Sheaff Brock

Innovative Portfolios for Intelligent Investors™

MARKET UPDATE
August 2018

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)

Sheaff Brock

8801 River Crossing Blvd.
Suite 100
Indianapolis, Indiana 46240

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

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.

Sheaff Brock

Innovative Portfolios for Intelligent Investors™

Monthly Update

Publication date: 8/22/18

SheaffBriefs

Go to sheaffbriefs.com. Check out our blog. Good stuff.

"Rule number 1: Never lose money. Rule number 2: Never forget rule number 1."
Warren Buffett

A History Lesson about Downside Risk

Johannes Gutenberg invented the moveable-type printing press in about 1450 when he was 50 years old. This invention was a high-tech marvel which forever changed communication and altered the world. In his lifetime, you would think he would have become famous and wealthy, but he didn't. Gutenberg died at the age of 68 with little wealth, and his connection to his invention mostly unknown. What happened?

Cool hat...

Not real happy...

But, a sweet hipster beard, which looks a lot like a guy I saw in Brooklyn last month!

On this date in 1450, Gutenberg needed cash and entered into a loan for 800 guilders with a banker-type-guy, Johann Fust. Soon Gutenberg needed more cash to expand (possibly to print Bibles). He borrowed another 800, and put his printing presses up as collateral (big mistake). By 1456, a few Bibles had been printed, they got into a dispute, and Fust-the-banker-type-guy wanted his money back. Gutenberg did not have the money and he was 20,000 guilders in debt! Fust went to court and got ownership of the printing business just a few months before the Bible project ramped up. Fust and his progeny expanded the printing business and became wealthy high-tech entrepreneurs. Fust made the money, but Gutenberg is remembered today; and since printing was the catalyst for the scientific revolution during the Renaissance, he is considered the most influential man of the second millennium. History is kind to Gutenberg, but as a businessman he was a failure. His sales were slow which reduced cash-flow and his debt was too high. If you were analyzing his business to invest in, you should have concluded there was too much downside risk to invest. Poor sales + no cash + high debt = a bad combo.

Using Downside Risk Today

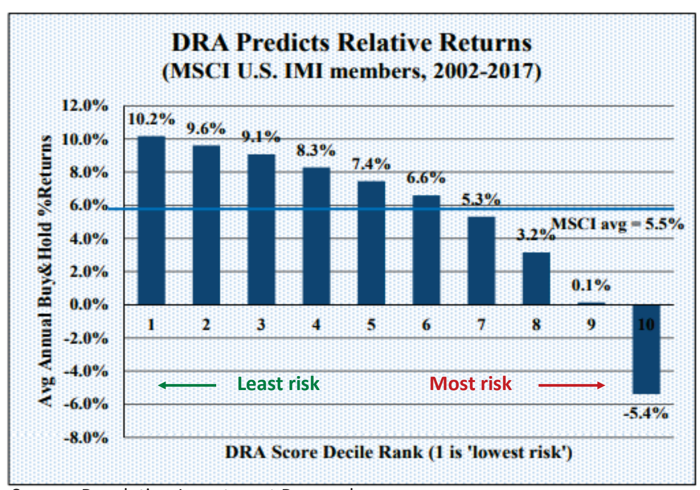
When we pick a stock for a portfolio we first consider downside risk. Certain factors, or attributes, are common among companies that underperform. Our research uses about 20 factors that identify riskier companies and is updated every week. Some concepts behind this research are obvious:

- ↓ Stocks that consistently report negative earnings surprises tend to underperform.
- ↓ Stocks with high debt levels underperform.
- ↓ Stocks with declining profitability underperform.

But, some concepts behind this research are counterintuitive:

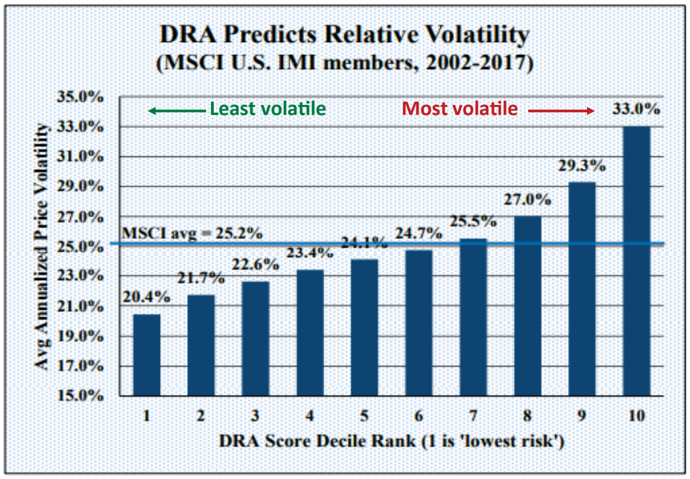
- ↓ Stocks with extreme profitability levels tend to underperform.
- ↓ Stocks with extreme analyst price targets underperform.
- ↓ Stocks with extreme trading volume underperform.

