“The Covered Call Strategy”

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OUR PREFERRED INVESTMENT STRATEGY

Introduction to Options

- **Call Option** - A call option is a standardized contract that gives the buyer the RIGHT (but not the obligation) to BUY a parcel of shares (100 -100shares) , at a predetermined price(strikeprice) on or before a predetermined date.
For a fraction of the price "buying" a call option gives you the RIGHT to control shares of The stock (the cost is the premium paid for this option).

- **Put Option** - A Put option is a standardized contract that gives the buyer the RIGHT (but not the obligation) to SELL a parcel of shares (100-1000 shares) at a predetermined price (strike price) on, or before a predetermined date.
The seller of the option has an obligation to buy the shares at the strike price in the event that the option is assigned.
For a fraction of the price "buying" a Put option gives you the RIGHT to control shares of The stock(the cost is the premium paid for this option)

	Buyer (Holder)	Seller (Writer)
Call Option	Right to buy	Obligation to sell
Put Option	Right to sell	Obligation to buy

Covered Call Explanation

- By purchasing stock and writing options over the stock the Sellers obligations are completely covered as you can deliver the stock if required. Using BHP as an example, say we bought 1000 BHP shares at $33.00 and at the same time we sold 1 BHP 33.00 Call option at $1.00 with one month to expiry.

  So we Buy 1000 BHP @ 33.00=$33,000 and Sell 1 BHP 33.00 Call option (1 month expiry) =$1,000

  At end of month, if the share price closes above 33.00 we get assigned and sell stock at 33.00 and receive a 3% return for 30 days.(1000/33000 = 3%) If share closes below $33.00 the option expires worthless and we keep our 3% premium($1000) and we can then write another call option for the following month. The covered call writer receives the juicy call premium, no matter what happens with the underlying stock. Covered call writing can provide a consistent monthly income. Instead of only receiving 2 dividends a year with some stocks you can potentially receive one every month of the year (great for Self Managed Superannuation Funds).

The Strategy Explained

- Our preferred investment strategy centres around a well-timed, multi-faceted investment approach.
- Dividends, Options Premium and Capital Gains give us three separate sources of investment returns to help us generate strong returns from this creative blue chip strategy with expert timing models.
- In order to really highlight the power of this strategy we have utilised a real client account and illustrated their trades on a Wesfarmers position on a yearly chart.
- From the illustration it should be clear that this strategy can prove profitable when employed on positions that may otherwise trade sideways or even fall in value.

The Trade Explained

- On the 7th of February we recognised that Wesfarmers was at a key technical support level and recommended buying the stock at $40.20.
- Normally a 10% rally might take months to occur but in this case it occurred in only 13 calendar days and had exceeded the past two trading peaks above $43.00.
- On the 20th of February we recommended writing a March 42.51 call Option @ 76c after it had gone x-dividend $1.03.
- By selling a $42.51 March Call Option @ 76c, we had orchestrated a guaranteed income stream of $1.79 (4.45%) for the months via option premium and dividend. With an exercise price set at $42.51 (which equated to another 5.75% if assigned) this left us room for the possibility of a nice capital gain also in this short period of time.


WES - Daily 6/06/2017 Open 41.86, Hi 42, Lo 41.4, Close 41.41 (-1.5%)
On 20/2/17 by writing a call option:
We have locked a potential sale price of 44.30
Sell price @ 42.51 + 0.76 + 1.03 = 44.30
Potential profit of $4.10 = 10.2% in 13 business days
20/2/17
S 8 WES Mar 42.51 C@ 0.76
X-div = 1.03
7/2/17
B 800 WES @ 40.20
WES - Stochastic %D(15,3,3) = 31.93, Stochastic %K(15,3) = 33.99, Volume = 1,518,542.00
Aug
Sep
Oct
Nov
Dec
2017
Feb
Mar
Apr
May
Jun

Breakdown Of Return

- Breakdown of our triple approach:
- Capital Gain $42.51-$40.20 = $2.31 (5.75%)
- Dividend 1.03 (2.49%)
- Option Premium 0.76 for Sell 42.51 march Call Option (1.89%)
- Guaranteed Income (if not assigned) (4.45%)
- Total Return (if assigned) (10.13%)
- An approach with three sources of income is a well-rounded strategy in our opinion. The down side to this strategy is that you might have to sell your stock in this relatively short time period and your upside potential is limited also as this strategy does cap your upside potential. If we are able to do this just a few times each year in what has largely been a sideways market in recent years then I think this strategy certainly has its merits. From a risk perspective, the call option acts as a hedge to some of your downside and covered calls can only be done over blue chip shares, so you are staying in one of the safer investment lanes.