Protecting Your Nest Egg

How to Automatically Boost Income and Protect Your Nest Egg at the Same Time!

By Don Fishback

The Protection Challenge

Here is a challenge.

I want you to think of “protection”.

Protection comes in all sorts of different forms. If it’s your house, protection can be an alarm system, locks, smoke detectors, fire extinguishers, even safety glass. Protection also comes in the form of insurance, so that you’re covered if something bad does happen.

If it’s personal protection, it could be in the form of safety devices, like seatbelts and airbags in cars, or perhaps medicine and vaccines, first aid kits for the home. Personal protection also comes in the form of insurance, so that you’re covered if something bad does happen.

So here is the challenge...

As diverse as these varied forms of protection are, what is the one thing they all have in common besides providing protection?

If you answered, “<u>they all cost money</u>”, you’re right. Protection costs money.

That’s why it is a widely accepted fact that if you want protection, you’re going to have to pay.

But what about your investments?

As the previous examples illustrate, it comes as no surprise that for you to be protected, it's going to cost you.

But what about your investments?

For most people, it would make perfect sense that it's the same with investments; protecting your investments should cost money.

In fact, it is a well-established assumption in economics that it costs money to add safety to an investment.

The more protection you want for your nest egg, the more it is going to cost you -- not necessarily in out of pocket dollars, but in lower returns. That's why a CD or a T-bill pays a lower guaranteed return than a non-guaranteed return on less predictable investments.

But what if I told you -- in fact, what if I *proved* to you -- that it is truly possible to not only add a level of protection to your nest egg, but that you would actually get paid to do it?

The best of both worlds

What I am about to show you is the best of both worlds. With the right strategy and the right investment tools, you *can* do two things at once – boost income and reduce risk.

In other words, in this concise educational course, you will learn a simple way you can automatically reduce risk *and* increase returns using a shockingly simple strategy.

Sound too good to be true? It's not.

It's quite true. And I'll prove it to you.

And not just me. Some very prestigious investment organizations have a lot to say about it.

That's important, because it's not just me saying it. What you are about to learn is based on authenticated and verified research done by highly qualified third parties you can trust.

Provide Income, A Cushion During Market Downturns

Russell Research, which is the consulting arm of the company that created the Russell Indexes -- which are tracked by approximately **$8.5 TRILLION** -- wrote that there is a strategy that "can provide income" as well as "a cushion during market downturns."[1]

Russell Investments

Russell Research

By: Scott Maidel, CFA, CAIA, FRM, Senior Portfolio Manager
Karl Sahlin, CPA, Portfolio Manager

DECEMBER 2010

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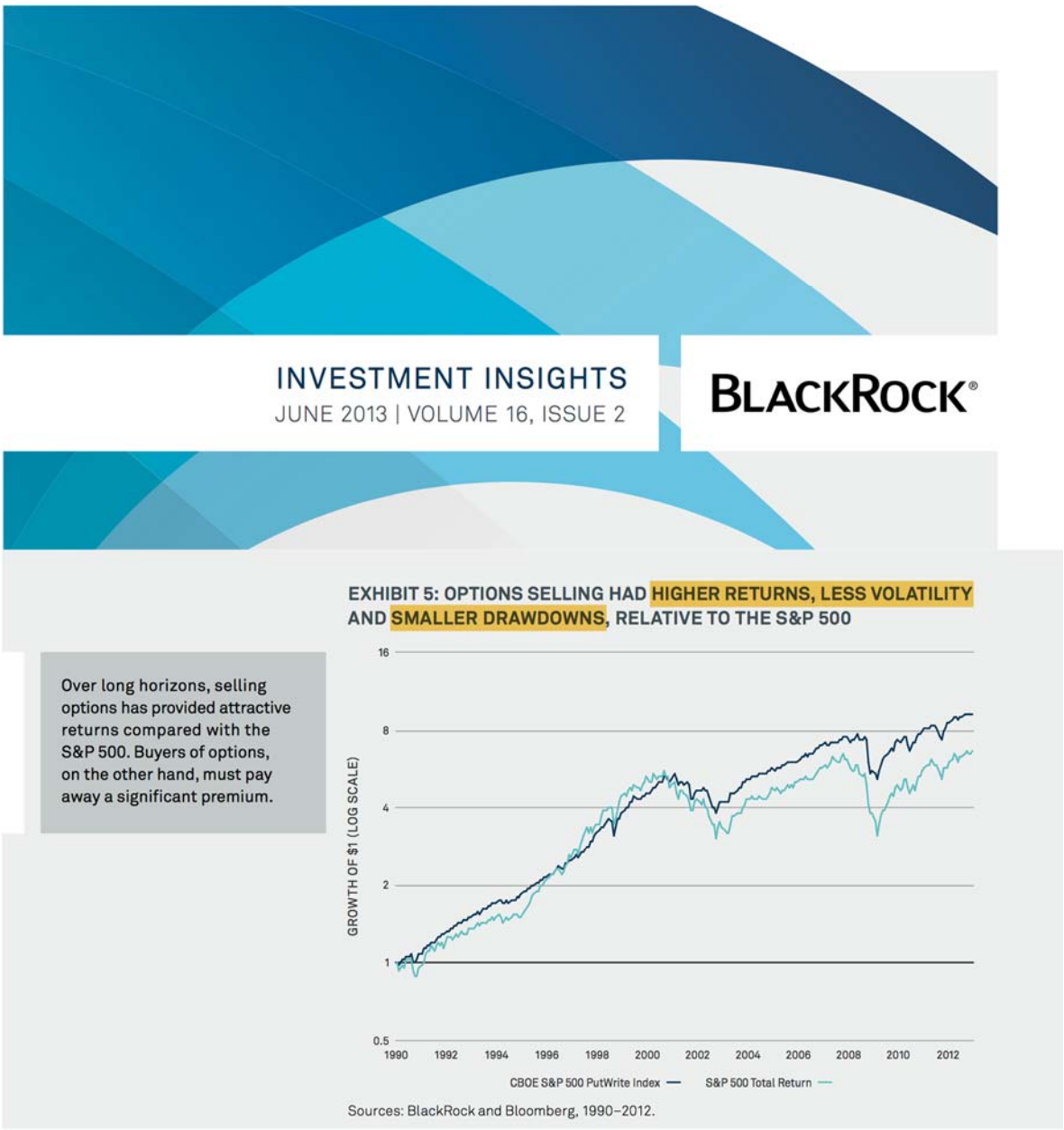
investment toolbox. They can provide income, attractive risk[1] adjusted returns and the potential for a cushion during market downturns. In this paper, we explore call overwriting, the impact of strategy construction and performance across various market environments.