The Downside Risk Alert runs 2400 stocks through the scoring system weekly and puts each into risk deciles. The #1 decile stocks have the lowest risk while the #10 decile stocks have the highest number of risky attributes. The assumption about investing is higher risk = higher reward, but in the stock market world that's not always the case. As you can see below since 2002, the stocks in the #1 decile returned over 10% per year, 15% per year better than the #10 decile which lost money. Each decile's performance followed lockstep with the risk attributes. The least risky stocks performed the best!



Source: Revelation Investment Research

Besides outperforming on the upside, the stocks with the lowest risk attributes also exhibited less volatility, making them more comfortable to own. As you can see below, the stocks in the #1 decile had 5% less volatility than the average stock while the risky decile #10 were 8% more volatile.

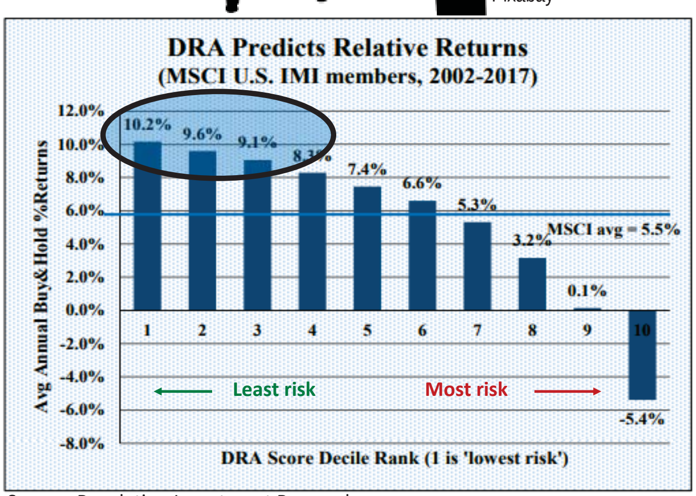


Source: Revelation Investment Research

Each decile's volatility followed lockstep with the risk attributes. The least risky stocks not only outperformed, but they were also less volatile. That's a nice combo!

For around three years we have been using the Downside Risk Alert research and are very pleased with the result. In our equity and Put Income portfolios we initiate positions in stocks in the top few deciles, the ones with the best historical returns and less volatility. When fishing for winners why not fish in the less risky pond where the fish may be bigger and bite more often?

Pixabay



Source: Revelation Investment Research

A joke you might hear from a six-year-old.

Hans and Franz are working the Gutenberg press.

Hans: I keep hearing music coming from the printer.

Franz: Maybe the paper is jamming.

Markets

Second-quarter earnings reports were stellar, consumer confidence is high, small business (the source of most new jobs) confidence is at a 35-year high and a smidgen away an all-time high, the Chinese seem to want to discuss tariffs, interest rates are still very low, and the smarter-than-average pundits we pay attention to are all still bullish on U.S. stocks. There may still be a month or two of choppiness before the mid-term elections. Remember though, the fourth quarter of a mid-term election year has historically been very good for stocks. Emerging markets are struggling from bad hombres running the countries, commodity price erosion, and strong-dollar pressure; but so far their illness isn't too contagious.

Portfolio Updates

Dividend Growth & Income

The portfolio is fully invested in 25 stocks and diversified in 10 of the S&P 500's 11 sectors (no utilities). Since the last newsletter, we added Lockheed-Martin (LMT) and Verizon (VZ). Lockheed is the world's largest defense company and globally defense budgets are growing. LMT's earnings growth looks healthy, and the company has raised their dividend over the last decade from $1.83 per share ten years ago to $8 per share this year. S&P has a one-year target price almost $100 per share higher than today's level. Verizon has a juicy dividend yield of 4.3%, is dedicated to wireless, and looks to be an early leader in the 5G race. VZ's dividend has increased annually for a couple of decades. Overall, the portfolio has done quite well year-to-date as compared with competitors.

