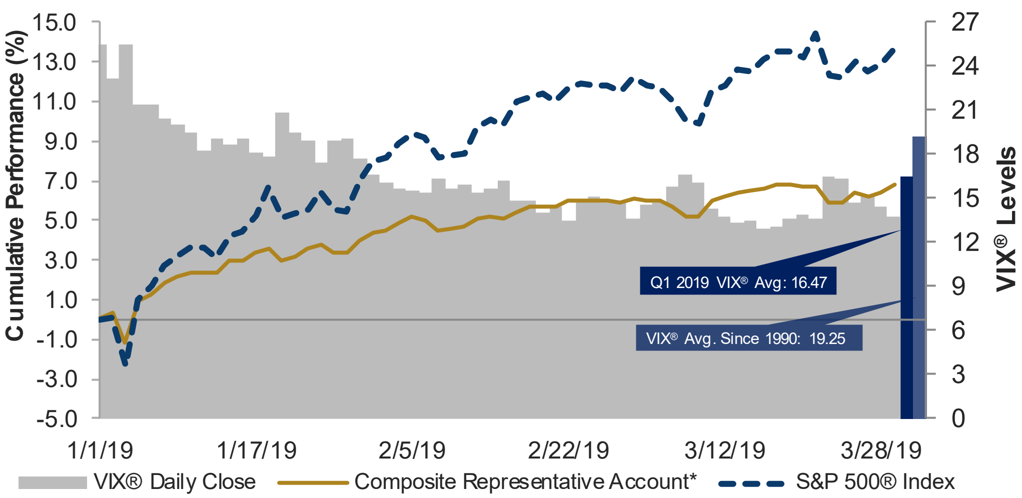
In Brief

- Gateway Active Index-Option Overwrite Composite (the Composite) returned 7.24%, net of fees, in the first quarter compared to the 6.77% return of the Cboe® S&P 500 BuyWrite℠ Index[1] (the BXM℠) and the 13.65% return of the S&P 500® Index.
- The Composite's active approach utilized longer-dated index call options than the contract the BXM℠ had exposure to for much of the month, resulting in outperformance of the passive, rules-based approach of the BXM℠.
- Though the S&P 500® Index has returned an impressive 21.22% since December 24, 2018, the equity market has yet to fully recover from the near-bear market decline suffered during the fourth quarter of 2018. Since its all-time high on September 20, 2018, the S&P 500® Index has returned -2.26%.
- Implied volatility exceeded realized volatility with Chicago Board Options Exchange (Cboe®) Volatility Index (VIX®) averaging 16.47 for the quarter while the annualized standard deviation of the S&P 500® Index was 13.55%. The BXM℠ had an annualized standard deviation of 6.67%.
- The combination of elevated equity valuations, which may be an indicator of increased downside risk, and a flattened yield curve in the bond market, which may limit a continuation of bond market gains fueled by the downtrend in longer-term yields, creates new challenges for long-term investors. In this environment, investors may benefit from increasing allocations to low volatility equity strategies that can provide consistent participation in equity market advances and a source of protection during equity market declines.

Market Path & Implied Volatility



*The portfolio performance and annualized standard deviation reflected for the Composite are those measured by a representative account. This information represents supplemental information to the GIPS-compliant presentation. This representative account was selected as it is the largest account in the Composite.

Market Recap

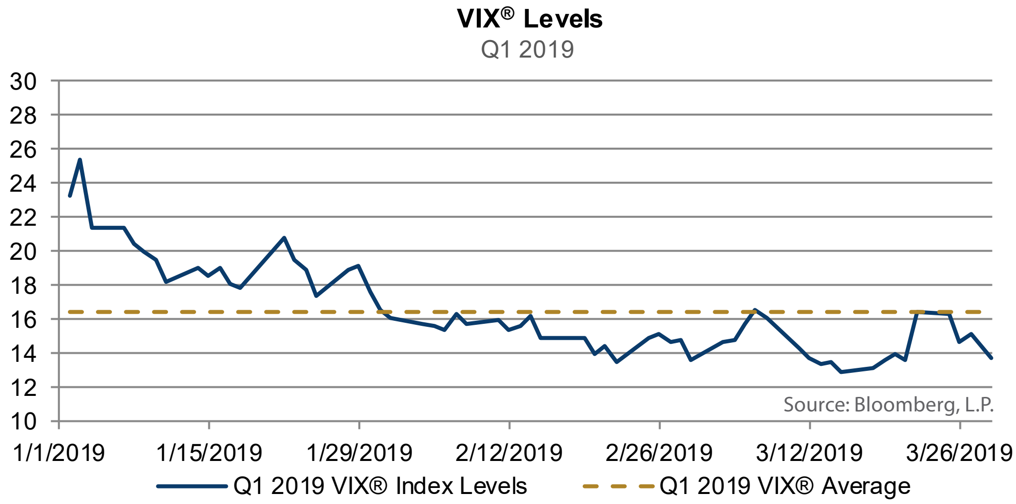
The S&P 500® Index advanced 13.65% in the first quarter of 2019, extending a rally that began after equity markets approached bear territory late in the fourth quarter of 2018 and posting its strongest quarterly return in almost ten years. The first quarter result was front-loaded with January's 8.01% return, the strongest start to a year since 1987, and the upward trend continued with returns of 3.21% and 1.94% for February and March, respectively. Though the S&P 500® Index has returned an impressive 21.22% since December 24, 2018, the equity market has yet to fully recover from the near-bear market decline suffered during the fourth quarter of 2018. Since its all-time high on September 20, 2018, the S&P 500® Index has returned -2.26%.

