Enhanced Equity Income
Q1 2019 Commentary

Market Review:

The US equity market got off to a strong start in 2019 with the S&P 500 returning +13.7% and the Russell 1000 Value +11.9%. It was the best quarter for the S&P 500 in ten years, since the 3rd quarter of 2009, and the best opening quarter of a year since 1998. Equities rebounded from the sharp selloff in the 4th quarter of 2018, when the S&P 500 was down 13.5%. Concerns that caused the 4th quarter decline, including fears of hawkish Fed policy and a worsening trade war with China, largely abated in the 1st quarter.

Every sector finished the quarter in positive territory, with nine of the 11 sectors posting double-digit gains. Information Technology (+19.9%) and Industrials (+17.2%), both significantly impacted by China trade negotiations, were two of the best performing sectors. Real Estate (+17.5%) outperformed as REITs benefitted from a decline in long-term Treasury yields, and is now the best performing sector over the past 12 months. Energy (+16.4%) also posted an outsized gain, aided by a recovery in oil prices after a 4th quarter decline. The worst performing sectors were Health Care (+6.6%) and Financials (+8.6%), although both recorded strong quarterly returns.

Income and Options Summary:

Options premiums remained attractive throughout most of the quarter, but began to exhibit compression from low-volatility by March. The year-to-date out-of-the-money average receded to 2.8%. However, income from premiums remained strong and efficient. Premium income in the representative account annualized 4% at quarter end, generated from only 13 positions written during March and only 40 during the first quarter of the options calendar. Equity market strength pushed assignment rates to 55% for the quarter, as 135 of 242 contracts written in the representative account were assigned.

Dividends remained strong, annualizing 3.7% and dividend growth continued. In the first quarter, 14 increases were declared averaging an increase of 5.2%. The strategy annualized a total income of 7.7%.

Performance Analysis:

Broad equity market performance during the first quarter of 2019 completed a V-shaped recovery from the market correction that began in September and bottomed in December 2018. Although all economic sectors participated, the growth style resumed its outperformance. The Russell 1000 Growth Index outpaced the Russell 1000 Value by 4.2% (16.1% vs. 11.9%).

The Enhanced Equity Income strategy outperformed its benchmarks significantly during the quarter, returning 9.8% (net of fees), compared with 6.8% from the CBOE S&P 500 Buy/Write Index (BXM) and 8.0% from the SPDR Barclays High Yield Bond ETF (JNK). The strategy's performance was driven primarily by its allocations in the Energy, Industrials, Financials, and Information Technology sectors. Its allocation in the Health Care sector outperformed the S&P 500's.

Figure 1: Enhanced Equity Income Returns vs. Benchmark

	Q1	YTD	1 Yr	3 Yr	5 Yr	Since Incept*
SCCM Enhanced Equity Composite (gross)	**10.1**	**10.1**	**10.5**	**9.2**	**6.7**	**9.4**
SCCM Enhanced Equity Composite (net)	**9.8**	**9.8**	**9.3**	**8.0**	**5.6**	**8.3**
S&P 500 Buy-Write Index (BXM)	6.8	6.8	3.3	7.4	6.0	6.8
SPDR Barclays High Yield Bond ETF (JNK)	8.0	8.0	6.1	7.7	3.1	5.2

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

Portfolio Changes:

Purchases

A new position in **Target (TGT)** was established in the quarter. Target, one of the largest multi-line retailers in the US, operates about 1,800 stores (84% owned) across the country. Its large-format stores offer general merchandise including: beauty/household (23% of sales), hardlines (18%), apparel and accessories (20%), food (20%) and home furnishings (19%). The company differentiates itself by offering higher-margin private label, signature categories (style, baby, kids and wellness) that currently represent one-third of total sales.

