



The Stock with 6 Annual Dividends

What if the company where you've committed your hard-earned capital, paid out a dividend to you every other month? Imagine six times a year the board of directors sitting down and cutting you a check, to share with you some of their bloated salaries, passing along profits you richly deserve for taking an ownership position in their common stock. Sounds good, right? Yet this scenario never becomes reality unless you trade options against your stock purchase. Surprised?

A buy write is the simple strategy using option premium to create dividend like income, and price protection. The trade's edge is to plan ahead so the option cycles match your buy write and your stocks earnings cycle. A buy write is a way to conservatively play those sexy high flying names provided they have earnings and you keep in mind you're buying a business and not speculating. Make sure the volume of stock traded and option traded daily gives you a "level playing field". These stocks can move around allot and therefore they have fat option premiums. The "rub" is that buying a stock and selling a call or doing a buy write is algebraically equal to a short synthetic put. Pick a quality company avoid earnings announcements and paper trade one as a means to check out the results before you actually do it.

Let's use stocks that are \$25 a share or better. In fact I like stocks \$40 or better because the "meaty" dollar value of the options means possibilities of turning the position over before expiration. Cramer's "four horseman", AAPL, AMZN,

GOOG, and RIMM, in the technology space are great for this strategy. A sexier group like POT, MOS and MON from the agriculture sector move around a lot, have high beta also make good candidates for this strategy. Stocks that move around also come with the big dollar value at the money options which is good downside protection.

The names I've mentioned have a lot of stock and option volume every day. Insure you can get in and out of your position fairly by picking an option that has a dime width and enter your offer between the bid and the ask. A wide bid ask spread and low volume may lead to slippage that can ruin a nice profit.

Look ahead annually at your calendar to break your trading plans into 6 equal parts of 2 months each. Calculate or plan ahead using fifty to seventy days until expiration to "zeroing in" on a specific option and a specific entry point. This amount of time will give you a "meaty" time premium.

Avoid having this position on over earning because of earnings are the quarterly "confessional" when a company gives you clues of how business is going. Volatility will peak during the week or two surrounding earning. The reason is that traders know the greatest chance for a gap price move occurs when earnings are released.

When reading quarterly earnings report forecast on the company's earnings prospects going forward. If the stock your considering warned earning will be bad, or margins are compressing, or any uncertainty about the near term future, find another name.

I'd bring charts into this but, "every ship at the bottom of the ocean has charts" that didn't do any good odiously.

Personally I feel if you buy good companies at even average entry points a conservative buy write means a good probability of making money. A buy write is a position trade, or a swing trade, to be held from a week or until expiration not a day trade.

However avoid a buy write after a big upward price movement. I don't want to chase stocks especially in an environment where the economic conditions don't warrant anxiety on the upside. Buy writes are short put positions you want an entry point that's in the lower half of the recent range. If you own a stock out rite and it's made a nice move higher and you don't want to sell it this instant sell a call and defer the decision until later.

Let's use Research in Motion as an example of a common stock that ought to pay a dividend six times a year. This name takes into account the number of people who have Blackberries and the anxiety most Americans have about texting/keeping up with a fast-paced world, making this is a hot tech stock, widely traded, high liquidity, etc. We like how these circumstances work together, not only to keep this company in business, but also to keep the common stock moving in a positive direction. RIMM makes a lot of money and we can use options to pay us dividends we deserve for taking the risk of owning said common stock.

I'll start with an entry point of 100 common RIMM at 68.35. Recently it traded down to 63.50 after reporting really quality earnings and giving a "luke warm" forecast going forward. The cost is \$6850 dollars for the 100 shares of common stock. Next we'll reduce the cost of out rite stock purchase by selling a 65 call as protection, or dividend income and or price decline. Recently the 65 call fifty to seventy days until expiration was 8.65 (with the stock 68.35) or a cost reduction

of \$865 dollars brings the total cost of the trade to just south of \$8000.