IntelliBuilD Growth™

Simple explanation. *Investors Business Daily's* IBD 50 and New America stock lists (about 85 stocks in total) are sorted by their "downside risk" characteristics and the portfolio owns the least risky. Boom. Currently, we own 32 stocks of which one-third of them have been purchased this year and two-thirds have been owned over a year. The average holding of all 32 stocks is 466 days and the average price gain of the current stock holding is 39%. The portfolio currently is about half large cap companies and half mid-to-small-cap stocks. The high-growth and portfolio turnover isn't for nervous nellies.

Bulls of the Dow

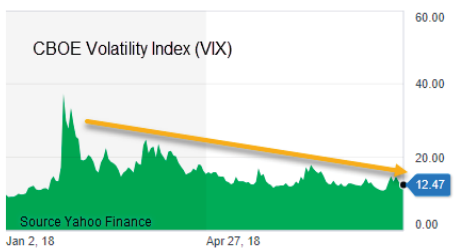
No changes this month, next change will be in October. The Bulls are doing well, still and again.

Twenty Under Thirty-Five

Our newest growth portfolio; we are quite excited about the little ten-month old. If we could, we would be posting cute pictures of it on Instagram. The methodology sort of follows the Bulls of the Dow playbook because we sort 2400 stocks by their low risk score and buy the 20 stocks with the lowest risk characteristics that are below $35 in price. We sell when the risk score tips to the higher risk side, which has happened to only five holdings so far.

Covered Call

Had a nice month in July. Volatility has been trending down since February (see VIX chart) which means option premiums are smaller now than then. Mid-term election blabber could spice up volatility. We're competitive, in the hunt, but want more.



Real Estate Income and Growth

REITs are starting to move and still pay a high dividend yield. 2018 has been an up-and-down year but the second half is looking better than the first, a lot better.

Preferred Income

Preferred stocks are on sale in our opinion. Prices are low while dividend yield is high. Yields being high and valuations being low should be a temptation for the income investor.

The following 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 Overlay

We're happy we brought the management of this in-house a couple of years ago; it's nice to have our hands on the wheel, and it's been a very productive couple of years. Put Income is a simple concept, but a daily chore to execute. It is (by a longshot) our biggest asset strategy, and clients who stayed the course, strapped themselves to the mast, and hung in there are generally a group of happy sailors now.

Index Income Overlay

This overlay is sort of the tortoise strategy using index spreads. Even though volatility has been low for most of the two years, results have been in-line with expectations by adding a single digit additional (incremental to the underlying portfolio) total return and income for the client. For the last couple of years the 3% out-of-the-money short-options have been a downside-risk sweet spot since all but one spread finished out-of-the-money. Lower leverage and methodical; the opposite of Gutenberg's risk. But, Index Income hasn't changed the world...yet.

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	Thru July 2018	2017	2016	2015	2014	2013	2012	2011
Fixed Income	Preferred Income - Preferred stocks	-0.55	7.44	1.61	5.23	14.01	-4.59	9.19	
Growth and Income	Covered Call Income - Quality stocks & covered calls	2.78	12.96	6.16	-1.11	6.33	22.28	10.23	-11.09
	Dividend Growth & Income - Dividend paying stocks	3.55	21.99	11.07	-7.27	5.04	36.23	12.17	5.62
	Real Estate Income & Growth - REITs/real estate stocks	3.01	2.99*	*5/1/17 inception					
Growth	IntelliBuild™ Growth - IBD growth stocks	5.61	25.40	-2.85	2.46	7.55	11.18*	*10/1/13 Inception	
	Bulls of the Dow - 10 stocks of the Dow Jones 30 Indus.	6.73	33.76	9.39	0.97	12.10	23.99*	*2/1/13 Inception	
	Twenty Under $35 - 20 best scoring stocks under $35	6.75	5.72*	*9/30/17 Inception					
Option Overlay	Put Income - Overlay of short equity puts	*4.14*	*5.66*	*0.21*	*-8.86*	0.55	4.04		
	Index Income - Overlay of unleveraged put credit spreads	1.85	2.68	3.76*	*6/1/16 inception date				
	Index								
	S&P 500	6.47	21.83	11.96	1.38	13.69	32.39	16.0	2.1
	S&P Mid-Cap 400	5.14	14.45	18.73	-3.71	8.19	31.57	16.07	-3.10
	CBOE S&P 500 Buy/Write	4.49	13.00	7.06	5.24	5.64	13.26	5.20	5.72
	Barclays Aggregate Bond	-1.59	3.54	2.65	0.55	5.97	-2.15	4.2	7.8

Composites include all fully discretionary accounts. Composite performance 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 and Index Income reflects the total return of only the option overlay. 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 . 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 opposite page.