Covered Calls – Active vs. Rules Based

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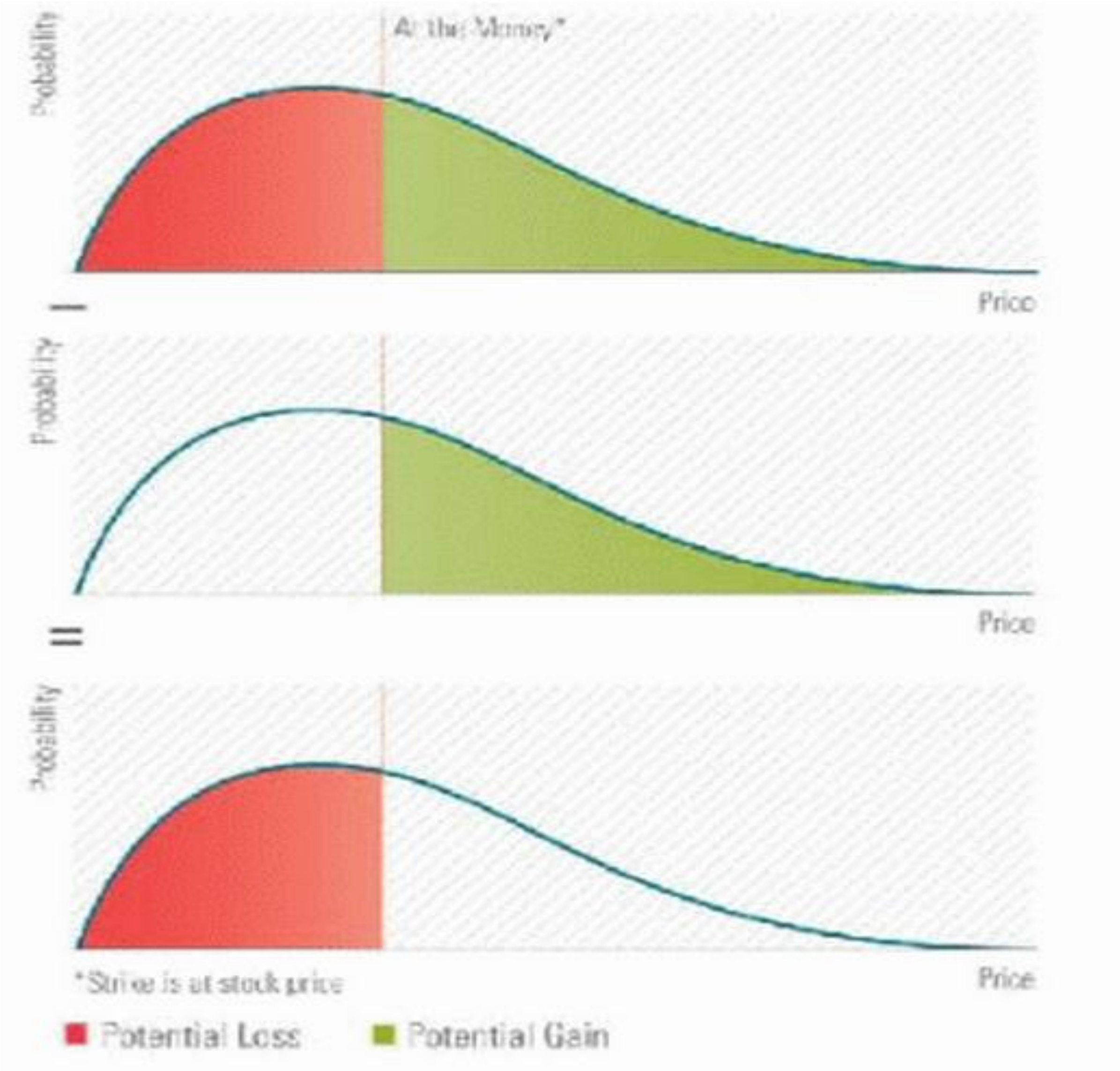
Variables to consider

- **Strike Price**—Collect larger premiums ATM. The further OTM the strike price, the smaller the option premium.
    - The greater the chance that the stock trades ITM, the more you should be compensated for forfeiting your upside.
- **Time to Expiration**—The longer the tenor of the option, the greater the premiums.
    - Time is on the side of the call seller.
- **Implied Volatility**—The higher the implied volatility, the greater the premiums.
    - More volatile stocks are more likely to make sudden and large moves,