[1] Source: Maidel, Scott, and K. Sahlin. "Capturing the volatility premium through call overwriting." Russell Research (2012).

Higher Returns, Smaller Losses, More Stability

And Blackrock, the world's largest money manager, with **$5.7 TRILLION** assets under management, wrote that this strategy has a history of higher returns, smaller losses and less volatility.[2]

Less volatility means more stability. Smaller drawdowns mean losses are smaller. And we all know what higher returns means; it means more money!



[2] Source: McFarren, Thomas. "VIX Your Portfolio - Selling Volatility to Improve Performance." Blackrock (2013).

Convert Potential Into Yield

So how is that possible?

How can you increase your protection – that is, make your portfolio more stable and shrink losses -- while making more money – i.e., higher returns?

After all, we began by stating the obvious: protection typically costs money. You're not supposed to get protection and *make* money. Adding a layer of protection to your nest egg and *increasing* income would seem to be impossible.

Well, it may seem impossible. But I have good news.

It is possible. And here's why.

This is straight-up research from the two biggest names in market averages -- S&P and Dow Jones -- which joined forces not too long ago. According to a Director of this combined behemoth, this income boosting idea works because it **"converts upside potential into yield"**.[3]

S&P DOW JONES INDICES
McGRAW HILL FINANCIAL

THE S&P 500® STOCK COVERED CALL INDEX: WHY, WHEN AND HOW IT WORKS

Introduction

Yield generation has been a popular investment theme in recent years. The covered call strategy is a common derivatives strategy used by traditional long-only asset managers seeking yield. Selling calls on securities that have limited upside potential allows investors to convert the upside exposure of securities into current yield, reducing the reliance on rising prices to generate returns. Covered call strategies generally outperform an outright long allocation except during a significant rally.

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[3] Source: Liu, Berlinda. "THE S&P 500 STOCK COVERED CALL INDEX: WHY, WHEN AND HOW IT WORKS." S&P Dow Jones Indices (2013).

To convert that potential into yield, we are going to employ a super-simple investment strategy that, according to Russell Research, basically puts us in the insurance business.

Call overwriting strategies can be viewed as selling a form of insurance

That is, by taking steps to protect our nest egg, we actually become the insurance company, which is really interesting because of the way we began this process.

We began by looking at ways to protect ourselves, and everything we looked at -- including the purchasing of insurance -- cost money.

In this instance, we are going to protect our nest egg. But instead of buying insurance and costing us money, we are going to become the insurance company and sell insurance, and in the process, gain yield.

Become the Insurance Company

Before we dive headfirst into a strategy that typifies becoming an insurance company, it might help if we had some idea of the financial performance of the insurance industry.

After doing an immense amount of research, I found the answer. And I'm pretty sure it comes as no surprise to anyone that insurance companies are some of the most profitable businesses on earth.

But don't take my word for it. Here are the profits reported by US Property and Casualty Insurance companies each year for the past 23 years[4].

