Enhanced Equity Income
Q4 2018 Commentary

Market Review:

Through the first three quarters of 2018, it appeared as though the US equity market was headed for another big year, as the S&P 500 was up over 10% to that point. However, the 4th quarter quickly erased those gains, with the S&P 500 finishing down 13.5% for the quarter and the Russell 1000 Value down 11.7%. It was the worst quarterly performance in ten years, since the depths of the financial crisis in the 4th quarter of 2008. The month of October turned out to be the worst-performing month since September 2011, and after a modestly positive November, the market finished the year with its worst December since 1931. The full-year 2018 turned out to be the worst year for US equities since 2008, with the S&P 500 down 4.4% for the year, despite the index EPS on track to increase approximately 20% from 2017. 2018 also ended the streak of nine consecutive years of positive returns for the S&P 500, which tied the longest streak in history since 1936.

On a sector basis, Energy was the worst performer, down 23.8%. The WTI oil benchmark, which began the quarter at a nearly four-year high of $75 per barrel, declined 38% to $45 on concerns of excess inventories in the midst of slowing global growth. Information Technology (-17.3%) was the next worst performer. After being up 38% in 2017, then another 25% through the first three quarters of 2018, Technology pulled back sharply as each component of the so-called FAANG index fell into bear market territory. Industrials (-17.3%) and Consumer Discretionary (-16.4%) were the next worst performers. Utilities (+1.4%) was the only sector to finish the quarter in positive territory, as it and other defensive sectors, including Real Estate (-3.8%) and Consumer Staples (-5.2%) outperformed. Healthcare was the best performing sector for the year (+6.5%), benefitted from its defense attributes and the perceived alleviation of regulatory scrutiny over high drug prices.

Income and Options Summary:

In the representative account, the strategy yielded a sum of 7.3% income for the year, 3.5% of which was paid by dividends and 3.8% by options premiums. Three companies of the 36 currently in the portfolio declared dividend increases during the fourth quarter, at an average of 10.8%. At year end, 28 companies have increased dividends at an average of 9.6%.

Increased volatility in 2018 improved options attractiveness and performance. During December, 17 positions were written, totaling 118 contracts; of these, only 10 were assigned, dropping the assignment rate to 36% for the year. Premiums annualized a return of 17.5% and a called return of 63.2% during the year; these numbers were even higher for the fourth quarter. One hundred and eighty-six call positions were written in the account during the year, at an average of 2.48% out-of-the-money.

Performance Analysis:

The investment trends which began mid-year, at the possible peak of the growth rally, continued throughout the quarter, with the value style outperforming growth by more than 4 percent (Russell 1000 Value Index -11.7% versus -15.9% for The Russell 1000 Growth). This downside capture outperformance was fueled by the same bond-proxy sectors (Real Estate, Utilities, Communication Services, and Consumer Staples) that were sold off during the momentum growth rush of the first quarter correction.

The strategy exhibited even better downside capture results during the quarter, as the composite netted -7.0%, compared with -10.8 for the S&P 500 Buy/Write Index (BXM) and -4.9 for SPDR Barclays High Yield Bond ETF (JNK). Since the change in style preference last June, marked as the 13th, the representative account has captured less than 16% of the downside of the S&P 500 Index (SPX).

Compared with sector performance of the S&P 500 Index during the 4th quarter, the strategy's Information Technology, Consumer Discretionary, and Communications Services sectors outperformed the S&P 500 Index's by more than 6.7%. The strategy underperformed in its Consumer Staples allocation.

Figure 1: Enhanced Equity Income Returns vs. Benchmark

	Q4	YTD	1 Yr	3 Yr	5 Yr	Since Incept*
SCCM Enhanced Equity Composite (gross)	**-6.7**	**-4.1**	**-4.1**	**6.3**	**5.1**	**8.5**
SCCM Enhanced Equity Composite (net)	**-7.0**	**-5.1**	**-5.1**	**5.2**	**3.9**	**7.3**
S&P 500 Buy-Write Index (BXM)	-10.8	-4.8	-4.8	4.8	5.1	6.2
SPDR Barclays High Yield Bond ETF (JNK)	-4.9	-3.2	-3.2	5.8	2.1	4.4

**December 31, 2010. Performance for periods greater than 1 year is annualized.*

Portfolio Changes:

Buys

A new position in **Cardinal Health (CAH)** was initiated in October, at an attractive, forward-looking P/E multiple of 10.5x and a dividend yield of 3.7%. As one of three large healthcare distribution companies in the country, we believe Cardinal stands to benefit from growing consumption of healthcare products by an aging Baby Boomer generation. The company generates a very strong level of cash flow, most of which is returned to shareholders with a steadily growing dividend as well as share repurchases. Headquartered in Ohio, Cardinal also derives the full benefit of US tax reform.

