Retirees: How to Use Options to Supercharge Your Passive Income

Description

In the investing world, options can be an intimidating word for beginners.

Some options-trading strategies can be pretty darn complicated, and you'd have to do a considerable amount of reading (and a tonne of practice trading) to get the most out of some of the more sophisticated options trading techniques out there.

Moreover, you've probably heard that trading options can be risky and is suitable only for seasoned traders who are confident enough to know where the markets are headed next.

Timing the markets over the short-term is a foolish (that's a lower-case "f") endeavour, and given the many options traders tout quick riches through short-term-focused all-or-nothing type options bets, it's not a mystery as to why conservative investors like retirees have shied away from the entire field of derivatives.

Like it or not, options aren't just a means for seasoned traders to make quick riches. Rather, they're terrific hedges for those who know how to use them wisely. Although some may think all options are risky, I'd argue that in conjunction with a diversified portfolio of stocks that certain options can reduce one's risk or tilt the risk/reward trade-off further in their favour.

For retirees, there are options-writing strategies that can boost one's passive income without adding additional downside risk. A reward for no further risk? It sounds like an opportunity to get a free lunch!

Sadly, there are no free lunches on Bay or Wall Street. There are ETFs incorporating such options-writing strategies like the **BMO Covered Call Canadian Banks ETF** (TSX:ZWB), which can offer larger yields relative to the yield of the ETF's aggregated consistent dividends. As I mentioned, such incorporation of the options-writing strategy doesn't introduce further downside risk.

What I didn't mention, however, is the fact that the covered call options transaction trades off upside potential for the premium income that's added to the dividends paid by the ZWC's constituents. Such a strategy introduces upside risk and could result in poorer returns relative to the ZWC's non-covered-call counterpart.

In a static or down market, however, the ZWC is the superior performer relative to any other garden-variety Canadian bank ETF.

Given that retirees ought to value income and safety above capital appreciation potential, I'd say the covered call strategy is more than worth the price of admission into the ETF, which is already quite low with a 0.71% MER.

Given the strong headwinds that have hit the Canadian banks (rise in provisions and restructuring expenses, with weaker capital markets activity), further pressures that could weigh on net interest margins (NIMs), and a lack of encouraging intermediate-term catalysts, the Canadian banks may be stuck in a rut for longer than most expect.

As such, the ZWB, which currently yields 5.5%, looks to be a better bet as the credit cycle looks to normalize.

Foolish takeaway

Options don't need to be confusing, however. With covered call ETFs like the ZWB, you have a safe way to spread your bets across Canadian bank stocks while getting a higher yield in the process.

CATEGORY

1. Bank Stocks
2. Dividend Stocks

TICKERS GLOBAL

1. TSX:ZWB (BMO Covered Call Canadian Banks ETF)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
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