YEAR	Propery & Casualty Insurance Company Profits (in billions)
1994	$10.9
1995	$20.6
1996	$24.4
1997	$36.8
1998	$30.8
1999	$21.9
2000	$20.6
2001	-$7.0
2002	$3.0
2003	$30.0
2004	$38.7
2005	$44.5
2006	$63.7
2007	$62.5
2008	$3.0
2009	$28.7
2010	$35.2
2011	$19.5
2012	$35.1
2013	$63.4
2014	$55.9
2015	$56.8
2016	$42.6
2017	$36.1
Total	$777.7

That's $777.7 BILLION in profits. In other words, insurance companies make massive amounts of money, year after year. So if we're going to employ a strategy that emulates what insurance companies do, we should be in good company!

[4] Source: Insurance Information Institute, www.iii.org

The strategy we are going to use, which Russell Research described as a form of insurance, is called “Call Overwriting”.

Call Overwriting is a super-simple investment strategy that involves combining stock and options to **boost** overall **returns** and **provide** a measure of downside **protection**.[5]

That means for you to get the most out of this free report, you will need to have at least a basic understanding of options.

> *For those of you who are new to options, may we suggest you check out what some have called the best options education money can buy.*
>
> *But here’s the best part. The book, **Options For Beginners**, is free. All you need to do is make a $14.99 donation to the American Heart Association and we will give you the book.*

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>
> *Instead, my goal is to educate you. And hopefully -- together -- we can make a difference by helping build healthier lives free from cardiovascular disease and stroke.*

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[5] Description Source: The Options Industry Council – Covered Call (Buy/Write) https://www.optionseducation.org/strategies_advanced_concepts/strategies/covered_call.html

A Brief Refresher – Option Basics

Call Overwriting involves simultaneously buying shares of stock and selling -- also known as "writing" -- a call on that same stock. The purpose is, as noted before, similar to going into the insurance business. Because when you sell an option, you literally "collect the premium" that the option buyer pays.

The strike price of the call should be above, or "over", the stock price. That is, let's say you have a stock whose price is 44. To implement a Call Overwrite, you buy the stock at 44 and simultaneously sell a call whose strike price is greater than 44. *Again, if you are not familiar with these terms, please take the opportunity to check out* ***Options for Beginners****.*

In a few moments, I'm going to provide you with an example of a hypothetical Call Overwrite. But before I do, I want to do a quick refresher on how a call option works.

Call Value

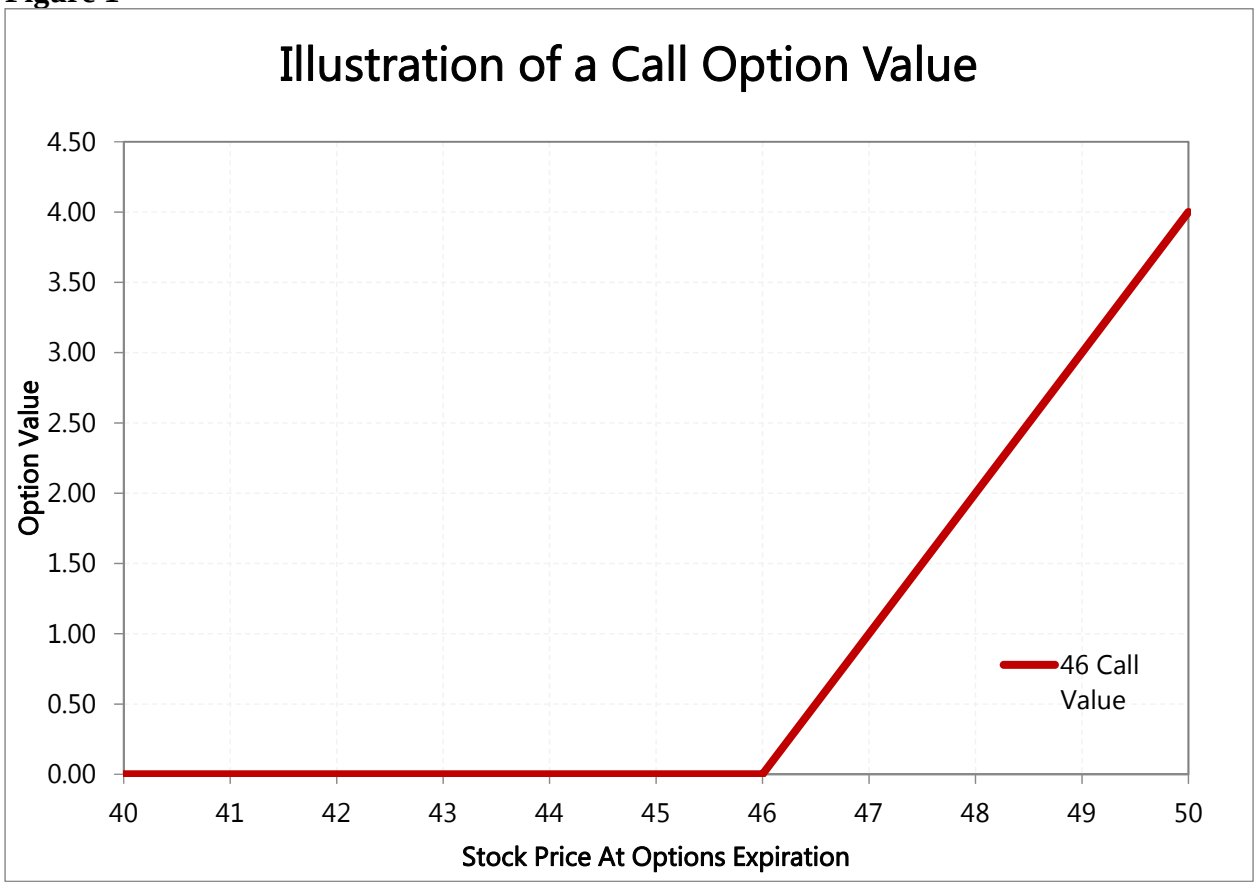
A call option gives the holder of the option the right to buy an asset at a future date at an agreed-upon price. The agreed-upon price is called the strike price.

