



How You Could Collect a 16.1% Yield From National Bank of Canada

Description

In 2016, it's not particularly easy being an income investor.

Traditional sources of income like bonds and GICs barely pay enough to keep up with inflation. Stocks offer much more attractive yields, but they come with risks. There are countless examples of formerly safe dividends being cut or eliminated.

Buying and holding stocks isn't the only way you can generate income. How would you like to juice your dividends so much that you can increase your yield to 10%, 15%, or even 20%? You might think this isn't possible or that you're taking on huge risks by doing so. But this strategy isn't nearly as risky as you might think. Many different Canadian investors just like you are successfully using it to really juice their income.

The skinny

The strategy is called selling covered calls, and it's deceptively easy.

Let's use **National Bank of Canada** ([TSX:NA](#)) as an example. This stock is already one of Canada's leading dividend payers, boasting an annual dividend of 5.8%. Although many investors are becoming bearish on Canada's banks, it's easy to argue that National Bank has a generous margin of safety.

The dividend is less than half of the company's trailing earnings. Over the past 12 months National Bank has earned \$4.50 per share in earnings while paying out \$2.08 in dividends. Shares trade at just 8.4 times trailing earnings, and the company is cheaper than its peers on just about every other valuation metric.

Here's how an owner of National Bank can really supercharge their yield.

Normally, call options give investors the right to buy a stock at a certain price on a certain day. Or investors can sell that option, which is effectively going short the stock. But if the investor owns the stock, what they're doing is locking in a sale price in exchange for more income today.

As I write this, the last trade for National Bank's March 18th \$40 calls was \$0.65. Which means if you sold a covered call on the stock, you'd get \$65 of income for every 100 shares you own.

Three things can happen, none of which affect the income you get from selling the call. The stock could go down, which means you keep the income and the option expires worthless. The same thing happens if the stock stays where it's at today.

The only situation where an investor loses is if National Bank rises. But even then, covered-call writers don't really lose. They just win less than someone who just owns the stock.

Say in March that National Bank shares trade at \$42 each. Based on the current price of \$37.90, somebody who bought the shares today would have a profit of \$4.10 per share. Somebody who bought the covered call would still have a profit but would only be up \$2.75 per share.

At that point, you'd have a decision to make. You could either buy back in at a higher level or take your gain and move on.

Repeat

Covered-call writing works best in a sideways or down market, like we're experiencing today.

You also have to stick with it. Getting \$0.65 per share is nice, but getting it several times per year is when you really start supercharging your income.

The March options expire in less than two months, which means if the stock price stays flat, investors could sell covered calls six times per year. Assuming the same type of option premium as we see today, it works out to 10.3% in additional annual income. Add on National Bank's 5.8% dividend, and you have an investment that yields more than 16%.

If you held 1,000 National Bank of Canada shares and successfully sold covered calls against them, you'd generate more than \$6,100 annually in additional income—not bad for an investment currently worth \$37,900.

Covered calls can be a powerful tool in an investor's arsenal. Many successful Bay Street professionals use them. Perhaps it's time you give the strategy a try.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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1. TSX:NA (National Bank of Canada)

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