rate is what matters, which has stayed flat. There also seems to be a big discrepancy in the method each state is using to report case numbers. The only important number is how many folks are dying from COVID-19. Is the virus becoming more lethal or less lethal? On the next page is an updated chart from last month's newsletter which shows the death "rate-of-change" from the virus. Therapies are improving as we wait for a vaccine, and the death rate is continuing to decelerate.

Maybe the states reopening will reaccelerate the death rate, but I wouldn't bet on it.

## THE FED

The Fed has investor's backs, which is a BIG, BIG deal. Last week, Fed Chairman Powell reiterated short-term interest rates will stay very low for some time; that the Fed is not even "thinking about thinking about raising rates." And he stated "the Federal Reserve is committed to using its full range of tools to support the U.S. economy." A friendly Fed is about the best friend an investor can have. This week's reports confirm the economy has started healing. Retail sales soared, industrial production gained and housing starts should be up sharply, showing the recovery started in May.

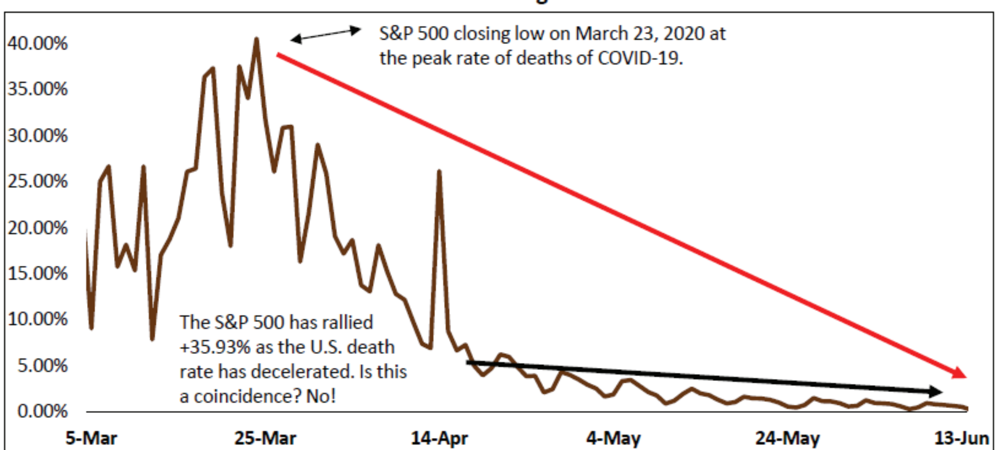


**Tiffany's Financial Planning Tips!** Tiffany VanHook serves our clients as a financial planner and estate specialist. Tiffany has many years of experience providing ultra-high-net-worth families financial and estate planning services. Her planning services are available for Sheaff Brock clients. Every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

- √ **Set your kids up for a healthy credit score** - Do you know what makes up your credit score? You may be surprised to learn that 15% of your credit score comes from the length of your credit history, 35% of your credit score comes from having good payment history, and 30% from the amount owed. When your kids are old enough to drive, consider getting them a credit card in their name to use solely for gas. Help them make sure they pay it off every month and by the time they go away to college, 80% of their credit score could be golden! The other two parts to your credit score are the credit mix (10%) and new credit (10%).

- √ **With interest rates so low**, you may be asking if you should refinance your mortgage. A good rule of thumb is that if you can lower your interest rate by at least 1%, it is probably a good idea to refinance. Remember, a lower interest rate means you can pay off your house quicker! Make sure you consider closing costs into your decision as lumping them into your mortgage could cause you to have a higher interest rate, which defeats the purpose.

**Total U.S. Deaths from COVID-19 on a rate of change basis**



Source: Worldometer, The Earnings Scout

## Portfolio Updates

For almost four months now volatility has ruled the day causing big swings in the stock market. Volatility, as measured by the VIX, has a long-term average of about 19 to 20. From October 2019 through most of February 2020, volatility was low and the VIX didn't go above 20. From February 24th through today, the VIX hasn't been <u>below 20</u>. The VIX peaked at an all-time high of 85 about 3-months ago, and today is at 35.

