The Ultimate Guide to WRITING COVERED CALLS

SniderAdvisors

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The Ultimate Guide to Writing Covered Calls

Covered calls have become one of the most popular option strategies. Income investors can sell covered calls on a regular basis to collect premiums, while others can sell covered calls to exit an existing stock position or achieve limited downside protection. The only drawbacks are that you can still lose money if the stock price declines and you must sell the stock at the agreed upon price even if the price rises much higher.

While simpler than most option strategies, writing covered calls still requires a basic understanding of options and how they work. You must also select the right stocks, choose the right strike price and expiration date, and carefully manage option positions. The good news is that many brokers and advisors offer tools that simplify these processes—the key is knowing how to use them properly and developing an effective system.

In this guide, we will take you through everything you need to know to get started writing your own covered calls, as well as show you where you can go to learn more.

Getting Setup for Covered Calls

Many investors that are interested in covered calls don't have much experience trading options. For example, you may be a retiree looking for a way to generate extra cash flow from your portfolio or an individual investor that's looking to get their feet wet trading options without all the risk. Covered calls are great tools for these purposes, but it's important to ensure that you understand them before placing a trade.

Before diving into covered calls, it helps to understand how options work on a broader level. An option provides the buyer with the right, but not obligation, to buy or sell an underlying stock at a certain price before an agreed upon time. Call options provide buyers with the right to buy a stock, while put options provide the buyer with the right to sell a stock. Option buyers pay option sellers a premium in exchange for these rights.

There are many different stock option strategies with varying levels of risk. For example, a naked call is one of the riskiest strategies whereby an investor sells a call option without owning the underlying stock. The strategy is risky because a stock can theoretically rise to unlimited heights, which translates to an unlimited potential loss on the trade. Covered calls are much safer since the option seller owns the underlying stock and has a limited downside.

There's also a big difference in how options are traded compared to stocks. You will need to sign a special agreement with your broker saying that you understand the extra risks, and option trades will be subject to a different fee schedule than stocks. The good news is that you often have access to an entirely new set of tools and research, such as option screeners, outcome calculators and, in some cases, proprietary research.

There are five key characteristics to look for when selecting an options broker:

- Low Fees & Minimums
- Specialization in Options
- Great Customer Service
- Reputation & Stability
- Trade Execution Quality

We recommend Ally Invest for our clients due to their low cost, great options trading platform, and excellent customer service. While it's one of the newer companies in the space, the broker offers steep discounts for active traders as well as 24/7 customer service for all clients. You may also consider using your existing broker to keep everything under one roof, but it's important to ensure that they have competitive option trading tools and commissions.

See the How to Select a Broker for Covered Calls chapter for more information on how to select the best options broker to get started on the right foot.

How to Screen for Opportunities

Covered calls are slightly more complicated than stocks when it comes to screening for opportunities. Rather than just predicting long-term price direction, you're predicting both the direction of the price and how volatile the price will be over a specific period of time. The goal is to generate an income from the premium payments rather than a profit on the underlying stock—which is very different from your goals when long-term investing.

There are a few steps involved in finding covered call opportunities:

1. **Choose a Stock:** Most investors prefer to buy stock in companies that they're comfortable owning over the long-term. That is, they should have strong fundamentals and predictable volatility. The entire stock portfolio should also be diversified to minimize risk and maximize income.

2. **Chose the Expiration:** Most covered call investors use rolling monthly options because of their liquidity and rate of return per unit of time. While Weeklies® provide greater income potential, monthly options are a good balance between risk, return and time commitments when it comes to setting up trades.

3. **Choose the Strike Price:** Most covered call investors use slightly out-of-the money strike prices to minimize the risk of an option being called away while maximizing the premium income. However, it's equally important to consider the volatility of the underlying stock when choosing the right strike price.

In addition to these three steps, you should also consider factors like earnings and dividends. Earnings dates can significantly increase volatility (and option premiums) while dividends can influence decisions to unexpectedly call away an option. There may also be sector-specific events to consider, such as new regulations or regulatory approvals, that can significantly influence the volatility and risks associated with a stock.

See How to Find Covered Call Opportunities for an in-depth look at each of these criteria, as well as How to Choose the Right Covered Call Expirations for a comparison of weeklies and monthlies. You can also use our free covered call screener to find opportunities sorted by potential return and other factors.

