NASDAQ OMX | Global Indexes

Covered Call Strategy
Frequently Asked Questions

Q: What is a Covered Call Strategy (CCS)?

A: A covered call or "buy-write" strategy is an investment strategy in which the fund buys a specific basket of stocks (such as the NASDAQ-100® Index) and sells covered call options that correspond to that basket of stocks.

Q: How Does a Covered Call Strategy (CCS) Fit Into a Fixed Income Portfolio?

A: With bond yields at near-historic lows, many investors are concerned because several traditional fixed income investments have the risk of declining in value and they generate minimal income. Covered call strategies can serve as a supplement for yield and diversification for fixed income portfolios as they do not have duration or interest rate risk as traditional fixed income and can generate high monthly income. Many investors can take 20% of their fixed income allocation and diversify it into an index tracking fund like the Recon Capital NASDAQ-100 Covered Call ETF (Ticker:**QYLD**), which has a current SEC yield of 9.74% and expense cap of 0.60%*.

Q: How is the yield so high on covered call strategies?

A: Covered call strategies generate yield in two ways.

1) The first way is through the option premium received by the writing (selling) of call options on the stock held in the portfolio. This premium is dependent upon market volatility, which is typically measured by the VIX Index. In the instance of the Recon Capital Nasdaq-100 Covered Call ETF "**QYLD**," the options written on the NASDAQ-100 Index are calculated off of the VXN Index. The VXN measures the volatility of the NASDAQ-100 Index and is more volatile than the VIX Index. Because of this key difference, the QYLD generates a higher yield than other strategies that utilize the VIX Index. A simple way to estimate the monthly option yield is to take the price of the VXN and divide it by 10. For example, if the VXN Index is at 14 then the monthly option yield for the QYLD will be around 1.4%.

2) The other way covered call strategies generate yield is by collecting dividends on the stock position. The combination of these two income streams enhances the overall yield and makes for a much more profitable method of investing over owning only stock.

Q: People often say covered call strategies are less volatile than a traditional equity investment and can lower the standard deviation of an overall portfolio, how does this work?

A: Covered calls can complement any investment portfolio by reducing volatility, providing monthly income and protecting against downward moves in the stock market. The premium from the call option generates monthly income and provides downside protection thereby reducing the risk of owning stocks.

When an investor incorporates a covered call strategy, he/she has introduced a low volatility asset class that can improve the overall risk adjusted return of his/her portfolio. An allocation to a covered call also affords him/her the opportunity to balance the remainder of his/her portfolio more aggressively towards stocks since they are compensating for the risk of stocks with the covered call's lower volatility and monthly income.

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