Throughout the quarter, many of the issues weighing on the market in late 2018 subsided. After concerns of aggressive tightening, the Federal Reserve (the Fed) showed its flexibility while softening its hawkish tone by suggesting fewer rate hikes anticipated in 2019. Additionally,

1: The Cboe® S&P 500 BuyWrite℠ Index (the BXM℠) is a passive total return index designed to track the performance of a hypothetical buy-write strategy on the S&P 500® Index. The construction methodology of the index includes buying an equity portfolio replicating the holdings of the S&P 500® Index and selling a single one-month S&P 500® Index call option with a strike price approximately at-the-money each month on the Friday of the standard index-option expiration cycle and holding that position until the next expiration.

the Fed announced plans in March to slow, then cease, balance sheet reductions before the close of the year. A prolonged government shutdown also seemed to produce negligible effects on an otherwise strong U.S. economy and trade tensions showed signs of easing. Gross Domestic Product growth for the fourth quarter of 2018 came in at 2.2%, in line with consensus expectations. Corporate earnings also remained relatively strong, with over 75% of companies reporting fourth quarter earnings meeting or exceeding analyst estimates and aggregate operating earnings for S&P 500® Index companies growing 21.76% year-over-year. The employment situation improved slightly throughout the quarter with the February unemployment rate declining to 3.8% and the participation rate holding at 63.2%. The February Consumer Price Index, released on March 12, showed a 1.5% year-over-year increase, in line with expectations, and below the 2% level targeted by the Fed.

Implied volatility, as measured by VIX®, averaged 16.47 for the quarter. VIX® exceeded S&P 500® Index realized volatility, as measured by its annualized standard deviation of daily returns, of 13.55% for the quarter. VIX® peaked early in the quarter on January 3 at 25.45 before drifting towards its low point of 12.88 on March 15 and closed the quarter slightly higher at 13.71.



The BXM℠ had a return of 6.77% for the first quarter of 2019. On the third Friday of each month, the BXM℠ wrote a new index call option as the option it wrote the previous month expired. The premiums the BXM℠ collected on written options have significant influence on its return potential over a period when the market advances. Premiums collected as a percentage of the BXM's℠ underlying value were 1.65%, 1.28% and 1.42% in January, February and March, respectively. With monthly returns of 3.43%, 1.43% and 1.76%, the BXM℠ underperformed the S&P 500® Index in each month of the quarter, with the largest differential occurring in January. Premiums collected by the BXM℠ did not provide enough return potential to keep pace with the above-average rate of return the equity market exhibited over the course of the quarter.

The Bloomberg Barclays U.S. Aggregate Bond Index (the Agg) increased 2.94% in the first quarter, its highest quarterly return since Q1 2016. The yield on the 10-year U.S. Treasury Note (the 10-Year) started the quarter at 2.69%, reaching an intra-quarter high in January of 2.79%, before drifting lower to end the quarter at 2.41%. The low point of the quarter came on March 27 with a yield of 2.37%.

Gateway Active-Index Option Overwrite Composite Performance

The Composite returned 7.24%, net of fees, for the first quarter, outperforming the BXM℠ by 47 basis points (bps). With monthly returns of 4.41%, 1.60% and 1.09% for January, February and March, respectively, the Composite's outperformance relative to the BXM℠ over the first two months of the quarter exceeded its underperformance in March.