Managing Covered Call Positions

Writing covered calls is an active trading strategy that requires regular follow-up. In addition to setting up new positions every month, you may be faced with important decisions mid-month, such as whether to buy back or deliver stock if an option is called by the option buyer. In order to make the optimal decision, it's important to understand all the options available to you as well as the pros and cons of each option.

Suppose that you have a covered call position that's at risk of being called away because the stock price is rapidly moving towards the strike price or there is an upcoming dividend. In this case, you have several ways that you could react, and each has its own pros and cons to carefully consider.

The three primary choices that you have include:

- You could take no action and let the stock be called away. The benefit of this strategy is that you receive cash from the stock sale and don't incur any other costs, but the downside is that you may be taxed on the capital gains income.

- You could close out or unwind the position by buying back the covered call and either keeping or selling the stock. The benefit of this strategy is that you don't necessarily have to sell the stock, but the downside is that you will lose money on the option trade.

- You could rollout the position by buying back the covered call and selling a new call at a later date, higher strike price, or both. The benefit of this approach is that you don't have to sell the stock and you can minimize your losses on the option trade, but the downside is that you're committed to a new option position right away.

The right choice depends on whether you would like to keep the underlying stock and/or if you want to realize any taxable gains or losses for the year on the underlying stock. It's important to have a strategy in place to answer these questions beforehand in order to avoid making costly mistakes in the heat of the moment.

Developing a Well-Defined Strategy

The best way to cope with the complexities of covered calls is to use a well-defined strategy. The Snider Investment Method is designed to make it easier than ever to identify the right underlying stocks, select the right strike price and expiration, and react to any changes to the position over time. This lets you confidently make trades with less stress and potentially generate a much more stable income over time.

In addition to these basic capabilities, the Snider Investment Method shows you how to screen stocks based on volatility and risk, as well as ensure the right level of asset allocation for the portfolio. These factors go beyond covered call option returns and consider the overall health of your investment portfolio. That way, you won't be caught off-guard if a specific sector experiences a decline or the entire market moves lower.

Finally, the system will show you how to ladder your portfolio to generate consistent cash flow over time. Many retirement investors require cash flow to meet their daily needs, which means that ladders can be invaluable in making covered call strategies successful and practical. These techniques can make covered call strategies much more like bond ladders in their ability to create a consistent income that can be withdrawn or reinvested.

Sign up for our free course to learn more about The Snider Method and how to effectively trade covered calls.

The Bottom Line

Covered calls are a great way to generate an extra income from long stock positions. By following the steps that we've covered in this guide, you can increase your chances of using covered calls successfully to generate cash flow from your portfolio. It's important to understand the ins and outs of covered calls before placing trades in order to avoid costly mistakes and maximize your premium income over time.

If you're interested in a more hands-off approach, Snider Advisors also offers a managed portfolio option for a fixed fee. You don't have to worry about any active management, but you can still realize the potential benefits of covered calls over bonds, dividend stocks, and other forms of income investing. Contact us today to learn more about the strategies that we use and how we can manage your accounts on your behalf.

How to Find Covered Call Opportunities

Covered calls have become one of the most widely used option strategies for generating income. While simpler than most option strategies, finding the right covered call opportunities can be challenging—especially when you're trying to build a holistic portfolio with minimal risk.

In this article, we will look at how to choose the right stocks and calculate the potential returns for covered calls, as well as look at various tools that can speed up and improve the process.

What Stocks Should You Choose?

Most investors focus on large-cap, blue-chip, dividend-paying stocks that have predictable volatility when writing covered calls. In general, you should be comfortable owning the underlying stock for a long period of time—even if the stock price declines during the covered call time period.

Check out our FREE Covered Call Screener! Use it to scan the market to find covered call combinations to boost income in your portfolio.

We screen for stocks using a few different criteria in the Snider Investment Method:

SIM Score: Our proprietary SIM Score measures price volatility over a multi-year period to filter out the most volatile stocks from our list of covered call candidates.

RapidRatings: RapidRatings is an objective methodology for quantifying bankruptcy and/or solvency risk based on various inputs from financial statements.

Diversification: We apply asset allocation rules to limit exposure to any specific sector, industry, and individual company. That way, the entire portfolio doesn't suffer from any single decline.