In this example, we are going to look at a call option on a made-up company that does not really exist. We will give the imaginary company a ticker symbol of XYZ. The price of XYZ shares are 44. The call option has a strike price of 46, which is "over" the stock price of 44. The option has an expiration date that is two months into the future.

Let's assume for the moment that, instead of selling the option as we would in a Call Overwrite, we buy the option. With XYZ shares at 44, the purchase price of the 46 call two months prior to expiration is 1.

Figure 1 illustrates the call option's *value* at expiration as the stock price fluctuates up and down.

Figure 1

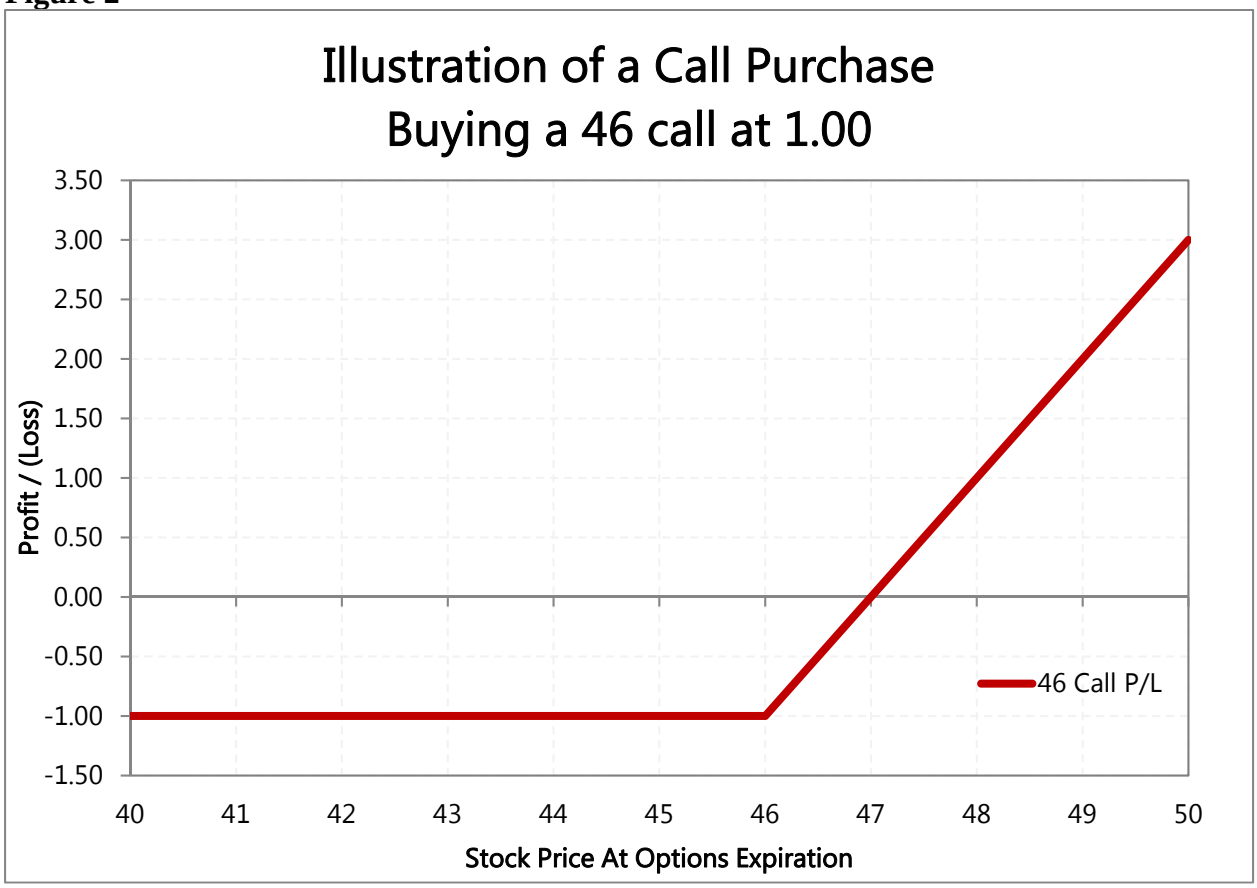


Notice how the call has no value until XYZ shares reach the strike price of 46. Once the stock price reaches the call's strike price, the call begins to gain value as the stock price increases.