The portfolio performance contributions, annualized standard deviation and portfolio statistics quoted for the Composite in the following paragraphs are those measured by a representative account.[2]

For the first quarter of 2019, the Composite's underlying equity portfolio contributed a total return of 12.78%, resulting in a negative performance differential of 87 bps relative to the S&P 500® Index. The Composite's index call option positions generated risk-reducing cash flow throughout the quarter while detracting from return each month, as expected during a period when the equity market advanced at an above-average rate. The Composite's annualized standard deviation of daily returns for the quarter was 7.06% as compared to 6.67% for the BXM℠ and 13.55% for the S&P 500® Index. The Composite exhibited a beta to the BXM℠ of 0.97 for the quarter.

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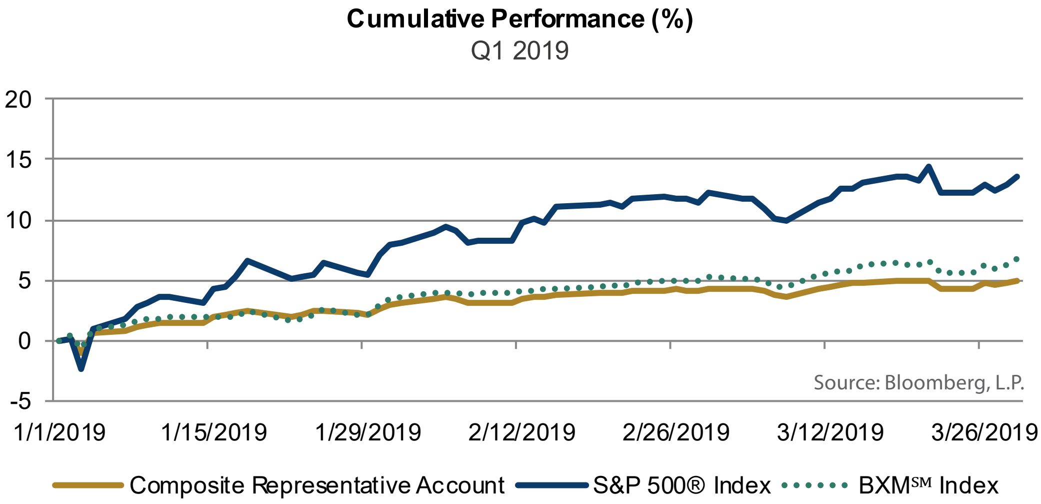


In managing the Composite's portfolio of written index call options, Gateway's investment team focused on exchanging option contracts well in advance of their expiration dates for contracts with later expiration dates and higher strike prices. This was in an effort to maintain a typical amount of equity market exposure during the market's rapid advance and protect the Composite from the potentially adverse impact of a sharp reversal in market direction.

At the end of the quarter, index call options were sold against over 95% of the equity portfolio's value and had a weighted average strike price between 1.5% in-the-money and 1.5% out-of-the-money, 38 days to expiration and annualized premium to earn between 10% and 12.5%. Relative to the beginning of the quarter, this positioning represented lower potential net cash flow and lower market exposure.