In addition, you should consider any factors that could influence a stock's price over short periods of time. The most common cause of short-term volatility is an earnings report, but you should also watch for industry events, analyst meetings, regulatory risks and other factors.

Take our free Stock Selection 101 educational course to learn the fundamentals of proper stock selection techniques.

What Options Should You Choose?

The next step is choosing the call options that you'd like to write against a given underlying stock. In short, most investors choose monthly call options that are slightly out-of-the-money, but you may choose other options based on your individual investment objectives and risk tolerance.

The two key factors to consider are:

1. Expiration Month: An option's value decays faster in the final 30 days of its life, which means that most investors stick to monthly call options rather than longer-term options. It's also important to consider months that the underlying stock has earnings reports or other unpredictable events that could have an impact on the price.

2. Strike Price: You should consider in-the-money options when you think the stock price will decline, at-the-money options when you think the price will remain even, or out-of-the-money options if you think the price will appreciate. Often, conservative investors use in-the-money options because of their greater downside protection.

Calculating Potential Returns

The final step is calculating the profit potential for options you're considering to select the best opportunity.

Most investors calculate both *flat* and *if called* returns for their covered call positions. These returns are the same when the covered call is in-the-money or at-the-money, but out-of-the-money if called returns are higher by the amount that the call option is out-of-the-money.

Let's look at how to calculate each of these returns, as well as annualize the returns to make fair comparisons.

Flat Return

The flat return assumes that the stock price remains the same through expiration. You can calculate the flat return in three steps:

1. Determine the time value. Time Value = Premium – Intrinsic Value
2. Determine the net debit. Net Debit = Stock Price – Call Premium
3. Determine flat return. Flat Return = Time Value Premium / Net Debit

If Called Return

The if called return assumes that the option is exercised, even if it's out-of-the-money. You can calculate the if called return in three steps:

1. Determine the time value. Time Value = Premium – Intrinsic Value
2. Determine the net debit. Net Debit = Stock Price – Call Premium
3. Determine the if called return, including profit. If Called Return = (Time Value Premium + Profit on Exercise) / Net Debit

Annualizing Returns

Annualizing returns can help you compare multiple covered call positions with different days until expiration. After all, a six percent return with many days to expiration may be far less desirable than a two percent return with fewer days to expiration—annualized numbers are what matters.

Start by calculating the non-annualized returns and the holding period in days.
You can use the following formula to annualize the return:

Annualized Return = Static Return / Holding Period * 365

You should always look at annualized flat and if called returns when comparing the profit potential for covered call opportunities.

Screening for Opportunities

The process of screening for stocks and calculating the profit potential for each call option using option chains on the CBOE's website would take days or weeks. By the time you found the right call option, you would have already missed the opportunity and would have to go back to the drawing board.

Our FREE Covered Call Screener searches for the highest income earning covered calls based on your criteria. Click here to give it a try.

The good news is that there are many different tools that can help you automatically identify potential covered call opportunities.

Covered Call Screener

Snider Advisors offers a free covered call screener that sorts through market data to produce the covered call combination of owning shares of stock and selling a call. After selecting an expiration date, stock price range and other factors, the screener returns a list of opportunities that includes key metrics like the if-called return and downside protection.

The free covered call screener implements the first layer of our comprehensive stock screening, record-keeping and portfolio management software, Lattco. The full version of Lattco is available exclusively for graduates of the Snider Investment Method course.

Proprietary Software

There are several proprietary software solutions designed to screen for covered call opportunities. While many platforms provide similar features to broker research tools, Snider Advisors takes a comprehensive approach with a complete portfolio management strategy centered on generating income with covered call positions.

For those that don't have the time to manage their own portfolio, we also offer full-service asset management. We monitor client portfolios daily to identify opportunities to sell covered calls and generate a return as close to one percent per month as possible.

Download the [Snider Investment Method Owner's Manual] to learn more about our strategy and how you can use it to generate an income using covered call positions.

The Bottom Line

Covered calls are a great way to generate an income from a portfolio of stocks. Rather than haphazardly selecting options based purely on return, you should build a comprehensive strategy that factors in both risk and return. You can then ensure consistent income over time.

If you're interested in learning more, sign up for our free course on Covered Call Stock Selection and learn how the Snider Investment Method can help you succeed with covered calls.

