How to Buy Telus Corporation 14% Cheaper With Options

Description

If you're anything like me, new all-time highs in the stock market make you nervous.

It really shouldn't be a big deal. If we look back over the last 20 years, stocks have spent much of their time at all-time highs. It's the nature of markets. And when stocks are down, it's usually for a very good reason.

But we investors can protect ourselves if we insist on waiting for a more favourable market. Sitting on cash might not look very prudent when stocks are rising, but it's a smart move to do so right before stocks tank.

There's a third option. What if investors can collect income for waiting for their favourite stocks to fall? They can use a strategy that's not that difficult to pull off.

Get paid to wait

Normally when we talk about getting paid to wait, dividends are the focus. This is something completely different.

Let's use **Telus Corporation** (TSX:T)(NYSE:TU) as an example. There are plenty of reasons to be bullish about Telus. It's a recession-proof business, generating plenty of consistent income. It continues to take market share away from rivals in the wireless space. And management has been generously giving back to shareholders for years now, both in the form of dividends and share buybacks.

There's just one problem. Telus shares are a little expensive. They currently trade hands at $42.10 each–close to a 52-week high.

Say an investor likes Telus, but would rather pay $36 per share rather than $42.10. What can this investor do?

The conventional theory is that this person is forced to patiently wait until the stock falls to that level. So they sit there, usually with a healthy amount of cash on hand, just twiddling their thumbs.

There's a way for an investor to make money on this commitment by using the option market.

The strategy works something like this.

Someone looking to buy Telus at $36 per share would sell a put option, which creates a buy obligation in exchange for pocketing a premium today.

Let's look at a real-life example. The May 19, 2017 Telus $36 put options last traded hands at $0.58. That means an investor who sells that put would pocket $0.58 per share in exchange for promising to buy shares at $36 on May 19.

Two possible outcomes can occur. If Telus is above $36 on May 19, the option expires worthless. Our imaginary investor would be slightly richer after collecting the option premium.

The other outcome is that Telus shares fall below $34 each. They'd be forced to buy Telus shares at $34, which would create a loss if the company traded below $33.42.

The risks

There are two important things to remember for any investor looking to execute this kind of strategy.

The first is to make sure you've got plenty of liquidity to actually buy Telus when the time comes. Selling a put comes with an obligation to buy the shares. There's no getting around it except for selling the obligation to another investor before the strike date.

Secondly, remember that it's likely the only reason why Telus shares would fall 14% is because of a pretty big piece of bad news. It takes a certain amount of fortitude to buy when things are looking rough.

The bottom line

Selling puts is a viable strategy for investors looking to create a little income while waiting for a stock they like to fall. Such a move today using Telus shares would create a yield of 2.8% or so, which is a little better than short-term fixed-income products.

But at the same time, investors need to realize there are downsides to such a deal as well. It creates an obligation that may look significantly less attractive once the time comes, and, at least with Telus, investors aren't paid a whole lot to take that risk.

CATEGORY

1. Dividend Stocks
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