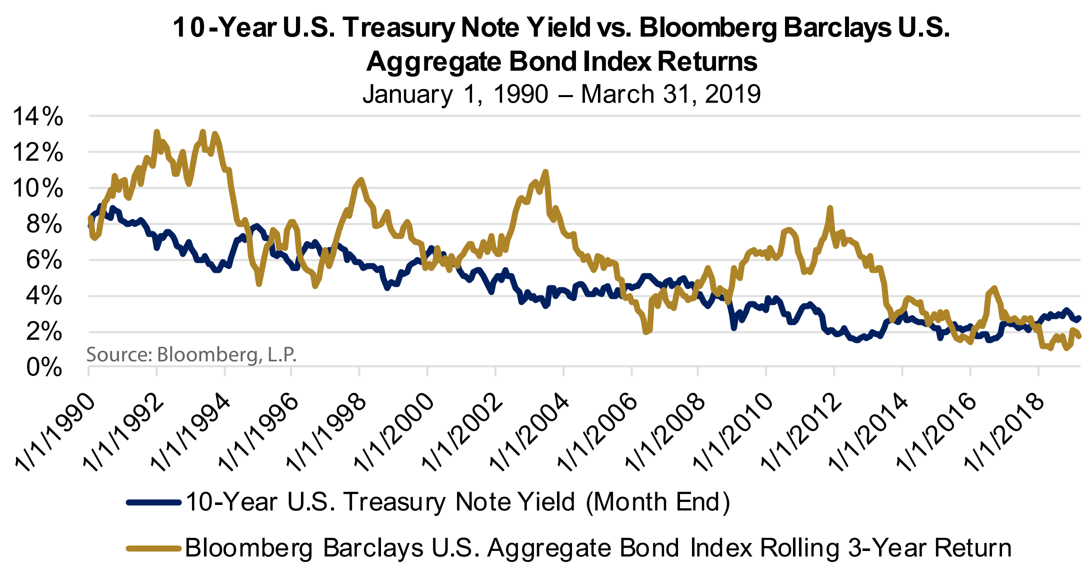
Market Perspective

Roosters typically crow in advance of the sunrise, but that knowledge does not provide much insight on the movement of the heavens. Similarly, the U.S. Treasury yield curve may typically invert in advance of recessions, but that knowledge does not provide much insight into when a recession will likely start, how deeply the economy may entrench or how negative the equity market response will be to economic deterioration. The first quarter of 2019 witnessed the yield on the 10-Year dip below the yield on the 3-month U.S. Treasury Bill for the first time since 2007, therefore, some investors looking for higher definition forecasts from market seers have likely been left wanting.

Should investors alter their long-term plans given current economic and capital market conditions? While a true long-term investment plan should have the ability to remain intact through a recession and/or bear market, investors may be understandably nervous about a test of their long-term mettle seeming to grow more imminent by the day.

The combination of current conditions creates unique challenges for long-term investors intent on maintaining their strategic risk profile. The strong rally in the beginning of the year has returned equity market valuations to the upper end of their historical range. This may be an indicator of increased downside risk – a risk that could be realized in the near to intermediate future, given where we are in the economic cycle. But what if the robust trends of an expanding economy with record-low unemployment, benign inflation and corporate earnings growth continue? How much return would investors leave on the table by reducing exposure to the equity market?

Despite positive returns from the Agg over the last two quarters, there is evidence that the bond market has become a less attractive safe haven. When yields were higher, it was possible for investors to garner a decent return while waiting for disaster to strike in the equity market. But, as the adjacent chart shows, as the bellwether 10-Year yield has trended downward, so has the return potential of the bond market.



Moreover, as seen in the adjacent table, the strong first-quarter return for the Agg is consistent with a pattern in recent years (beginning in 2012) when brief periods of falling interest rates have helped generate quarterly returns for the Agg that were well above yields on the 10-Year, while calendar year and multi-year annualized returns for the Agg have rarely exceeded 3.5%. If longer-term yields remain range-bound, investors could expect this pattern to continue.

Bloomberg Barclays U.S. Aggregate Bond Index Returns (%)
2012 - 2019

	Q1	Q2	Q3	Q4	Year
2012	0.30	2.06	1.59	0.21	**4.22**
2013	**-0.12**	**-2.33**	0.57	**-0.14**	**-2.02**
2014	1.84	2.04	0.17	1.79	**5.97**
2015	1.61	**-1.68**	1.23	**-0.57**	0.55
2016	3.03	2.21	0.46	**-2.98**	2.65
2017	0.82	1.45	0.85	0.39	**3.54**
2018	**-1.46**	**-0.16**	0.02	1.64	0.01
2019	2.94				

Source: Bloomberg, L.P.

The combination of elevated equity valuations, which may be an indicator of increased downside risk, and a flattened yield curve in the bond market, which may limit a continuation of bond market gains fueled by the downtrend in longer-term yields, creates new challenges for long-term investors. In this environment, investors may benefit from increasing allocations to low volatility equity strategies that can provide consistent participation in equity market advances and a reliable source of protection during equity market declines. Delivering this profile has been the sole focus of Gateway's risk-first approach to long-term investing for over 40 years.

Important Information

1: The Cboe® S&P 500 BuyWrite℠ Index (the BXM℠) is a passive total return index designed to track the performance of a hypothetical buy-write strategy on the S&P 500® Index. The construction methodology of the index includes buying an equity portfolio replicating the holdings of the S&P 500® Index and selling a single one-month S&P 500® Index call option with a strike price approximately at-the-money each month on the Friday of the standard index-option expiration cycle and holding that position until the next expiration. 2: Represents supplemental information to the GIPS-compliant presentation. This representative account was selected as it is the largest account in the Composite.

All data as of 03.31.2019, unless noted otherwise.

For more information and access to additional insights from Gateway Investment Advisers, LLC, please visit www.gia.com/insights.

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