Extreme Income Alert: Get 18.5% Annually From Suncor Energy Inc.

Description

Seemingly dependable dividends from oil companies vanished in 2014 and 2015, as producers made the easy choice to prioritize their overall financial health over payments to shareholders.

This hit investors hard and most reacted in one of two ways. Some swore off the sector forever, content to get their yield from industries not dependent on commodity pricing. Others moved from riskier names into stalwarts of the industry–either into pipeline stocks or producers such as **Suncor Energy Inc.** (TSX:SU)(NYSE:SU).

It's easy to see why these investors invested in Suncor. It has dependable production from the oil sands, which will continue for decades. It also has significant downstream operations, including a liquids business, several refineries, and its fleet of Petro-Canada gas stations numbering more than 1,500.

Because of these downstream operations, Suncor shares have performed much better than most of its smaller peers. Management has used this suddenly valuable stock as currency to make acquisitions, most notably buying Canadian Oil Sands and its stake in the Syncrude oil sands project.

And with a yield that currently stands at 3.3%, Suncor is a decent dividend stock as well.

A 3.3% yield is nice, but ambitious investors can do much better. Here's how to really supercharge your yield from Suncor.

Using options

Many investors think the options market is a strange and confusing place.

It certainly can be. There are all sorts of exotic-sounding strategies like straddles, iron condors, or naked strangles–terms I'm told actually exist. There are thick books out there that outline all of these complex strategies.

Instead, let's focus on something much more basic. Call options give investors the right to buy a certain stock on a certain day for a certain price. Selling a call–i.e., going short–means investors take on that obligation in exchange for receiving a cash payment up front.

It's easier to understand if we use an example. The August 19th $36 call option for Suncor last traded at $0.44 per share. So somebody going long on this option would pay $0.44 per share for the right to buy at $36 on August 19th.

The person going short on this option creates the obligation to sell at $36 in exchange for $0.44 today.

Where this trade makes much more sense is if the person going short on this option owns Suncor shares. If this investor buys today at $34.94 and then collects a $0.44 per share premium in exchange for taking on a sale obligation, it's a bet without a terrible outcome no matter what happens.

This is called writing a covered call.

If Suncor shares stay below $36, our buyer gets to keep the option premium as well as their Suncor shares. As long as Suncor shares don't tank, this is a very acceptable outcome.

And if Suncor shares go up above $36 each, our buyer has locked in a profit of $1.50 per share, consisting of a $1.06 per share capital gain and a $0.44 option premium. Not bad for an investment lasting about three weeks.

Generating real income

Where this strategy can really pay off is if Suncor sticks in a trading range.

Say Suncor shares stay between $32 and $35 each and an investor continues to sell calls against this position, generating $0.44 per share each month. That's a yearly income of $5.28 per share, which is the kind of income you just can't get anymore.

It gets better. Remember, Suncor pays a dividend of $1.16 per share annually. Add the two sources of income together and you get a yield of 18.5%.

Perhaps the chance of doing this trade is unlikely over the course of a year. That's a valid argument. Suncor shares do move around a fair bit. But even if an investor can only pull off this trade over a few months, it still generates some substantial income on an annualized basis.

Covered calls are a valuable income source for many investors. Retirees and other folks who depend on income should at least check the strategy out.

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