Exencial
Wealth Advisors

Covered Call Strategy Methodology

Based on a client's investment objectives and risk tolerance, we may utilize a covered call strategy for a portion of a managed portfolio.

What is a Covered Call?
A covered call strategy is constructed by selling call options on stocks that are owned in a portfolio. The sale of call options produces income, which is received in exchange for the opportunity for future price appreciation over the strike price of the call option. The goal of our covered call strategy is to enhance total return by generating income and providing limited downside protection.

What is a Call Option?
A call option gives the owner the right to buy a stock before a specified date (expiration) and at a specified price (strike price). In a covered call portfolio, this right is sold to someone else, thus generating income for the seller of the option.

Do options increase the risk in my investment portfolio?
While certain option strategies can be high risk, covered call writing lowers the overall risk of a stock portfolio. The income received from selling call options dampens the volatility of a portfolio, which means the portfolio loses less money in bear markets and makes less money in bull markets. A covered call portfolio is an equity strategy, and therefore does contain risk. However, all else being equal a covered call position has less risk than owning the stock outright.

What type of stocks are best for this strategy?
We identify stocks with minimal downside risk to current price levels and modest upside potential. Large cap stocks are targeted due to the significant liquidity advantage in the options market that large cap stocks hold over small caps. The universe of large-cap stocks that are candidates for covered call portfolios is derived from our core, large-cap quality growth equity process.

When is this strategy most effective?
A covered call strategy works best in a relatively flat or slightly positive market environment. In these scenarios, the owner of a covered call portfolio receives income from writing the call, dividend income from the underlying stock, and modest appreciation potential of the underlying shares.

How do taxes affect this strategy?
The premiums received when selling options are taxed as capital gains. When shares of stock are called away by the party that buys the option, the seller may also experience capital gains from the resulting sale of stock. Therefore, an option seller must always be prepared for the tax consequences of the strategy.

13801 Reese Boulevard, Suite 155 Huntersville, NC 28078 704-659-7810 (office) 704-766-0592 (fax) www.exencialwealth.com