Income Investors: Get an 8.8% Yield From TransCanada Corporation

Description

For retirees looking for income, there seems to be only one solution out there.

All of the experts agree that stretching for yield is a bad idea. If a stock yields more than 5%, the market is giving a very strong message that the dividend isn't safe. So stick to blue chips that pay dividends between 3% and 5%.

In reality, it's not quite that simple. There are dozens on stocks trading on the TSX that have paid dividends of 6%, 8%, and even 10% annually for years without a hitch. The key is to identify the ones with sustainable payouts, a task usually much easier said than done.

There is one option that investors can use to really goose the income they get. Here's how investors can use a covered-call strategy to nearly double their income from **TransCanada Corporation** (TSX:TRP)(NYSE:TRP).

Why TransCanada

There's a lot to like about TransCanada. The company has diverse operations with pipelines across Canada and the United States. It also has nuclear power assets in Ontario. The company also is aggressively expanding, using both new growth projects and acquisitions. It recently announced an agreement to acquire **Columbia Pipeline Group** for US$13 billion including assumed debt.

TransCanada has been one of Canada's premier dividend-growth stocks for years now. Over the last decade the company's annual dividend has increased from $1.28 per share to an expected payout of $2.26 in 2016, good enough for 6% annual growth. That's not bad in a world where inflation averages less than 2% annually.

TransCanada has an attractive current yield of 4.5%. Even though the company will have to swallow the US$13 billion deal for Columbia, management still says the dividend is safe. In fact, the company still expects dividend growth to be 8-10% a year in the next five years.

While that's an attractive dividend on its own, it just isn't enough for some investors. They need more but don't want to transfer money into riskier stocks than TransCanada.

These investors can augment their income using a covered-call strategy. Here's how it works.

Huge income

In the option market, investors use puts and calls to speculate on stocks. If an investor wants to bet on a stock going up, they will buy a call option. If they think a stock is going down, put options are used.

As with stocks, investors can take both sides of a put or call option trade. Investors selling a call option reserve the right to sell a stock at a certain price on a certain day.

If an investor already owns the underlying stock and then sells a call option, it's called writing a covered call. They enter into a contract that gives them the right to sell the shares they already own on a specific date for a certain amount.

Let's look at a real-life example.

TransCanada shares currently trade hands at $50 each. The $52 April 15, 2016 calls last traded at $0.18 per share. An investor who sells these calls would receive $0.18 per share today in exchange for agreeing to sell their TransCanada shares at $52 each on April 15.

There are two possible outcomes. If TransCanada shares stay below $52 for the next three weeks, the investor gets to keep their shares and the option premium. If shares go above $52, the investor is forced to sell for a profit of $2.18 per share. This is a 4.4% profit in just three weeks, which isn't such a bad result.

If TransCanada's share price cooperates, investors can do this trade 12 times per year, creating their own dividend of $2.16 per share. Add on TransCanada's current dividend of $2.26 per year, and the strategy nets a total return of 8.8% annually before taxes and other expenses.

This type of income can really make a difference. An investor who does this strategy using 1,000 TransCanada shares could generate $4,400 in yearly income compared to getting $2,260 from dividends alone.

With just a little more work, income investors can really supercharge their payout from blue-chip stocks like TransCanada Corporation. Perhaps such a strategy makes sense for your portfolio.

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