The macro environment within US retail appears to be supportive for continued growth driven by rising wages, healthy employment levels and relatively low rates in the context of deleveraged consumer balance sheets. Target's growth is being driven by significant investments it has made over the last few years to offer a comprehensive, omni-channel retail experience. Given the rapid growth of e-commerce in the US (digital sales now account for roughly 10% of total retail sales in the country), it is becoming increasingly clear that retailers must establish a significant online presence to survive and ultimately thrive in a competitive landscape led by Amazon. Management's investment in its digital business has resulted in online sales growth of 31% year-over-year in its last quarter, with digital now accounting for over 7% of total sales, up from 4.2% a year ago. Target aims to create a seamless, multi-channel experience with multiple delivery options, leveraging its distribution centers and physical stores. The company is also in the process of remodeling its existing stores, including the conversion of backrooms to distribution centers that will facilitate online shipments, and launching urban-oriented, small-format stores. Several high profile competitors have entered bankruptcy or closed a large number of stores over the past year, including Toys 'R' Us, Sears Holdings, Bon-Ton Stores and others; this wave of consolidation could likely benefit strong incumbents including Target.

At purchase, Target traded at 12.5x earnings, a substantial discount to its historical average and at a 40% lower multiple than its primary competitor, Walmart, which currently trades at 21x. Target yielded 3.6% and its annualized dividend growth over the past five years has been 9.8%. The company has a strong A-rated balance sheet and relatively stable cash flow and earnings in economic downturns, providing a potential margin of safety for investors.

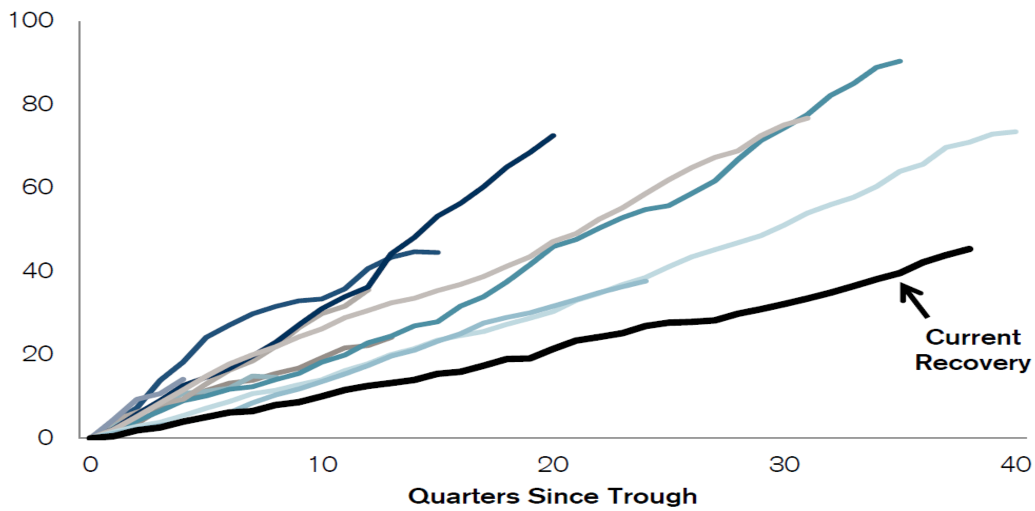
Sales

Cardinal Health (CAH) was sold from the portfolio in early March as it became increasingly apparent that the difficulties facing the healthcare and pharmaceutical supply chains would continue to plague the industry for the foreseeable future. In the time since purchase, the pharmaceutical distribution business has become increasingly competitive and with the management teams becoming more doubtful about their ability to improve profitability through more equitable contract terms with both customers and suppliers. While the industry structure remains favorable, the change in the growth outlook encouraged us to look elsewhere to invest. At the time the stock was sold it was a 1.0% portfolio weighting and fully written.

Market Outlook:

The strong equity market rally in the first quarter, driven by the Fed's shift to a dovish policy stance and signs of a resolution to the China trade war, largely ignored deteriorating global economic data and downward earnings revisions. The market's optimism is focused on stabilizing global growth, naturally occurring and through renewed monetary and fiscal stimulus. These periodic mid-cycle consolidations over the past ten years have helped to sustain the length of this now historic bull market. While the current cycle is now one of the longest, the sub-par growth in this recovery can further extend the cycle, especially in light of continued accommodative Fed policy and continued corporate earnings growth.

