



Commentary

Example of a Buy Write

After a spectacular May it is not surprising that we gave up some ground in June. The green shoots which were the focus of investors' hopes quickly turned brown in the heat of summer. The mantra of growth and recovery has been cast aside as the significant gains from the March bottom are consolidated. We expect a range-bound and volatile market to persist. In such a market, covered call writing is one of the best strategies for making good returns. Covered call writing allows one to generate a significant yield from an equity position by selling away some potential upside returns in exchange for an upfront cash payment.

Let's examine a recent covered call position to explore why this strategy makes good sense: On June 19th we purchased Potash Corp. of Saskatchewan at \$93 USD and at the same time sold July \$95 call options for \$5.70 in premium.

By selling the calls we limited our potential maximum gain in the stock to \$7.70 (\$95 strike — \$93 purchase price + the \$5.70 premium) or 8.3% for the 28 day period. We would have done better without the option only if the stock rose above \$100.70.

Though we had expected Potash to increase in price, it declined to \$84 at one point in July. Had we not written the call options our loss would have been \$9 or 9.7%. However, the loss with the call option is \$3.30 (\$5.70—\$9.00) or 3.6%. By writing the calls we have lowered the losses from 9.7% to 3.6%.

If the stock price had closed back at \$93 by expiration, we would have generated option premium income of \$5.70 or 6.1%. Without the call, the return would have been 0%.

Given the likelihood of a sloppy, sideways market, covered call writing is a great way to increase returns, mitigate losses and lower volatility

-Derek Webb

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