Income Investors: Get a 14.8% Yield From Inter Pipeline Ltd.

Description

Many investors avoid the option market all together.

It's a complicated place where only speculators hang out. And besides, aren't options just a form of derivatives, and didn't derivatives help cause the financial meltdown of 2008-09?

These investors have a point. Some of the strategies employed by options traders would make the average long-term buy-and-hold investor sick to their stomach. Overall, a gambling mentality does dominate the options market.

But many long-term investors are doing themselves a disservice by completely ignoring the options market. I'm not saying these folks should become speculators like their peers. Rather, they should use the speculation of the options market for their own personal gain.

Here's how.

Covered calls

Let's look at one of Canada's top pipeline stocks, **Inter Pipeline Ltd.** (TSX:IPL), as an example.

There are plenty of reasons to like Inter Pipeline as a long-term hold. Shares are down more than 30% compared to highs set in 2014. Because it focuses largely on the oil sands, its volumes aren't down as much as some of its peers. This also means the company only has to negotiate with one government to get a new project approved.

The very interesting thing about Inter Pipeline is the available capacity on its main three oil sands pipelines. The company built these projects with the future in mind. They're currently operating at about half capacity, meaning just about any additional oil that sloshes through its Polaris, Corridor, and Cold Lake pipelines goes almost directly to the bottom line.

In the world of options, investors use calls to make bullish bets on stocks, and puts to make bearish bets on stocks. Calls give an investor the right to buy a certain stock at a certain price on a specific date. Puts give an investor the right to sell.

What dividend investors can do is take the opposite side of a call bet to really goose their income.

Here's how it works.

An investor in Inter Pipeline can sell a $28 per share June 17th call option for $0.20 per share. The investor gets the $0.20 per share immediately in exchange for creating an obligation to sell their shares for $28 per share on June 17. You essentially create your own dividend.

Currently, Inter Pipeline shares trade hands for $26.83. If they rally and close above $28, the investor would be forced to sell. If not, the options would expire worthless and the investor would keep the $0.20 per share without consequence.

Even if an investor is forced to sell their shares at $28 each, they've still made a profit of approximately $1.40 per share, including the option premium. That's not bad for holding for less than a month.

Ideally, investors are hoping Inter Pipeline shares trade in a tight range. If that happens, an investor can use this strategy every month of the year to generate some pretty serious income. Annualized, writing covered calls on Inter Pipeline could generate an annual income of 9% alone.

And remember, Inter Pipeline also pays investors a great $0.13 per share monthly dividend. Add that onto the covered-call income, and the total yield hits 14.8%.

That's the kind of yield that can make a huge difference in a portfolio. An investment of just $10,000 would spin off an annual income of $1,480. In a world where a $10,000 GIC would give between $100 and $200 per year, it's easy to see how impressive this strategy can be.

Covered calls aren't perfect. A covered-call portfolio requires some monitoring, and there's always the risk a stock could move up, forcing a sale. There are also tax considerations to consider. Still, investors shouldn't ignore the potential income from such a strategy.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Date
2025/09/11
Date Created
2016/05/30
Author
nelsonpsmith