5 THINGS
Investors Should Know About Covered Calls

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This is an extra resource to go along with the original article:
How Your Portfolio Can Generate Income in Retirement

Covered calls are a great option for investors looking to make an income from their portfolios, but there are a few areas to be aware of if you're new to the concept. Here are a few things investors should know about covered calls.

1. TERMS ON THE TRADE

Option sellers are able to set the terms on their trades. The premium collected from selling calls depends on three factors:

- **Strike price** – This is the pre-determined price that the underlying shares will be traded at should the option be exercised.
- **Time to Expiration** – Sellers can choose from many different expiration dates that range from weeks, months, or even years away. Longer timeframes typically means more premium but also allow for more opportunity for the stock price to exceed the strike price.
- **Contracts (Not shares)** – For every 100 shares of stock held, investors can choose to sell 1 call contract.

2. "OUT-OF-THE-MONEY" VERSUS "IN-THE-MONEY"

"Out-of-the-money" is a term used to describe a call option with a strike price that is higher than the market price of an underlying asset. It can also refer to a put option with a strike price that is lower than the market price. An "in-the-money" option has a strike price that's already passed the current stock price. Out-of-the-money options have no intrinsic value but they do have **time value**. As Snider Method investors, we consider ourselves ***time*** farmers.

3. EXPIRATION DATES

Options don't last forever, and eventually they will expire. Sellers must sell shares at the specified strike price at or prior to the expiration date. There are two ways to describe when an option is sold:

- **American style** – An option contract that may be exercised at any time between the date of purchase (or sale) and the expiration date. (These are the most common and heavily traded on American option exchanges.)
- **European style** – An option contract that can only be exercised on the expiration date.

4. OUTCOMES OF AN EXPIRED CALL

If you hold your calls until expiration, there are two potential outcomes:

- If the stock option closes above the strike price, the seller (you) will be required to sell 100 shares of the stock to the option buyer for each contract.
- If the stock closes under the strike price, the call options expire worthless.

In both cases, you receive the premium for selling the call on the same day as you place the trade. Whether your call expires worthless or gets exercised, you get to keep the premium.

5. THE RISKS OF COVERED CALLS

Just because a call is "covered" doesn't mean that you're completely risk free. Covered calls hold two main risks:

- If the underlying stock price drops in value, the investors holding value will also fall (though a falling covered call is still more profitable than someone who owned the stock on its own)
- If the stock price rises dramatically, the seller of the option will only receive the 'exercise price' of the option that they sell together with the premium received on the option.

Covered Calls are a primary component of the Snider Investment Method. This popular option strategy is both *simple and effective in generating additional income from your investments and reducing risk. If you'd like to* learn more about the Snider Investment Method, please visit ***https://www.snideradvisors.com/strategy/.***

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The intent of this handout is to help expand your financial education. All investors should consult a qualified professional before trading in any security.

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How to Calculate Covered Call Outcomes

Covered calls are one of the most popular option strategies used by both short-term traders and long-term investors. In fact, The Snider Investment Method uses covered calls at its core to generate consistent cash flow. The strategy is more conservative than most option strategies and is relatively simple to execute - the key is understanding all the possible outcomes.

In this chapter, we will quickly review covered calls and look at how to calculate expected returns and possible outcomes before entering a position.

What Are Covered Calls?

Covered calls are a two-part strategy where stock is purchased, and calls are sold on a share-for-share basis. For example, you might purchase 100 shares of stock and simultaneously sell one call option. You receive a premium for the call option and you're only required to sell the shares if the stock price is higher than the strike price.

There are three popular reasons for using covered calls:

• **Generating Income:** You can generate a cash income by selling calls on a regular basis against an existing stock position. The Snider Method helps investors execute this strategy to fund their retirement income requirements. You can also reinvest the income to capitalize on the benefits of compounding over time.

• **Exiting a Position:** You can use covered calls to exit an existing stock position if you're in no hurry to sell. If the stock rises to a price level that you're comfortable with selling, you receive both the premium income and the capital gains—a win-win.

• **Limiting Downside:** You can use covered calls to help limit downside if you don't want to sell a stock in your portfolio. If the stock price declines in value, the premium income offsets some of those losses with a cash income. If the stock recovers down the road, you still keep the premiums as extra income.