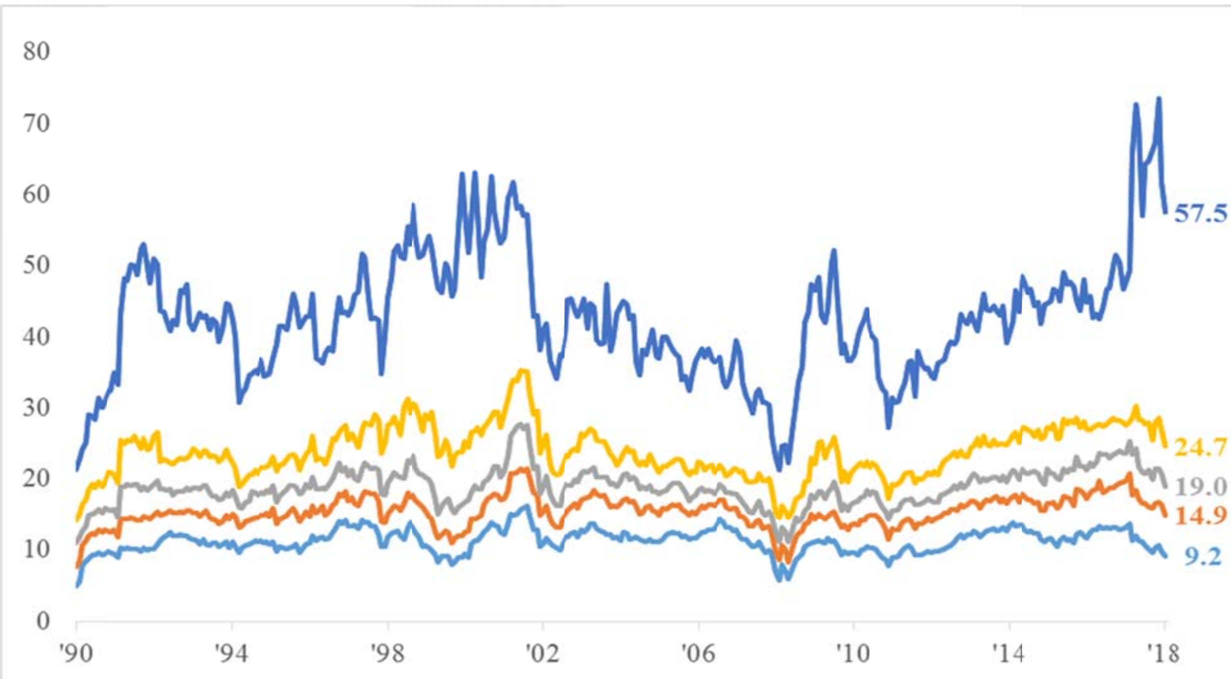
Sells

Novo-Nordisk **(NVO)** was sold from the portfolio in November, due to the growing competition for treating type-2 diabetes with the GLP-1 class of treatments. Further, price decreases continue to weigh on other major product areas.

Market Outlook:

Strong US economic data and robust corporate earnings growth in Q4 took a backseat to the market's increasing concerns on slowing global growth, the China trade war and normalizing monetary policy. The risk-off environment in 2018 resulted in 90% of major asset classes posting a negative return, versus the historical average of 29%, a pattern not experienced since 1921. While S&P 500 index earnings are expected to be up over 20% for 2018, with the index price decline, the Price/Earnings multiple fell 22%. Valuation multiples compressed the greatest for deep cyclicals (Energy, Financials, Industrials) and the least for stable sectors (Health Care, Utilities). The rapid market sell-off and elevated volatility have presented an increasing number of attractive investment opportunities not seen for quite some time. However, the dispersion in valuation multiples remains high - a number of industries are trading at recession-like multiples while Growth stock valuations remain high. In past cycles, heightened volatility has historically led to multiple compression driven by the highest multiple stocks[1]. Even with the recent underperformance of Growth relative to Value stocks, the valuation of Growth stocks are at extreme levels relative to historical averages.