Call Purchase

Figure 2 goes a bit further and takes into account the original transaction – the purchase of the option. In our example, the purchase price of the option is $1. If we buy that call option, that is money out of our pocket. So if there is no value when it comes time to sell the option, we lose that $1. But once the stock eclipses the strike price of the call, then there is option value that we receive when we sell the call that we originally purchased. Once the stock price exceeds 47, the option value more than offsets our original $1 out-of-pocket cost to buy the option. So we make a profit.

Figure 2

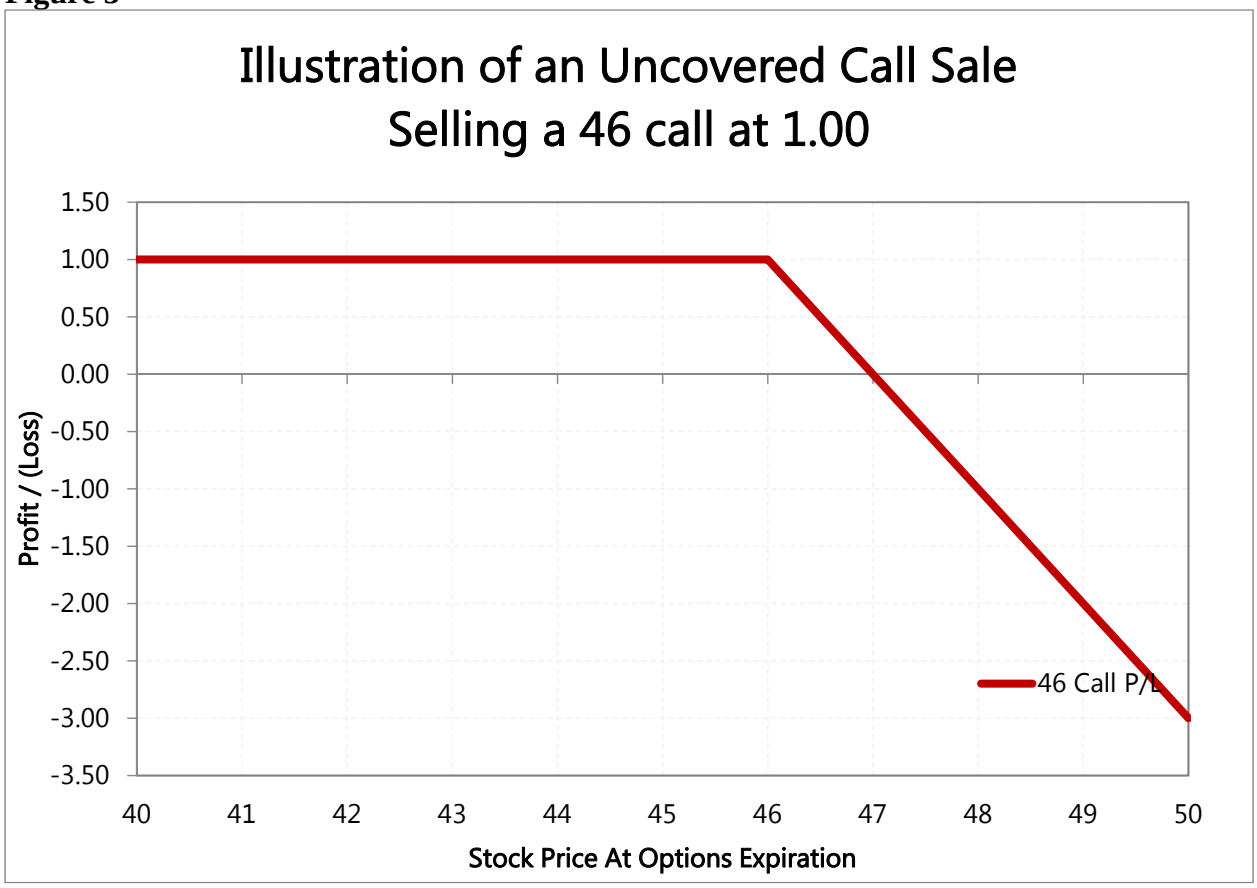


As noted, Figure 2 illustrates what happens when we *buy* the call option. But in a Call Overwrite, we *sell* the option. So let's take a look at how profits and losses are generated in an option sale.

Call Sale

Figure 3 illustrates the at-expiration profit and loss performance where a trader sells a call at a price of 1 and where the strike price of the call is 46.

Figure 3



Notice how losses pile up rapidly as the stock price rises. That happens because the option is considered uncovered, or “naked”. In other words, the option is on its own, and there is no protection from a rapid rise in the stock price.

That is something that we want to avoid at all costs. The good news is that this kind of negative outcome is automatically eliminated in a Call Overwrite, as our next illustration will show.