Here's how this entry point works to create a 6 dividend annually trade. If we assume this is approximately 60 days away, one sixth of a year--don't let all the sixes in this example make you nervous. The two-month buy-write strategy, AKA the in the money covered calls, can be used to break the year into 6 somewhat even cycles.

Remember the guts of the strategy is to own a quality common stock and six times a year sell a two month option, creating a dividend for approximately every 2 months.

We know that day after day we put this trade on RIMM's common stock price will fluctuate and scare the heck out of us, raising the question, "What was I thinking?!" I'm here to tell you that, based on the 68.35 entry on the stock purchases, and the sale of a 65 call for example at 8.65, your stock purchase is protected down to 59.7 through the third Friday of the expiration cycle you choose. The call option sale will protect your stock purchase on a down move 12.5%. The upside profitability of this trade isn't shabby either. If RIMM finishes above 65, your stock and option position profit of as much as 12.65%.

In other words, you effectively bought RIMM at 59.7 and sold it at 65.

$59.70 / 65 = 12.65\%$ yield in 2 months.

$2/12$ or $60/360 =$ just 16.7% of a year

Annualized 12.65% return 6 times a year is an amazing 75% return on your money annually.

INSANE

This is why you won't carry the position until expiration and find yourself turning over option inventory even though it's still working for you. After all if in our example the buy write is up 7,8,9 or 10% on your \$8000 investment before expiration, you've made between \$500 and \$800 quickly, the positions worked for you and as the old saying goes "bulls and bears make money, pigs get slaughtered". To many people fall in love with option position and graphs that show at expiration pictures.

AND how many companies pay you an 8% dividend?

This demonstrates why you want to use an in the money call, sixty days until expiration, therefore six times a year. It seems to conservative at first but "do the math" and you'll find out how fat option premium with 60 days until expiration can work for your option profitability.

What happened if the stock goes sideways and finishes below 65?

If RIMM finishes your chosen expiration cycle and isn't 65 dollars and our "angst" hasn't gotten the best of us by now, we can sell another 65 call, for example, another 2 months away, to protect our stock. Yes--it is possible to do it again and again and again, until perhaps the stock is called away because it finally ends the cycle above the strike we sold as protection.

What if the stock goes down?

Let's pretend we can look ahead, out 37 days, and the "talking heads" at CNBC are questioning the future earning

power of RIMM. RIMM is 62.50, with markets collapsing; "cats are living with dogs". We calmly buy back our original 65 call and sell a 60 call against our stock. If we use straight-line depreciation and the stock 62.50, our June 65 calls that originally sold at 8.85 will be 3.49.

If you: Subtract $8.85 - 5.36 = 3.49$.

We've just lowered our stocks' purchase price from 68.34 to 62.98.

68.34 (original purchase price) - 5.36 (profit from option sale) = 62.98 our new cost basis for our stock purchase.

Next we sell a 60 call, another 2 months away and we've defended our position, created another dividend, and stayed in the game to fight another day.

If RIMM goes up you can readily turn over the trade get out and get back in every day they trade the stock and the NASD. Personally I struggle to "hold on to" option position through expiration because I like to "turn over" inventory, take profits and move on to other set ups. I've done the RIMM trade four times in seven months it's become a "beard and butter" trade to me.

A buy write is a synthetic short put position. Every time you buy write this stock and it moves higher you can take it off profitable and start over. A conservative buy write has both time decay and positive price movement that can work for you. Fat option premiums means the short put you've created has a big dollar value it can collapse on and an easy position turnover.

If a stock grinds lower the time decay and the fact you used an in the money or at the money option will protect your investment. The sharp unexpected down move is the killer for this position. Remember that's the reason you plan the entry point, use a big dollar value option and buy a good business.

A buy write can be viewed as a means to create option income like a stream of dividends that are just too infrequent with common stock. Make sure you do a conservative write using a slightly in the money or at the money option. Do the math to figure a reasonable return. Make sure the stock and option volume provides ample liquidity that will provide a level playing field so you can get in and out of the trade between the bid and ask. Buy good quality businesses that have profitable, growing business stories going forward. Practice a few times with your paper money to get the execution down and see if this strategy is for you.