
BMO Covered Call ETFs: Which One Is Best for Passive Income Investors?

### Description

I previously wrote an article about how **BMO Global Asset Management's** lineup of covered call exchange-traded funds (ETFs) might not be suitable for beginner retail investors. For a more nuanced explanation, consider giving it a read.



To sum it up, I noted that they had high management expense ratios (MERs), failed to outperform their vanilla index counterparts in both bull and bear markets, offered little protection in a crash, and had an overall poor risk-return profile.

There were two exceptions though, and for some investors they can be an excellent holding depending on your investment objectives or strategy.

## The (very specific) use case for covered call ETFs

First, I noted that buying a covered call ETF could be a good play if you expected the market to trade sideways. In this case, the premiums collected would help you beat an index fund. However, predicting and timing market movements is very difficult, so this point is moot for most investors.

Second, I noted that buying a covered call ETF could be a good investment for income-oriented investors who also have a high risk tolerance and long time horizon. This excludes retirees, as covered call ETFs do a poor job of protecting your investment's principal.

However, this does apply to financially independent, retire early (FIRE) folks. If you happen to be relatively young and retired with a decently sized portfolio ($1,000,000+), then covered call ETFs might be a good option for your monthly income needs.

With yields of 5% and up, buying a covered call ETF with a portfolio of that size can easily provide you with a healthy income stream totaling $50,000+ annually, all without having to sell shares.

## The best covered call ETFs for the role

If this sounds like you, the next step would be to find the ideal covered call ETF that suits this purpose. Your criteria should be:

1. Low MER: every percent you pay in fees comes directly out of your investment
2. Broad diversification: you don't want to take on uncompensated sector-specific risk
3. High yield: maximizing your monthly income is the goal after all

Our candidates from BMO therefore boil down to three ETFs:

1. **BMO Covered Call Canadian Banks ETF** (TSX:ZWB): This ETF holds six Canadian bank stocks with a covered call overlay. The MER is 0.72% and the distribution yield is 6.05%.
2. **BMO Covered Call Utilities ETF** (TSX:ZWU): This ETF holds 23 Canadian and U.S. utility stocks with a covered call overlay. The MER is 0.71% and the distribution yield is 7.17%.
3. **BMO Canadian High Dividend Covered Call ETF** (TSX:ZWC): This ETF holds 35 Canadian dividend stocks from the financials, energy, telecom, utilities, and industrial sectors with a covered call overlay. The MER is 0.72% and the distribution yield is 6.01%.



It is worth nothing that all three BMO ETFs write (sell) covered calls on just 50% of the holdings, all at out-of-the-money (OTM) strike prices. What this means is that you get the most optimal blend of capital gains and yield, which is preferable if these will be a long-term holding in your portfolio.

## The Foolish takeaway

ZWB is way too concentrated in just six Canadian bank stocks. As solid as they are, taking on sector-specific risk is something long-term investors should avoid. I would also avoid ZWU despite the higher yield, as utilities are sensitive to rising interest rates and often have high debt loads.

ZWC strikes a good middle ground. With total of 35 quality Canadian dividend stocks from a variety of sectors, ZWC offers better diversification. It also has a similar MER and yield as the other two options. If you're looking for high monthly income, ZWC is the best option here.

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**TICKERS GLOBAL**

1. TSX:ZWB (BMO Covered Call Canadian Banks ETF)
2. TSX:ZWC (Bmo Canadian High Dividend Covered Call ETF)
3. TSX:ZWU (Bmo Covered Call Utilities ETF)

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