I do want to once again remind you that if you feel you need a more in-depth refresher, or a more comprehensive introduction to options, be sure to check out our highly acclaimed ebook, ***Options For Beginners****.*

We give the book away as a free gift. The only thing we ask is that you make a small $14.99 donation to the American Heart Association.

Find out more at www.optionsforbeginners.com.

Call Overwrite

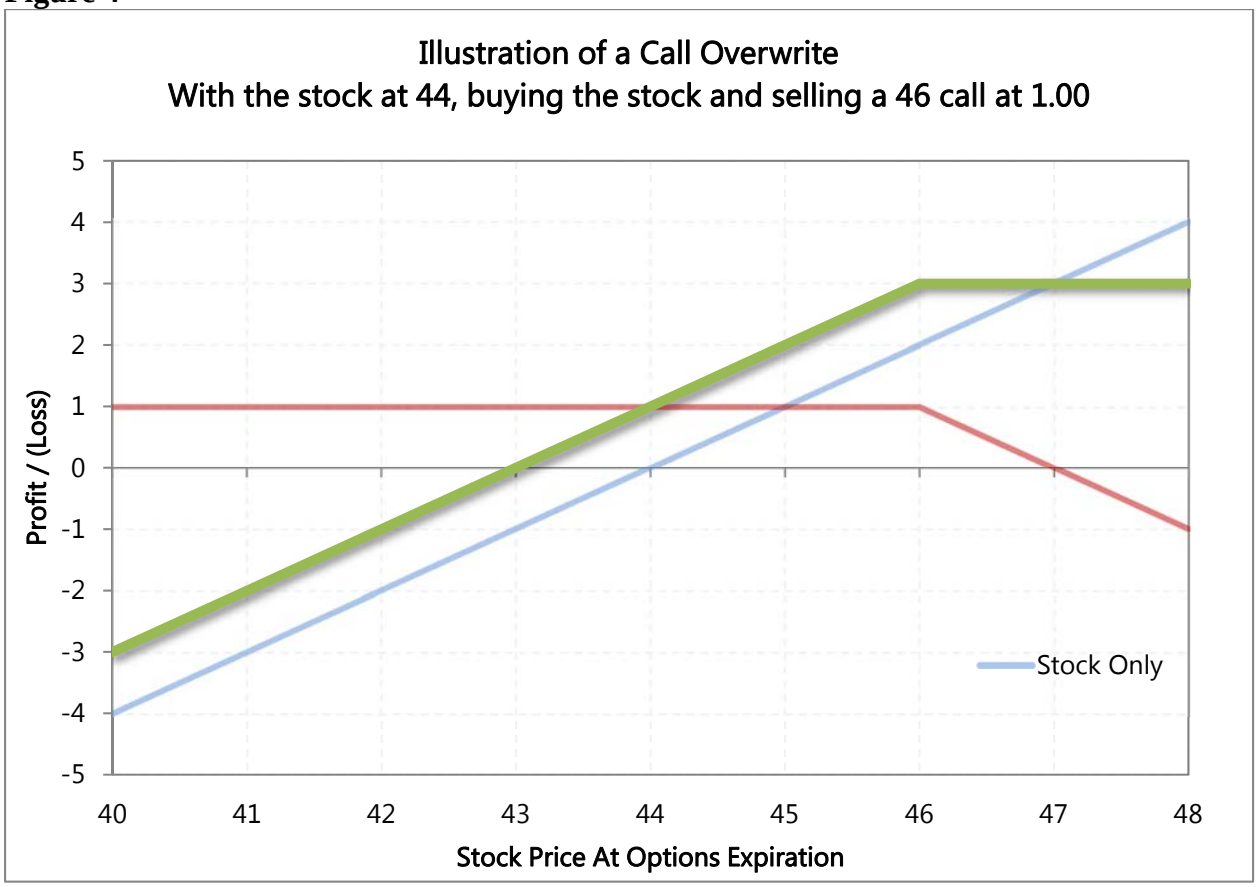
Now that we know how a call works -- whether we are buying the call or selling it -- let's look at the following example illustrating the results of a hypothetical Call Overwrite.

Remember, a Call Overwrite involves simultaneously buying shares of stock and selling [also known as "writing"] a call on that same stock. The purpose is, as noted before, similar to going into the insurance business

In this example, the stock is the same imaginary company. The ticker symbol is still XYZ. The current stock price is still 44. And the option is the same: a call with a strike price of 46 that is "over" the stock price, with an expiration two months from now.

Figure 4 illustrates the various profit/loss lines of the two different components of the strategy. The red line should look familiar. It's the chart from the prior page. The light blue line should also look somewhat familiar. It's a chart of the profit and loss of a simple long position in the stock. The thick green line is the profit/loss illustration of the *combination* of the option and the stock -- the Call Overwrite position.

