

Income Investors: Get a 13.1% Yield From National Bank of Canada

Description

Canada's banks have recovered nicely off lows set back in January and February.

Two of the big issues concerning investors back then have, at least temporarily, been quieted. Crude oil has recovered nicely with the commodity now approaching \$50 per barrel. Some pundits are convinced crude will head even higher because production has decreased so much.

The other concern was Canada's housing bubble. Many people are still convinced Canada is massively overvalued, but we're seeing little evidence that the bubble is about to burst. Prices in Toronto and Vancouver continue to be on fire. We're seeing declines in some of Canada's other markets, but none are substantial. Overall, the housing market continues to be healthy, and areas like Alberta are holding up better than expected.

With these concerns out of the way, many investors are piling back into Canadian banks, attracted by their dividend yields, low price-to-earnings ratios, and history of profitability. **National Bank of Canada** ([TSX:NA](#)) continues to be the favourite of many because its yield has recently surpassed 5% again, and because it trades at barely above 10 times earnings.

There's another reason why investors should like National Bank. Despite its name, National Bank isn't really a nationwide Canadian bank. It has a big presence in Canada's eastern provinces and very little exposure out west. And unlike many of its rivals, it has no meaningful operations in the United States.

There's plenty of speculation that the company will change that. It can see the better valuations commanded by its more diverse peers, and it's not usually very hard to convince a management team to make a big acquisition. There are hundreds of regional U.S. banks out there, too.

Huge income potential

Traditionally, investors have just sat on National Bank, content to get its attractive dividend.

But there's a way an investor can easily supercharge their payout from the stock, increasing it to more than 13% annually. That works out to \$1,310 in yearly income for every \$10,000 invested in the stock.

Here's how it works.

Shareholders of National Bank would go into the option market and sell call options, collecting a premium in exchange for agreeing to sell at a certain price on a certain day.

Here's a real-life example. Shares currently trade hands at \$42.17 each. Investors can write a covered call today, giving them a premium of \$0.28 per share in exchange for a commitment to sell their shares at \$44 each on June 17th.

There are two possible outcomes to this scenario. If National Bank shares close below \$44 on June

17th, the investor keeps the premium and their shares. If shares close above \$44, the investor is forced to sell their shares to the buyer of that call option for \$44 each.

If the second scenario happens, an investor has locked in a profit of at least \$2.11 per share, a return of approximately 5% in a month. That's not such a bad result.

How an investor really supercharges the yield is by writing covered calls each month of the year. A \$0.28 per share premium each month works out to an annual yield of 8% on its own. Add on National Bank's 5.1% dividend, and investors get a total yield of 13.1%.

The downside

There's one big downside to writing covered calls. They limit an investor's profit potential.

Say National Bank announces a big acquisition between now and June 17th, and shares go from \$42 to \$46 quickly. An investor who uses a covered-call strategy would miss out on some serious upside.

Additionally, it also involves more active portfolio management. Covered-call writers will end up being forced to sell positions during strong market months. That money has to be put back to work. Additionally, figuring out the best covered-call opportunities can be time consuming.

Even though there are some issues with covered-call strategies, it's still a very effective way to generate income. Dividend investors, take notice.

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1. Editor's Choice

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1. TSX:NA (National Bank of Canada)

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Date

2025/09/11

Date Created

2016/05/18
Author
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