Covered calls are among the safest option strategies, but there are still two key risks to keep in mind:

• **Opportunity Cost:** You miss out on any appreciation in the underlying stock beyond the option's strike price. If a company receives a buyout offer and the price soars, you are still committed to selling at the original strike price.

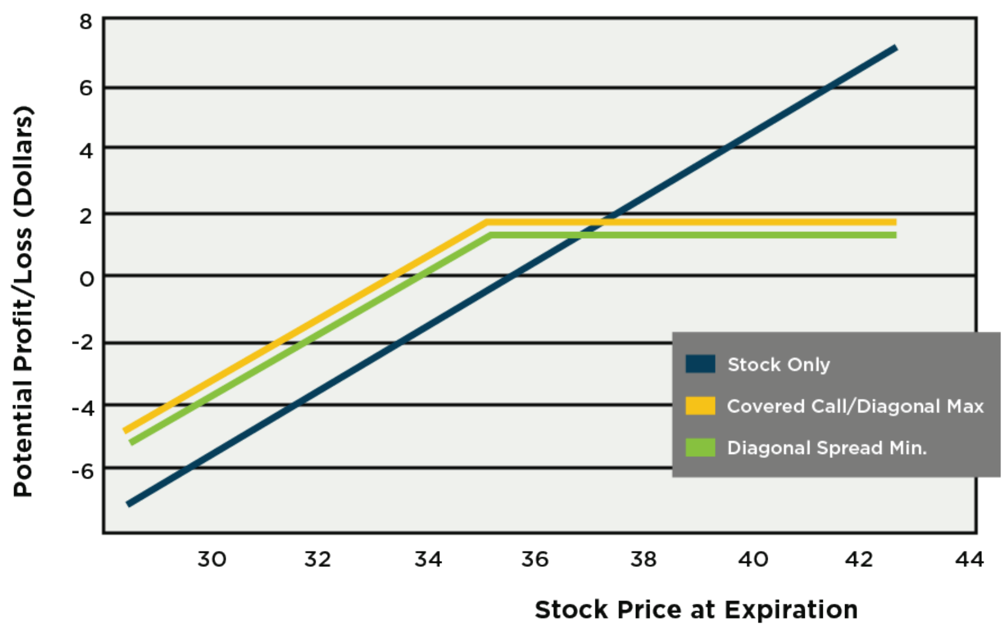
• **Stock Decline:** You are on the hook for losses if the underlying stock declines in value. While you have offset some of these losses with premium income, you still may be in the red on a net basis.

Covered calls are generally considered a neutral-to-bullish strategy, and they work best when you expect the underlying stock to maintain or slightly increase in value. If you are very bullish, you may want to simply hold the stock or purchase call options for more leverage. If you are very bearish, you may want to sell the stock or hedge with protective puts.

Visualizing Possible Outcomes

Option outcomes are often expressed in a profit-loss diagram that shows the max profit, max loss, and break-even point on a graph. The X-Axis represents the stock price at expiration and the Y-Axis represents the potential profit or loss. By looking at this diagram, you can visualize how the underlying stock price impacts the covered call's profitability.

Let's look at an example of a profit-loss diagram for a stock trading at $35.47 and a call option trading at $2.23 with a $35.00 strike price:



Covered Call Profit-Loss Diagram – Source: CFRA

In the example above, the red line shows the covered call position and the blue line shows a long stock position for comparison. The covered call position levels off at the strike price of $35.00, reflecting the max profit potential. The covered call position also shows a break-even point of $33.24 where it crosses $0.00 on the potential profit-loss Y-Axis.

There are three key outcomes to calculate before entering a covered call position: The max profit, the break-even point, and the max loss.

Max Profit

Covered calls have a profit ceiling since you're agreeing to sell stock at a specified price. Even if the stock doubled in price, your upside would be limited by the strike price of the option and the premium that you received.

Max Profit = Call Premium + (Strike Price – Stock Price)

Break-even Point

The break-even point is the price at which you would break-even on the covered call position.

Break-even = Stock Price – Call Premium

Max Loss

Covered calls have a loss ceiling since you're selling the right to something that you own. In the unlikely event that a stock price went to zero, you could lose the entire amount that you paid to establish the stock position, but still keep the premium.

Max Loss = Call Premium – Stock Price

Calculating Expected Returns

The most important calculation for many investors is the expected return of a covered call position. After all, if there's a low expected return, it might not be worth the cost and effort to establish and manage a covered call. It's also important to look at how expected returns are impacted when the underlying stock is called away.

