Take Action: 1 Easy Strategy to Generate Yield From Non-Dividend Stocks

Description

Feeling fearful about holding on to high growth, high valuation stocks when the market is heading down? Or are you interested in generating yield from these stocks instead of simply watching the stock price fluctuate? By using a covered call strategy on your shares, you can earn a little income while you wait.

Choose your shares carefully

There are a few ways to mitigate the downside on the stock. The most important is to choose a stock that you want to hold for the long run. Although the covered call might force you to sell, you should feel comfortable enough with the stock to hold it over an extended period of time. This way, you won't be tempted to panic close out your position should a stock fall. In fact, you may decide to add more shares as the price decreases.

Companies that you have been waiting for, especially non-dividend payers like **Spin Master Corp.** (TSX:TOY), are great examples of potentially covered calls. Spin Master has come down around 20% in price since its highs in the summer. This has had the effect of reducing its price to earnings ratio to a trailing P/E of around 19 times trailing earnings.

This essentially debt-free, growing company has the potential for long-term growth. In the third quarter of 2018, Spin Master increased its revenue by 2.3%. Its free cash flow was also positive, up 3% over the same time period. These numbers signify a healthy company ready for a long-term investor to enter a position.

Overload your position

What I mean by this is that you want to own more shares than those upon which you write covered calls. Since you will be forced to sell once the shares exceed the strike price (a situation which may occur frequently if you pick excellent stocks), you will most likely want to own some shares that you will continue to hold no matter what.

If everything works out well, you should make some capital gains on both the covered call premiums and the stocks that are sold. These capital gains may eventually pay for the stock you intend to hold for the long haul.

Be patient before writing covered calls

In my personal opinion, the best time to write your first covered call on a portion of your position immediately. As a general rule, write one call option on 100 shares, or one-third of your position. This will allow you to capture premium right away in case the share price continues to fall. In the case of Spin Master, if you buy the shares around $40 sell your first covered call at the next strike price above, say $42.

If the shares continue to fall, build your position by buying more shares at lower prices. If the shares rise, then hold onto the remaining shares or write more covered calls on your remaining position. If the shares stay at the same level, write another call at the same strike.

So what's the catch?

The biggest downside to a covered call strategy is the fact that the shares will be called away from you if the stock price starts to move upwards, which will cause you to lose your shares and pay capital gains tax on the earned proceeds.

Don't rush

Market downturns don't happen every day, and stocks don't always go up overnight. Build your positions on stocks like Spin Master as they fall over time. Make sure you identify how many shares you want to continue to hold for the long term.

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