How to profit from underperforming stocks

- Sometimes there are stocks in our portfolio’s that seem to go through flat periods. This can be due to a number of reasons, some great companies can move from higher growth to lower growth outcomes as they reach critical mass, sometimes a political decision can change the short term economic landscape for some industries, sometimes it might be just some sector rotation as fund managers get buoyed by one sector while they get net short another and these cause flat periods in the stocks price cycle.

- One way to look at profiting from a long flat period is writing covered puts and covered call options. A covered put option gives us a potential buying obligation slightly below the current share price if that suits your portfolio and once you own the stock, every time it has a bit of a mild rally you can write a covered call option slightly out of the money which gives you potentially a slightly higher sell price than is on offer in the equities market.

- In the example below, we looked to enter a long position in CCL after the stock fell over 14% from its highs in June 2015. Coca Cola was a great company but it was going through a period of P/E contraction where high double digit growth was slowing to be only single digit growth. A lot of good companies can just move to a lower growth multiple over time.

- Instead of sitting through such a long period of flatness or sideways action, we could profit more handsomely with a covered put strategy that might eventually turn into a covered call strategy if we eventually take ownership of the stock.

- On 11th of June 2015 we sold 35 July 9.50 Put Options for 26.5c. Potentially owning 3500 shares at a break-even price of $9.235. We were assigned on this position and took ownership of the shares in late July.

- We also added to our potential position by selling another 35 CCL Dec 9.22 Put Options @ 0.26 which gave us a potential break-even entry price of $8.96.

- Although there was a short term volatile period for the stock in the next 12 months, it basically traded sideways for that following period.

- Rather than sit in a sideways market and accept very little or no returns, you can use the covered call strategy to increase your returns in this period. Sometimes a sideways market can provide you with wonderful trading opportunities.

- In our case we sold the following calls over the following months ahead after each mild rally and each of our options expired worthless as price stayed below our written strike each expiry month until we finally got assigned in late June 2016.

- 20/11/15 Sold 35 CCL Jan 9.50 call Options @ 0.17
- 7/03/16 Sold 70 CCL April 9.25 Call Options @ 0.17
- 12/05/16 Sold 70 CCL June 9.25 Call Options @ 0.235
- 12/07/16 Sold 70 CCL Aug 9.00 Call Options @ 0.24

- In this period, our 7000 shares were entered at an average price of $9.10.

- We picked up dividends of 20c in August 2015 and 23.5c in February 2016 per share.

- We also picked up 4 premiums which added up to a total of 82c per share.