Static Return

The static, or unassigned, return is the covered call's projected annualized net profit, assuming the stock price remains the same until expiration.

Static Return = (Call + Dividend) / Stock Price x (360 / Days to Expiration)

Assigned Return

The assigned, or if-called, return is the covered call's projected annualized net profit, assuming the stock price rises above the strike price by expiration.

Assigned Return = (Call + Dividend) + (Strike – Stock Price) / Stock Price x (360 /Days to Expiration)

Expected Return

The overall expected return assigns probabilities to the static return and if-called return to come up with an overall expected return—although this calculation is more subjective.

Expected Return = (Probability of Being Called x Static Return) + (Probability of Not Being Called x If-Called Return)

The Bottom Line

Covered calls are a great way to generate cash income, sell out of positions, or limit downside, but it's important to understand all of the potential outcomes. At a minimum, you should be familiar with the position's max profit, max loss, break-even point, static return, and assigned return before making a trade.

Covered call outcomes aren't the only thing that investors must decide when using covered calls—they must also decide what stocks to purchase, what strike prices to use, what expiration dates work best, and many other factors.

The Snider Investment Method provides a complete framework for selecting stocks, choosing options, and managing covered call positions with the goal of generating a cash income. If you're interested in a more hands-off approach, we also offer asset management services.

OPTION TERMS EVERY INVESTOR NEEDS TO KNOW

Option trading comes with a few terms that you may not find in other forms of investing. Here are a few of the most common option terms you may hear and what they mean.

CALL

A call option contract gives its holder (buyer) the right (but not the obligation) to buy a specified quantity of a security at a specified price (strike price) within a fixed period (until its expiration).

PUT

A put option contract gives its holder (buyer) the right (but not the obligation) to sell a specified quantity of a security at a specified price (strike price) within a fixed period (until its expiration).

BUY TO OPEN/SELL TO CLOSE

When you enter an option trade, you are essentially opening a position. If you buy an option, either a put or a call, you must enter a "buy to open" order.

IN-THE-MONEY

In-the-money (ITM) means that a call's strike price is below the market price of the underlying asset or that the strike price of a put is above the market price of the underlying asset. An ITM option has intrinsic value in addition to any time value.

VOLATILITY

Historical volatility is the stability/instability demonstrated by the underlying shares over a period of time. Implied volatility is the level of stability/instability of the underlying shares that is implied by the current option price. More volatile stocks will have more expensive option premiums.

NAKED CALLS

A naked call is an option strategy whereby the investor writes (sells) calls against shares of stock that he does not currently own.

EXPIRATION

Option contracts are limited to a specific time period which ends at a predetermined expiration date. After that date, the option contract is no longer valid and no longer has any value.

COVERED CALLS

A covered call is an option strategy whereby the investor writes (sells) calls against shares of stock that he currently owns.

TIME DECAY

Time decay is the rate at which an option loses value. As an option approaches its expiration date, its time value declines because the probability of it being profitable is reduced. It is also called Theta.

STRIKE PRICE

The strike price is the price at which the holder of an option can buy or sell the underlying shares when the option is exercised.

SELL TO OPEN/ BUY TO CLOSE

When entering a trade, if you are writing (selling) an option, either a put or a call, you must enter a "sell to open" order.

OUT-OF-THE-MONEY

Out-of- the-money (OTM) is a term used to describe a call with a strike price higher than the market price of the underlying asset, or a put with a strike price lower than the market price of the underlying asset.

OPEN INTEREST

Open interest represents the total number of option contracts that have been opened but not yet closed by either an offsetting trade or an exercise or assignment.

Knowing these option terms will be useful if you are looking to get started trading options and placing your first trades.

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The intent of this handout is to help expand your financial education. All investors should consult a qualified professional before trading in any security.

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How to Choose the Right Covered Call Expirations

Covered calls are a popular strategy for generating income from a portfolio of stocks. While the strategy may seem straightforward, investors must decide between various strike prices and expiration dates that influence the risk of selling stock, as well as premium income and capital gains.

In this article, we will look at how expiration dates impact option risk and return, as well as how to choose the right expiration dates for your covered calls.

