Income Investors: How to Get a 13.7% Yield From Royal Bank of Canada

Description

Many retirees who are frustrated by low yields and the high valuations of many of their favourite dividend stocks don't know where to turn.

Low interest rates mean a small- or medium-sized nest egg just won't go as far as it used to. One could switch their portfolio to include some high-yield stocks, but we've all been warned about the danger of chasing yield. It's hard to sleep at night when you're worrying about risky stocks that could slash their dividends.

Fortunately, there's a solution. Big yields are out there. Here's a little-known strategy that can consistently produce yields of 8%, 10%, even 13.7%.

Yes, it is possible. Here's how.

Supercharge your income

Many investors refuse to touch options, afraid these opaque securities will somehow cause them to lose all of their money.

There are many option strategies that are way too complicated for me. There's no doubt about that. But there are also outrageously simple ways for regular investors to use options to their advantage. One of the easiest techniques is something called covered calls.

Here's how it works.

A call option gives somebody the right to buy a stock at a certain price on a certain day. Depending on the conditions, this option can either be worth a lot of money or be completely worthless.

Aggressive investors use call options to make big bets on stocks while only risking a small percentage of their portfolio. If the bet works out, the value of the option skyrockets in value.

Covered-call investors are taking the opposite side of that bet. They're pocketing the premium in exchange for creating a sell commitment for shares they already own.

It’s better explained using a real-life example. **Royal Bank of Canada** (TSX:RY)(NYSE:RY) shares currently trade hands at $93.46 each. The February 20th $94 call option last traded hands at $0.79 per share.

A Royal Bank shareholder would sell this particular call option, which means they get to keep the option premium. In exchange, this shareholder has created an obligation to sell their shares at $94 on February 20.

Two things can happen. If Royal Bank shares fall from today’s level, the investor gets to keep the premium and the shares. But if shares rise above $94, the investor has to sell. This isn’t the end of the world, however, because a small profit has already been locked in.

The only downside of the strategy is this investor misses out on additional upside.

Crazy income potential

Covered-call writing works best in sideways or falling markets. After a 15% move since the U.S. election, it looks like financials could take a step back, creating the perfect environment for such a strategy.

Over the course of a year, this strategy can generate huge amounts of income. An investor can collect $0.79 per share 12 times per year for a total of $9.48 per share.

As a shareholder, this investor would also collect $3.32 per share in regular quarterly dividends.

Put the two together, and investors are looking at a 13.7% annualized yield. That’s the equivalent of generating $1,280 per year in income for every 100 Royal Bank shares. Good luck finding that kind of income potential anywhere else.

Or, to put it another way, doing this strategy for just a month or two generates the same kind of income as a GIC or government bond — for a whole year!

The bottom line

Getting huge income doesn’t have to be complicated. All an investor needs to do is embrace a deceptively simple covered-call strategy. With yields of over 13% available, this is an opportunity many can’t afford to ignore.

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