



Income on Steroids: Collect 16.8% Annually From Enbridge Inc.

Description

In today's low interest rate world, many dividend investors are happy with a yield between 3% and 4% for their portfolio.

That seems to be the sweet spot. Sure, investors could stretch for a higher yield, but the consensus seems to be anything much higher than 5% is inherently risky. You can add a few higher-yielding names, but good portfolio management would dictate an investor add in some lower-yielding names in order to offset the risk. Thus, the total yield works out to somewhere around 4%.

That's all fine and good for an investor with a seven-figure retirement fund. A 4% yield on a million-dollar portfolio works out to \$40,000 per year. Add in things like a retiree's Canada Pension Plan and Old Age Supplement, and you're looking at a retirement of \$50,000 per year. I think most people reading this would be happy with that.

But what if you don't have such a large nest egg? Fortunately, there's a way you can really supercharge your dividends. Instead of earning 3%, 4%, or 5%, this method can put 10%, 15%, even 20% dividends in your pocket on an annual basis.

Income on steroids

It's not that this method is hard. It's been used by Bay Street traders for decades with a decent amount of success. It's just misunderstood as being risky.

Let's use **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)) as an example. As I write this, shares of the pipeline operator trade hands at \$47.16 per share.

The first thing you need to do is own the stock. There are many reasons why you should, including its fairly predictable earnings even after the colossal collapse in crude oil prices, its ambitious expansion plans, and its generous dividend, which currently sits at 4.5%.

Then what you'd do is use a call option to generate even more income.

Call options allow investors to buy a stock on a certain date for a certain price. This can be advantageous for an investor who thinks Enbridge will be much higher a few months from now. The investor pays a small premium for the right to lock in a purchase price. If the market cooperates, they can make a nice profit.

The Enbridge \$50 March 18 call last traded for \$0.97. If an investor purchased this call, it would cost less than \$100 to lock in the opportunity to buy 100 Enbridge shares at \$50 on March 18. If the shares are below \$50 on March 18, the options expire worthless. If the company trades at \$52, an investor would make a gain of more than 100% on the original investment.

What I'm suggesting is taking the other side of that bet. If you sold the same Enbridge option, you'd exchange income now for being forced to sell your shares at \$50 on March 18.

Two things can happen. If Enbridge goes down or goes up just a bit, you get to keep the premium generated by selling the call today. That works out to a little more than 2%.

Or Enbridge could head higher and you'll be forced to sell. But that's not the end of the world, since you've locked in a gain of 8.1% consisting of \$0.97 per share in income from the covered call and \$2.84 per share in capital gains. That's not bad for owning the stock for less than two months.

Say Enbridge trades sideways for the rest of 2016. This would give you the opportunity to sell covered calls six times, generating nearly \$6 per share in income. Add in Enbridge's already generous \$2.12 per share dividend, and that works out to an annualized income of 16.8%.

If you owned 1,000 shares of Enbridge, it's easy to see how covered calls could generate some great income. Based on an investment of \$47,160, it's possible to generate \$7,917 annually in extra income.

Covered calls are not free of risk. Essentially, investors are exchanging potential capital gains for income today. It's easy to see how that might not be ideal when the market is shooting higher. But for folks who are really looking to goose their income, covered calls are a very viable option.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
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1. Editor's Choice

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2. TSX:ENB (Enbridge Inc.)

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