Figure 4

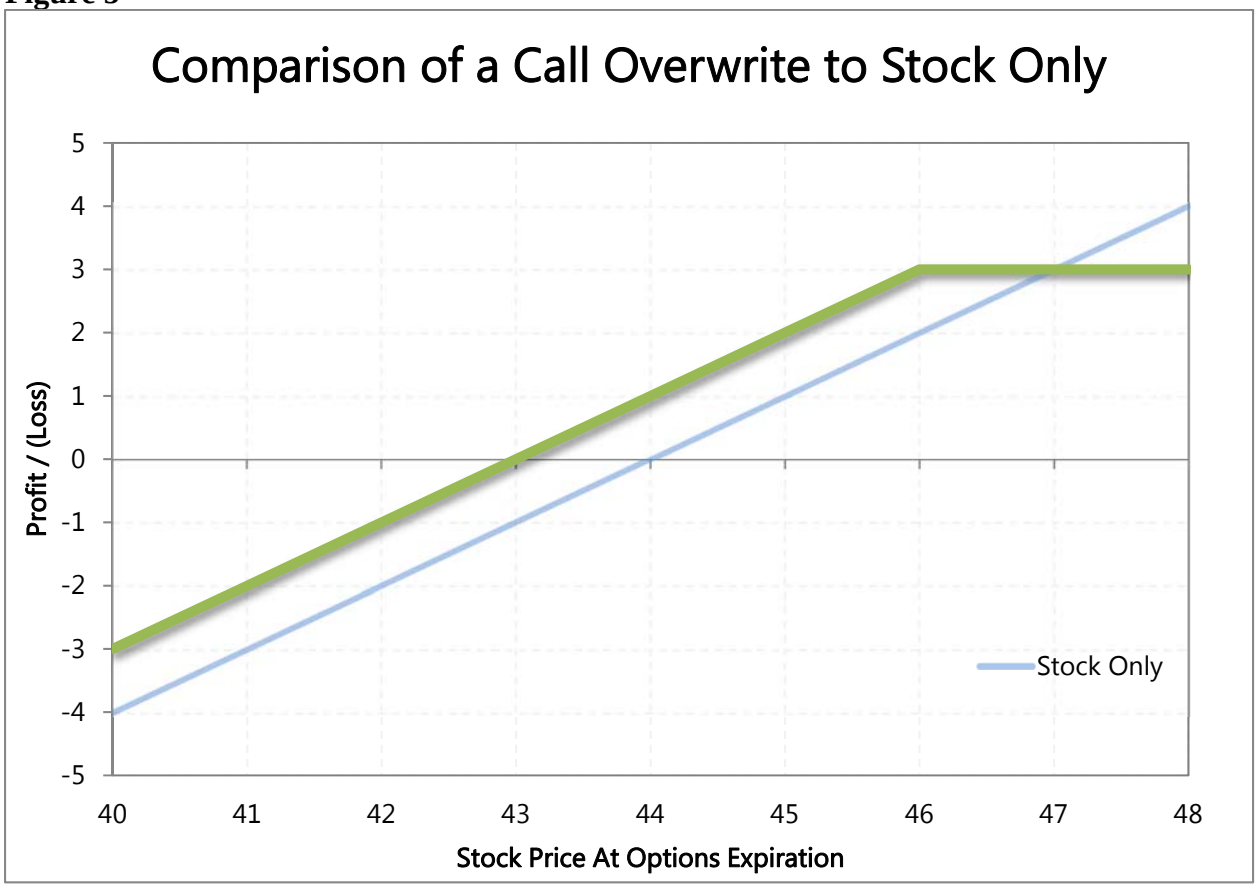


The green line is the one we want to focus on. Had we bought the stock at 44 and collected the premium from the sale of the call at 1, we would have paid a net of $43 at inception.

Now fast forward to options expiration. Looking at the chart, if the stock stayed flat at 44, we would make 1. So the net return would be 2.33% (1/43=2.33%). If the stock rose above 46, we would make 3. So the net return would be 6.98% (3/43=6.98%).

Figure 5 allows us to visually compare a position in the stock to the Call Overwrite so we can see whether using options improves things or not.

Figure 5



At nearly every point, the green Call Overwrite line is an improvement over the blue Stock Only line. If the stock were to go down, the Call Overwrite position's loss is smaller than that of the Stock Only position. If the stock were to stand still at 44, the Call Overwrite makes a profit while the Stock Only position makes nothing. And if the stock goes up, the profit in the Call Overwrite is generally better than the Stock Only position.

It's only once you get past a certain point higher that the Stock Only position has an advantage.

Basically, we've reduced our exposure to further gains. But what is the likelihood of those further gains?

As a matter of fact, when you crunch the numbers, you find that the likelihood of further gains is appallingly low. What is far more likely is that the stock does *not* climb past the point where the Call Overwrite loses its advantage.

In other words, we did what the Director of S&P/Dow Jones said we would do.

We converted our exposure to potential further upside into actual, current yield, thereby reducing our reliance on unlikely price increases to generate returns.

We used options to reduce risk and increase profits.

Proven Performance You Can Count On

Call Overwriting adds a layer of protection to our nest egg, while building income.

At least, that's our intent. But where is the proof? Are there any numbers that actually support that claim? Well, I don't make any statements without having some hard and fast numbers to back them up. So let's look at that evidence!