Figure 2: S&P 500 Median Trailing P/E By Quintile



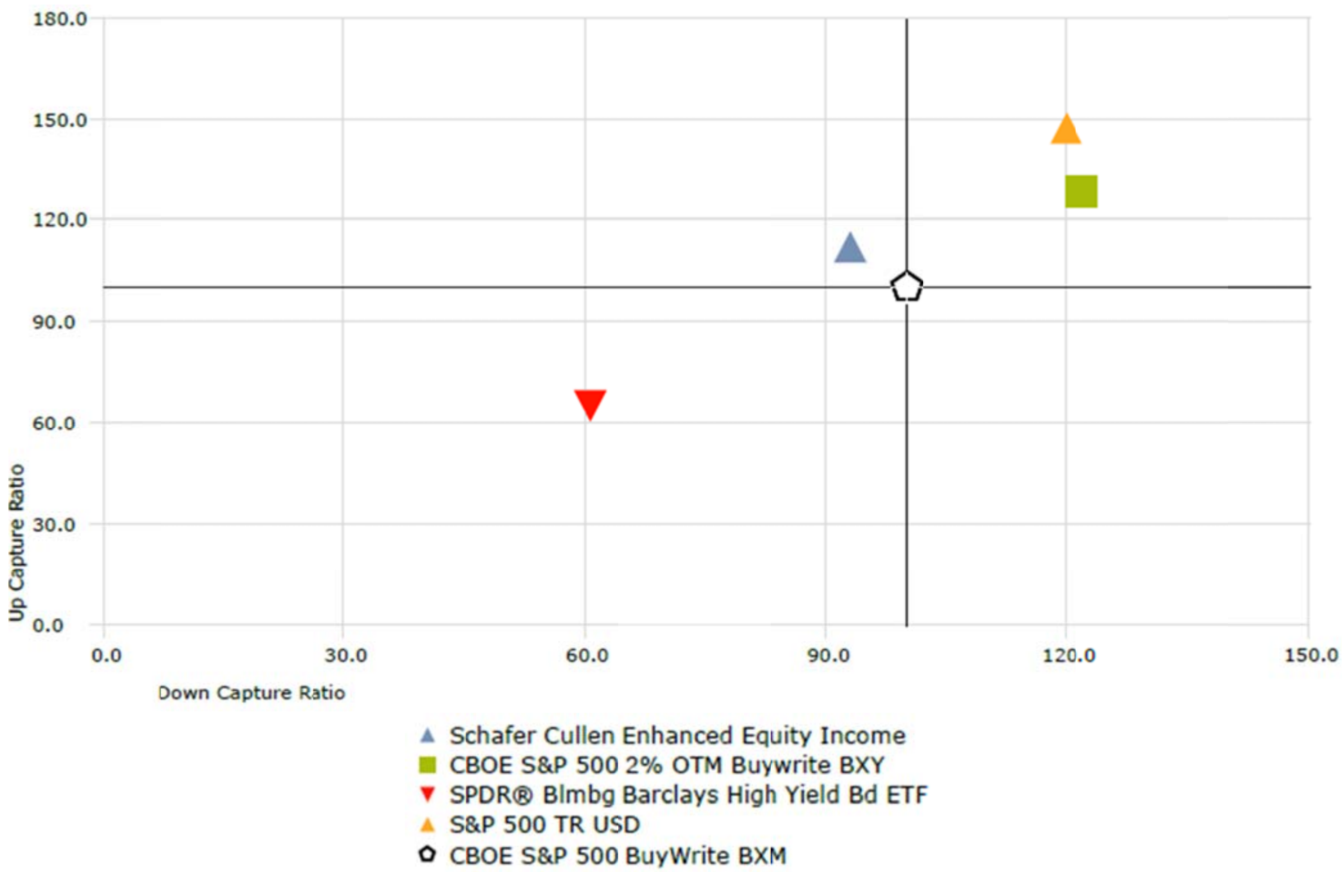
Source: Strategas Research, 12/31/2018.

A headwind to global equities has been the tightening of monetary policy by world central banks. At year-end 2018, 56% of developed and emerging market central banks were tightening policy (30+ countries), the largest proportion in seven years. Historically, equities tend to deliver lower returns when more than half of the world's central banks are tightening policy[2]. In addition, the Federal Reserve's balance sheet run-off (quantitative tightening) continues to drain excess liquidity with the real global monetary base currently contracting 1% and projected to further contract by 4%+ by December 2019 if the Fed's current target of nearly $500B in assets roll off and the ECB and BOJ maintain assets at current levels. However, with global growth decelerating, central banks are already looking to adjust monetary policy, helping to stabilize global equities.

[1] Bernstein Research, "US Portfolio Strategy", December 2018.
[2] Ned Davis Research, "Global Monetary Tightening Hurting Equities", December 2018.

Fundamentally, in our view, the prospect for US equities in 2019 appears positive, supported by a mid- to high-single digit year-over-year growth in S&P 500 earnings, relatively attractive valuation multiples and market sentiment coming off extreme levels. However, the current economic recovery's record length and the stark divergence between the economic recovery and financial recovery since 2009 should be considered. Nominal GDP growth in this cycle has been one of the weakest since the 1930's while equity market returns have been one of the strongest driven in part by unprecedented stimulus and aggressive monetary easing and a record level of share repurchases estimated at $4.5T in the US corporate sector. With less stimulative monetary policy and rising sovereign and corporate debt levels, the wide dispersion between asset price inflation and real economy inflation are at risk of convergence. In this environment, risk-adjusted returns are likely to adjust to more normalized levels and strategies that have delivered superior risk-adjusted returns through market cycles become even more critical.

Figure 3: SCCM Enhanced Equity Income Since Inception Downside Capture



Thank you for your continued support. Feel free to reach out to us if you have any questions.

Respectfully,

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