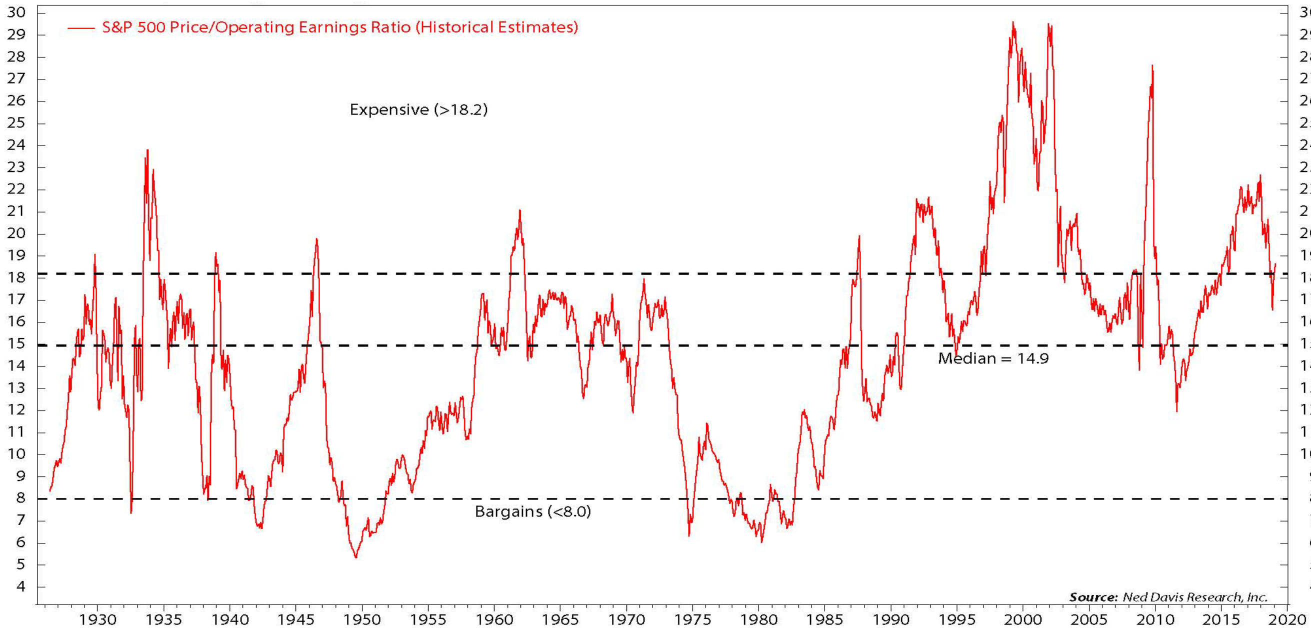
Figure 2: Cumulative GDP Growth Post- Recessions



Note: 1949 to present; Cumulative nominal GDP since trough indexed to 0.
Source: Credit Suisse, "Equity Strategy Navigator," April 2019.

With US equity markets rallying on improving conditions, sentiment has shifted to elevated optimism and favorable technicals and momentum continue to aid the market in its attempt to break through to new highs. Meanwhile, equity risk premiums have declined significantly and should signal a degree of caution. Multiple expansion has been the driver of the rally thus far and while earnings estimates have stabilized, the previous tailwinds of ultra-loose monetary policy and corporate share buybacks are less present and meaningful going forward. Record levels of corporate and government debt and valuation excesses in pockets of the US equity market are factors likely affecting growth and returns ahead. The S&P 500 Index currently trades at 18.5x 2019 earnings while the median price/earnings ratio is 22.2x. Historically, when valuations on the index move into elevated territories, forward returns are more muted.

Figure 3: S&P 500 Price/Operating Earnings Ratio and Forward Index Performance



Median S&P 500 % Gain After Reaching Extremes Analysis Dates: 1926-03-31 - 2019-03-31			
Months Later	**PE >18.2**	**PE <8.0**	**All Periods**
3	-0.1	15.4	2.5
6	-8.4	13.6	4.8
9	-7.7	17.7	7.0
12	-1.7	12.4	9.6
24	0.8	33.6	16.9

Source: Ned David Research, March 31, 2019.

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

Respectfully,

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