Forget Dividend Stocks: This Bitcoin ETF Has Yields of Over 13%

Description

Like many other risky asset classes, **Bitcoin** (CRYPTO:BTC) had a rough start to 2022. Currently, the largest cryptocurrency by market cap trades around the US$38,000 range, a stark fall from its 52-week high of US$68,789.

However, If you can stomach the volatility, the current low price could be an excellent buying opportunity. Bitcoin's massive fluctuations tend to benefit swing traders, who can make a quick buck. However, a new ETF allows you to reap a fat yield from the high volatility by selling covered calls.

How does it work?

Purpose Bitcoin Yield ETF (TSX:BTCY.B) is a covered call ETF. This is an options strategy where the seller of the call option (the ETF manager) owns an equal amount of the underlying Bitcoin.

The ETF holds a long position on the underlying Bitcoin, and sells the right for someone else to buy it at a higher price (the strike), good until a certain date (expiry). For that, the ETF earns a cash premium.

Generally, the higher the volatility of the underlying asset, the more the premium will be. In this case, Bitcoin is highly volatile, allowing BTCY to earn a large premium from writing calls. This is then paid out monthly as the ETF's yield.

BTCY can be held in a TFSA/RRSP, while Bitcoin cannot. It does also cost a management expense ratio (MER) of 1.10%. The annual distribution yield of 13.70% is very high and even outclasses preferred shares.

However, the yield is subject to fluctuation. Generally, the more volatile and upward moving the Bitcoin share price is, the higher the yield will be. During periods of low volatility, such as following a crash, the yield might drop.

What are the risks?

Covered call ETFs like BTCY have the same downsides as holding the actual asset. In this case, if Bitcoin tanks, the value of BTCY will as well. However, BTCY will only participate in some of the upside of Bitcoin.

If the price of Bitcoin sharply shoots up, BTCY will underperform. If the price of Bitcoin is higher than the strike price of the call sold, the buyer of the call will “exercise” the option to buy BTCY at the lower strike price.

This means that the ETF will have to sell BTCY at the strike price, despite being able to get a better price in the market. This causes BTCY to miss out on gains, and thus limits your return on a good day.

Overall, the risk-return relationship is not favourable. You’ll fully feel the effects of any crashes, while missing out on the full extent of gains from a extended bull market.

Who is this ETF right for?

I generally avoid covered call ETFs because their downside risk is unlimited (the underlying could go to $0), while their upside is capped at the strike price. This makes them underpeform in a bull market.

There is no free lunch with ETFs like BTCY – you’re simply selling future gains for an immediate premium. Over the long term, normal Bitcoin will outperform substantially, especially with the momentum and volatility we’ve seen before.

BTCY is better suited to income-oriented investors who are seeking a high yield for some reason. This niche will likely be FIRE (financial independance, retire early) folks who want to live off distributions versus selling shares.

The other use case is if the crypto market trades sideways for an extended period. With the recent crypto bear market and some time to go before the next Bitcoin halving, BTCY could produce some decent gains.

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