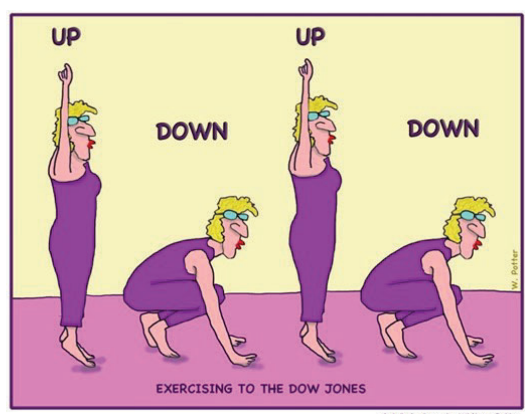
Besides volatility, the stock market has also been a tale of two different extremes between style and size with:

**Large-Cap stocks** outperforming **Small-Cap stocks**
**Growth stocks** outperforming **Value stocks**

Today, the spread between the best and worst is historically extreme. **Large-Cap Growth** as measured by the Russell 1000 Growth index has gained about **+9%** YTD through June 16th, while **Small-Cap Value** as measured by the Russell 2000 Value index has lost **–23%**. According to Bloomberg, the 30+% difference in return is larger than the spread in 1999!

Relative to our benchmarks, the lion's share of our strategies are enjoying very good performance. Quality stocks, like the ones that come through our low-downside-risk screens, are improving while the go-go stocks have plateaued a bit.

**Dividend Growth & Income**
Through May, our composite was –17.5% net-of-fees vs. –20.8% for our benchmark, the Dow Jones Select Dividend index. This consists of large and mid-cap dividend payers with a history of rising dividends. Of course, there is no guarantee, but already this year, even with all of the tumult, twelve of our stocks have increased their dividend. In the last 5 weeks we added seven new positions, all with strong "downside risk" scores, a rising dividend history, and a dividend yield averaging 2.7%. There are now 29 positions in the portfolio. Our goal is to be at 33 positions later this summer.



Art & Cartoons by Whitney Potter

**Bulls of the Dow**
This has again been our best performer with a return of –3.3% net-of-fees vs. –10.0% for the Dow Jones Industrial Average (DJIA). This is a simple portfolio of ten stocks from the thirty Dow Jones Industrials (DJIA), with all trades quant-computer generated and rebalanced quarterly. The next portfolio refresh will be in early July. Over 600bps of outperformance over the DJIA is,...well..., pretty darn good. Actually, really darn good.

**IntelliBuilD Growth™**
IntelliBuilD™ consists of 33 positions and is fully invested. Buys and sells are quant-computer generated to reduce human bias. All are growth stocks from *Investor's Business Daily's* lists. April and May were great months for the portfolio with the composite gaining over 26%, which was 9% more than the S&P 500 over those same months. This return-burst brought our YTD number to a smidge better than the S&P 500. A solid comeback.

**Twenty Under Thirty-Five**
This is a 20 position portfolio of lower-priced stocks (under $35 when purchased), and mostly small-cap value stocks, which you just read was the worst subset to be in. 2020 has been really tough on small-cap value constituents.

**Covered Call**
Income from covered calls, dividends, and appreciation are the goals. Through May, the composite was –8.9% net-of-fees vs. –15.0% for the CBOE Buy/Write index. The 600bps of alpha was due to entering the downturn with high-ish cash, a recovery in uncovered stock prices, overwriting on many positions (now 77% of assets are covered), and a bit of luck.

**Real Estate Income and Growth**
In the past, REITs have often zigged when the S&P 500 has zagged. This year, they zagged with the market and then forgot to zig. We have upgraded the portfolio by adding two REITs, one that leases space to the U.S. Defense Department and contractors, and the second leases offices and labs to biopharma companies like Eli Lilly and Roche. Dividend yields are high; it may be a good time to shift some cash this way.

