# Covered Writing: Value Added.

During the past few years, we have experienced exceptionally low interest rates.

However, as the world begins to reopen, interest rates are rising. We can already see the impact of this reflected in lower prices for bonds as yield turns up. As a result, bond investors have seen valuations ravaged.

***So where do they go?***

Primarily dividend paying stocks.

Something I have reflected on recently is the apparent marketing push by many mutual fund and ETF providers advertising minimal covered call overlays to their fund. The current situation seems to be forcing some to look for creative avenues to create value through *yield for investors*. However, these fund providers often only write covered calls over one third of their portfolio.

Many appear to have only recently caught on to the value being created through a sensible covered call strategy – something I have been implementing tactically for my clients for over 30 years.

***How does covered writing work…***

I wanted to take a moment to refresh your memory on how our covered call strategy works, why we do this, and ultimately how it directly impacts your portfolio overtime as we will continue to actively manage your investments and apply these techniques.

Most equity investors buy a share in a stock for a given market price and will either lose money if the stock price goes down in value or will gain money if the stock price rises in value.

Active covered call writing does a few things for investors.

By selling a call contract against one of your stocks, we are selling someone the right to buy the investment from you for a fixed price for a fixed period of time (e.g., 3-6 months) typically at a higher price. The call either expires, typically when the stock does not reach the strike price of the call option, or it is assigned, when you sell your stock at the agreed upon strike price of the options contract. When you sell a call against a stock, you will receive a premium up front – which you will keep no matter the outcome, which is considered a capital gain.

The impact this activity has on your investment is three-fold right away. By selling the call you are receiving additional income right away, unlike a dividend, that you must wait for. That income effectively lowers the cost of your stock by the amount you received. We are also providing down-side protection and hedging against risk as the share price would have to fall below your new effective cost base before realizing a loss. Last, by writing the call we are enhancing the income beyond any dividends while you continue to hold the security. Many of you may recall our meetings prior to Covid where we measured client's total dividend income and compared it to total income from selling calls, and how much that call income augmented investment income beyond dividends.

***In summary, an active strategy of selling call options, increases income, reduces risk, and creates a market driven exit strategy out of a stock.***

A minority of options-licensed advisors exist that implement these strategies due to the amount of time and attention to detail that they require. We will continue to work in your best interest and execute on our strategy which has set us apart in terms of results, thought leadership and candid engagement as we strive to create value for each of our clients every day.

***You can also view a short educational video related to selling calls – which illustrates key points in this covered writing strategy*** – here.

Please reach out to us should you need further information.

I have prepared this commentary to give you my thoughts on various investment alternatives and considerations which may be relevant to your portfolio. This commentary reflects my opinions alone, and may not reflect the views of National Bank Financial Group. In expressing these opinions, I bring my best judgment and professional experience from the perspective of someone who surveys a broad range of investments. Therefore, this report should be viewed as a reflection of my informed opinions rather than analyses produced by the Research Department of National Bank Financial.

Best,
National Bank Financial

Rob Hunter
Senior Wealth Advisor

The opinions expressed are based on our analysis and interpretation of these particulars and are not to be construed as solicitation or offer to buy or sell the securities mentioned herein. National Bank Financial may act as financial advisor, fiscal agent or underwriter for certain of the companies mentioned herein and may receive remuneration for its services. Rob Hunter, National Bank Financial and/or its officers, directors, representatives, and associates may have a position in the securities mentioned herein and may make purchases and / or sales of these securities from time to time in the open market or otherwise.

The opinions expressed herein do not necessarily reflect those of National Bank Financial.

Several of the securities mentioned in this article may not be followed by National Bank Financial's Research department.

The securities mentioned (inclusive of income trusts and option strategies) in this article are not necessarily suitable to all types of investors. Income trusts and preferred shares are equity investments. Please consult your investment advisor to discuss investment risks. All prices and rates are subject to change without notice. Stocks typically fluctuate in value. Stock values can go to zero.

Selling calls against stock (Covered Writing): Shares may need to be sold at the strike price of the option at any time prior to expiration. If the calls are assigned, further opportunity for appreciation in the underlying security above the strike price is foregone.
Risk/Reward of the strategy = Strike price minus the purchase price of the underlying plus the premium received from the sale of the call. The maximum loss is the same as holding a long position less the premium received.

The investment advice given only applies to residents of the provinces of British Columbia, Alberta, Manitoba, Ontario and Quebec.

National Bank Financial is a member of the Canadian Investor Protection Fund.

CIPF
Canadian Investor Protection Fund
MEMBER

IIROC
Investment Industry Regulatory Organization of Canada