Visual Definition of a Covered Call

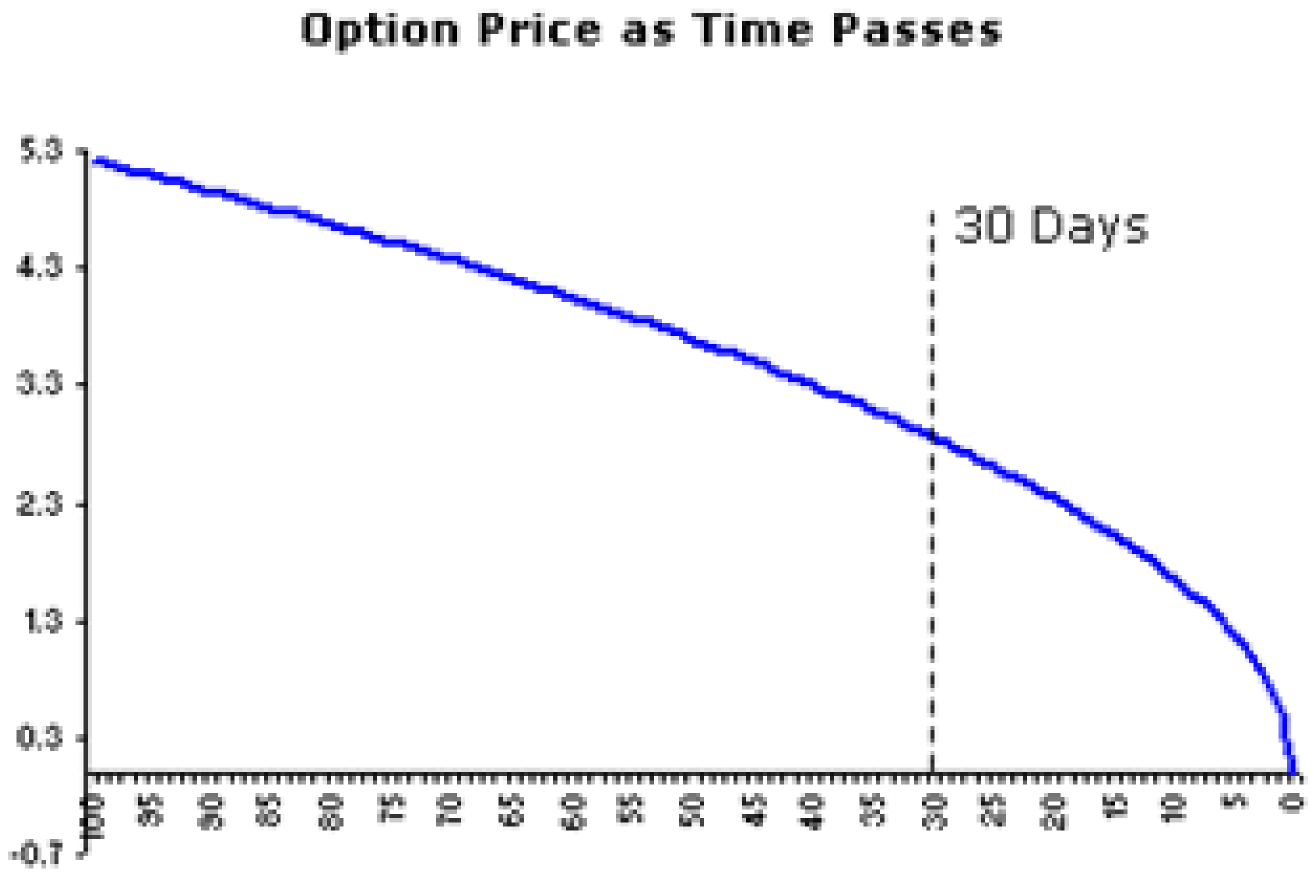


(#1) Risk Profile
for an investor long a
given stock/ETF

(#2) Risk Profile
for an investor long a
call option

Subtract (#2) from (#1) to
get the Risk Profile for a
Covered Call investor

Time Decay is on your side



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Isolating Implied Volatility and Time

- With Cisco (CSCO) trading at $23, the impact of implied volatility on premium can be demonstrated with two real world examples:
- With 30 days to expiration, at 30% implied volatility, CSCO at-the-money calls trade for $1.12
- With 30 days to expiration, at 50% implied volatility, CSCO at-the-money calls trade for $1.63
  - Holding all else constant, the call option gains 46% when implied volatility rises from 30% to 50%
  - Conversely, a decline in implied volatility from 50% to 30% results in a loss of 31% for the call option

Two Ways to Implement an Active Covered Call Strategy

- **Actively managed covered call strategy funds offered by Horizons ETFs.**
    - Professional money manager with decades of experience at the helm.
    - Let the professionals handle the heavy lifting, while you collect fat distributions each month.
    - May not have options approval, or experience trading options, which can in many cases have wide bid-ask spreads.
    - MER could be much lower than the transaction costs incurred by an inexperienced options trader trying to implement the strategy on her own.
- **Implement the strategy tactically in client portfolios when attractive opportunities present themselves.**
    - More hands-on, higher level of service, may appeal to sophisticated clients looking for customized or personalized solutions.
    - Cash secured put options to enter positions, and covered call options to exit positions to significantly reduce cost basis of the position.
    - The risk averse may choose protective puts when implied volatility is relatively low, for superior downside protection.
    - Instant net credit to the account. Flexibility to buy back calls to maintain upside, or avoid writing options altogether.