Dividends on Steroids: How to Get a 14.9% Yield From Bank of Nova Scotia

Description

I think everyone would like a little more yield. After all, who doesn't want more of a good thing?

Getting additional yield the old-fashioned way is challenging. A general rule of thumb today is anything paying a dividend of more than 5% is risky. Sure, we can all point at situations where that isn't true, but the underlying fact remains that higher dividends are riskier than lower ones.

There's a way investors can have their cake and eat it too using a special technique to really supercharge their dividend income. Yields of 8% … 10% … or even higher are quite possible using this one simple trick–a strategy Bay Street veterans have used for years successfully.

Let's take a closer look at this strategy, using **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) as an example.

Why Bank of Nova Scotia?

There's one big reason to like Bank of Nova Scotia over its Canadian peers, and that's its international portfolio. While the rest of Canada's "Big Five" banks have expanded in the United States, Bank of Nova Scotia has acquired assets in Mexico, Colombia, Peru, Chile, and other Latin American countries. It also has a small but steadily growing presence in Asia.

Since 2010 much of the company's growth has come from these developing markets. Revenue from the region has grown from $2.9 billion to $5.8 billion in 2015, which is good enough for an annual growth rate of 15%. That compares to just 6% revenue growth in its core Canadian operations.

Earnings from the international division have grown almost as much, increasing from $1.08 billion in 2011 to $1.85 billion in 2015. International banking earnings make up 27% of total profits with the company's global banking and markets division accounting for 23%. Earnings from Canadian operations still make up the majority of the bottom line.

Bank of Nova Scotia is well poised to continue growing its business in the region. Organic growth should still continue as folks get richer and need more banking services. And there are dozens of small-or medium-sized banks in the region it could acquire.

Get a 14.9% yield

Bank of Nova Scotia pays a 4.3% dividend yield today, which certainly isn't bad, especially when combined with the bank's history of dividend growth. But there is a way investors can substantially increase that income.

The strategy is called writing covered calls, and it isn't nearly as complicated as you might think.

Here's how it works.

By going into the option market and selling a call option, a Bank of Nova Scotia shareholder gets paid a premium in exchange for taking on a sale obligation.

It's easier to explain if I use a real-life example. Bank of Nova Scotia shares currently trade at $66.80. If I were to sell a $68 September 16, 2016, call option, I'd be taking on a commitment to sell shares at $68 in exchange for receiving a premium of $0.59 per share. In other words, I'm exchanging some of my upside potential for income today.

There are two possible outcomes to this trade. If shares trade under $68 each come mid-September, nothing happens. I've pocketed my premium. But if shares trade higher than $68, I'd be forced to sell my shares at that level even if they trade much higher.

But that's not the worst result in the world because I'd be locking in a profit of approximately 2.5%. That's not bad for a month.

As long as the share price cooperates, investors can do this trade over and over again since Bank of Nova Scotia has monthly options. Annualized, this works out to a 14.9% return. On a $10,000 investment, this is almost $1,500 annually.

Who couldn't use more income?

Using covered calls is an easy way for investors to generate additional income. Sure, it requires a little more management than buying and holding forever, but it can make a huge difference to a retiree looking for a little extra freedom.

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