**Preferred Income**
Preferred stocks of the $25-par retail type and the $1000-par institutional type. Many preferreds pay tax-advantaged dividends. Prices have recovered a lot, but still allow for a 5%+ average dividend yield. If income is your goal, perhaps preferreds should be investigated.

*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**
**Put income** overlay uses a client's otherwise invested account as collateral to sell index put credit spreads as well as puts on individual equities. The goal is to create incremental income/capital gains on top of another portfolio. In May, as the market swoon continued to drive positions in-the-money, rolled-out puts created taxable losses, however cash-flow remained positive. As we've seen in prior years, the current recovery in equity prices could create gains later this year. **Index Income** is similar but only uses the S&P 500 index option credit spreads for the income augmentation overlay. In May, we had positive cash-flow, but the mark-to-market pricing caused total return to suffer. As of today, one of the index spreads is out-of-the-money and the other two are only two and six points away. Big improvement.

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 | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| Fixed Income | **Preferred Income** - Preferred stocks | -3.86 | 13.62 | -5.66 | 7.44 | 1.58 | 5.47 | 14.29 | -4.65 | 9.42 |
| Growth and Income | **Covered Call Income** - Quality stocks & covered calls | -8.94 | 23.73 | -10.36 | 12.95 | 6.16 | -1.01 | 6.36 | 22.28 | 10.23 |
| | **Dividend Growth & Income** - Dividend paying stocks | -17.54 | 26.48 | -8.95 | 21.99 | 11.07 | -7.27 | 5.04 | 36.23 | 12.17 |
| | **Real Estate Income & Growth** - REITs/real estate stocks | -21.68 | 24.50 | -5.41 | 2.77* | *5/1/17 inception | | | | |
| Growth | **IntelliBuilD™ Growth** - IBD growth stocks | -4.51 | 32.79 | -11.30 | 25.40 | -2.85 | 2.53 | 7.47 | 11.56* | *10/1/13 |
| | **Bulls of the Dow** - 10 stocks of the Dow Jones 30 Indus. | -3.34 | 28.68 | 4.51 | 33.76 | 9.35 | 0.96 | 11.41 | 24.35* | *2/1/13 |
| | **Twenty Under $35** - 20 best scoring stocks under $35 | -31.95 | 26.65 | -18.74 | 5.72* | *10/1/17 Inception | | | | |
| Option Overlay | **Put Income** - Realized gains return | -18.32 | 7.32 | 0.58 | *5.66* | *0.21* | *-8.86* | 0.55 | 4.04 | |
| | **Index Income** - Cash-flow return | 1.42 | 4.69 | 1.67 | 2.48 | 3.35* | *6/1/16 inception date | | | |
| | **Index Income** - Total return mark-to-market^ | -5.62 | 8.99 | -3.59 | 2.46 | 2.49* | | | | |
| | **Index** | | | | | | | | | |
| **Large-Cap Stocks** | **S&P 500** | -4.97 | 31.50 | -4.38 | 21.83 | 11.96 | 1.38 | 13.69 | 32.39 | 16.0 |
| **30 Giant Stocks** | **Dow Jones Industrial Index** | -10.06 | 25.35 | -4.78 | 28.09 | 8.66 | 7.70 | 10.05 | 22.41 | |
| **Mid-Cap Stocks** | **S&P Mid-Cap 400** | -13.86 | 26.21 | -11.10 | 14.45 | 18.73 | -3.71 | 8.19 | 31.57 | 16.07 |
| **Covered Index** | **CBOE S&P 500 Buy/Write** | -15.01 | 15.67 | -5.26 | 13.00 | 7.06 | 5.24 | 5.64 | 13.26 | 5.20 |
| **Fixed Income** | **Barclays Aggregate Bond** | 5.47 | 8.73 | 0.02 | 3.54 | 2.65 | 0.55 | 5.97 | -2.15 | 4.2 |

*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)