To do that, we're going to look at two indexes. One index is the S&P 500 Total Return Index (SPXTR), which measures the performance of the S&P 500 plus dividends. This gives us a true view of the stock market.

The other index we're going to use also comes from S&P by way of the Chicago Board Options Exchange. This index measures the performance of Call Overwriting. The CBOE S&P 500 30-Delta BuyWrite Index (BXMD) is a benchmark index designed to track the performance of a hypothetical covered call strategy that establishes a long position indexed to the S&P 500 Index (SPX Index) and writes a monthly Out-of-the-Money (OTM) SPX Call option.

Figure 6 is a chart that puts the two indexes together, allowing us to compare the stock market's total return to Call Overwriting[6].

Figure 6

You can see that the gap between the two lines was narrow at the beginning, then it expanded as time passed, indicating superior long-term performance of the Call Overwriting strategy.

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[6] Sources: Bloomberg, CBOE, Global Financial Data, Thomson Reuters

And the numbers back that up:

- As far as performance, the higher the better:
    - 2365.5% for Call Overwriting vs 2014.2% Stock Market Total Return
    - Returns for Call Overwriting are 17% higher.
    - That is good, and it proves our point about building income.

- As far as stability, we measured volatility. The lower the better:
    - 15.9% for Call Overwriting vs. 18.2% for the Stock Market Total Return
    - Portfolio volatility for Call Overwriting is 13% less, which indicates greater stability.
    - That is good, and it proves our point about protecting your nest egg.

- Drawdown measures the worst-case scenario. The greater the drawdown, the bigger the worst-case loss.
    - 15%: The drawdown for Call Overwriting is 15% smaller than the drawdown for the stock market.
    - That smaller drawdown is good, and it proves our point about protecting your nest egg.

Bottom line, as these numbers prove, Call Overwriting really does reduce risk and increase profits. It accomplishes that task by converting exposure to potential further upside into actual current yield. Instead of relying on unlikely gains to generate returns, Call Overwriting adds a layer of protection to your nest egg, while building income.

Even More Proof

The performance figures I just showed you are impressive. But one potential weakness is that they are isolated to a broad-based, large cap stock market index.

What if we dig deeper and look at some of the individual stocks that make up the index?

That's what this table tells us[7]. It quantifies the improvements you get by implementing a Call Overwriting strategy on a variety of widely held stocks vs simply owning the stocks.

Company	Increase in Returns	Decrease in Volatility
Coca-Cola	+7.8%	-11.3%
Microsoft	+30.7%	-18.1%
Oracle	+6.1%	-17.9%
Wells Fargo	+7.7%	-24.9%
Exxon Mobil	+5.5%	-18.4%
Berkshire Hathaway	+5.3%	-13.1%

As you can see:

- Call Overwriting generates a substantial increase in returns, once again proving our point about building income, and;
- Call Overwriting produces a substantial reduction in volatility. So the portfolio is more stable, once again proving our point about protecting your nest egg.

[7] Source: Hemler, Michael L., and Thomas W. Miller Jr. "The Performance of Options-Based Investment Strategies: Evidence for Individual Stocks During 2003–2013." (2015).

The best of both worlds

As I said at the beginning, this super simple options strategy gives you the best of both worlds.

Call Overwriting, which involves buying a stock or ETF, and simultaneously selling a call whose strike price is above the then-current stock price, gets it done.

You want protection? Call Overwriting provides an additional layer of protection to your nest egg.

You want to build income? With Call Overwriting, you get paid to have that protection. And when you get paid, it means additional income.

We have demonstrated, and proven with verified 3rd party performance statistics, that with the right strategy and the right investment tools, you really can do two things at once – boost income and reduce risk.

You now know that options in general, and Call Overwriting in particular, provide a simple way you can automatically reduce risk *and* increase returns using a shockingly easy strategy.

As a reminder, if you feel you need a more in-depth refresher, or a more comprehensive introduction to options, be sure to check out our highly acclaimed ebook, ***Options For Beginners****.*

We give the book away as a free gift. The only thing we ask is that you make a small $14.99 donation to the American Heart Association.

Find out more at www.optionsforbeginners.com.

But why stop at two worlds?

Just a moment ago, we said that Call Overwriting is the best of both worlds. But why stop at "both". "Both" implies you're limited to just "two". And while two worlds are better than one, what if we want even more? What if we want something different from income and protection?

In fact, options strategies can be used to make money from all sorts of scenarios. With options, you are not limited to protecting your nest egg or building income. You can also use options to profit from pure market movement -- in either direction -- up or down. And that is just one of the many aspects of options and different options strategies you can use to your advantage.

With the flexibility that various strategies provide, options can be used to custom tailor a strategy to meet your personal objectives.

I strongly encourage you to use this opportunity to expand your knowledge of options, and how you can benefit from them.

We have much more at our website:

www.donfishback.com

And if you would like additional information on how we can help, you can always reach us by email:
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