Income Investors: Get a 26.4% Yield From Teck Resources Ltd. Yes, Really

Description

We currently live in a world where GICs, government bonds, and other fixed-income vehicles yield less than 3%. Dividends offer a little better payout, but as the rule of thumb states, anything with a payout of more than 5% annually is considered risky.

For many retirees and other income seekers, this isn't a big deal. When you've got $1 million in investments, a paid-off house, and both you and a spouse receiving CPP benefits, a 3% yield is just fine. It's not a big deal to take a little capital every now and again when you're sitting on seven figures.

Other retirees aren't so lucky. They have to resort to more innovative ways to generate income. These include buying riskier dividend stocks or debt, acquiring real estate, and so on.

There's one option many income investors don't even consider, most likely because the strategy seems complicated. It really isn't. Here's how investors can use stocks like **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) to generate eye-popping dividends of 10% … 15% … even 26.4%.

Yes, really.

Writing covered calls

The option market has traditionally been the stomping grounds of sophisticated investors, hedge fund managers, and hardcore speculators. But there's a place for regular income investors, too.

Here's how it works. Normally, investors use call options to make a levered bet on a security going up in value.

The $38 December 16th call options for Teck Resources currently trade hands at $0.76. That means investors are paying $0.76 per share for the right to buy Teck shares at $38 on December 16.

One of two outcomes can occur. If Teck shares rise above $38.76, the investor gets to keep the profit. And since she only paid $0.76 per share for that contract, the profits will be succulent as a return on investment.

The other outcome is that shares either stagnate or go down, which means the investor is left with a worthless option come December 16.

Covered calls work a little different. Instead of buying the call option, an existing Teck shareholder would sell the option, pocketing the premium. If shares did rise above the $38 threshold, the shareholder would be forced to sell, but at a nice profit. If shares stagnate, the investor keeps the premium and their shares.

Why Teck Resources?

There are dozens of companies on the Toronto Stock Exchange with monthly options. What makes Teck Resources so special?

The reason is the company’s volatile share price, which leads to huge option premiums.

Teck shares have surged in 2016, rising from a low of under $4 each back in January all the way up to $35, where they trade today. That’s a move that will be talked about for years.

Each month an investor writes a covered call on Teck shares, they have the potential to earn 2.17% if the investment goes their way. If it doesn’t and Teck rises to $38 per share, the investor would make a profit of $3.76 per share–good enough for a 10.7% return in a little over a month.

Say Teck stays in a tight trading range for a year. Investors who write 12 monthly covered-call options have the potential to earn 26.04% annually. Add on Teck’s paltry 0.4% yield, and we get a total return of 26.4%.

Good luck finding an income investment that pays anything close to that high.

Yes, there are risks. Teck shares could shoot 20% higher, which would minimize the total gain. Or the company could tank, putting shares 20% lower. But that’s a risk every equity investor has to take. And at least the covered-call writer would make up some of those losses in option premiums.

The bottom line

There are some huge potential profits available for investors who write covered calls on their Teck Resources shares. Most covered-call investments will potentially generate 10-15% per year in extra income. Teck investors could earn 26% extra. It doesn’t get much better than that.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
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