The Impact of Expiration Dates

All stocks with options have expirations listed for the two immediate upcoming months and a quarterly expiration cycle in the future. Some stocks also have two more long-term expiration dates, known as LEAPS®, and/or short-term expiration dates, known as Weeklys®.

There are two important factors at play when choosing expiration dates:

Time Decay (Theta): Most investors know that there's less time value built into the price as an option nears expiration, but the rate of time decay actually accelerates as the expiration date nears. This is the biggest variable when it comes to covered call returns.

Time Investment: Investors using shorter-term covered calls spend a lot more time managing trades than those choosing longer-term covered calls. You'll need to pick stocks, sell options, watch positions, and make adjustments to manage the trades over time.

Long-term options have the greatest immediate income potential since there's more time value built into the price, but short-term options have the highest amount of time value per unit of time. In other words, short-term options have better static and if-called rates of return than long-term options.

You can calculate your annual percentage income from a covered call position using a formula like this:

(Premium Received / Cost of Shares) * (365 / Days Until Expiration)

Let's look at an example:

Suppose that it's January 24 and a well-known tech company is trading at $152.00. Let's look at all the available call options at the $155.00 strike price.

Expiration	Premium	Annualized Return
January 25	0.39	93.81%
February 15	4.20	45.84%
April 18	7.45	21.30%
July 19	10.95	14.94%
January 17	16.00	10.73%

The example shows that the annualized income for one-day January 25 call options is much higher than the July 19 call options, at 93.81 percent versus 14.94 percent, even though the premium is $39.00 for the January 25 option versus $1,095.00 for the July 19 option. Keep in mind that it is impossible to sell an option that expires the next day all year long. Also, this calculation does not factor in the underlying value of the stock.

Rolling Monthly Options

Most covered call investors use monthly options because of their liquidity and rate of return per unit of time. While Weeklies® may provide greater income potential, most investors see monthly covered calls as a good compromise between risk, return, and time commitments when it comes to setting up trades. also, the greater liquidity of monthly options contributes to tighter bid/ask spreads reducing slippage when opening and closing the positions.

The problem is that there is a lot of management involved with implementing covered calls—even on a monthly basis:

- What stocks are best suited for covered calls?
- What strike price should be used?
- How much money should be allocated per stock?
- What do you do if the stock price appreciates?
- What do you do if the stock price drops?
- How many option contracts should you sell?

It can be challenging to run through these questions and make decisions every single month. Without a strategy in place, you may also experience variable returns each month, which makes it difficult to plan out cash flow. This is especially true for retirement investors that rely on income.

You can reduce the amount of time that it takes to manage short-term covered calls by using a well-defined strategy. For instance, the Snider Investment Method is designed to make these strategies a lot easier to execute with a well-defined system of rules rather than subjective analysis.

Using Long-dated Options

Long-dated options—between 90 days and six months—require less effort to manage, but they have lower returns and there may be a greater risk of the stock being called away.

These options make the most sense in these situations:

- Dividend timing can play a factor in annualized returns and the risk of the stock being called away.
- Long-dated options may offer greater peace of mind, which can be important for risk-averse individuals.
- Higher strike prices can be selected, enabling investors to participate in capital appreciation of the underlying stock.

Long-dated options can also be used as a stock substitute in covered call-like strategies known as diagonal spreads. While not a true covered call, the lower cash outlay for LEAPS® could make the strategy more profitable than conventional strategies that require the purchase of underlying stock.

Using a Hybrid Strategy

Some investors use both short- and long-dated options to create covered call ladders. In the bond market, ladders are a common strategy to smooth out fluctuations in interest rates. Investors might buy 1-year, 2-year, 3-year, 4-year, and 5- year bonds to diversify interest rate risk.

The same strategy can be employed for covered call strategies to mitigate stock price volatility. By spacing out stock purchases, dollar cost averaging limits volatility. More shares enable investors to sell more covered calls to generate more income over time with less volatility-driven risk.

If the covered call position is called away, you can close the position at a profit and start the process over. If there are no calls available above the cost basis, you can still sell calls against some lower-priced shares to generate an income. The idea is to reduce the risk of unprofitable trades.

The Bottom Line

Covered calls are a great strategy for generating income from an existing stock portfolio. When executing the strategy, it's important to select the right strike price and premium for your investment goals. Well-defined strategies, like the Snider Method, can ensure consistent results over time

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Sign up for a free online 3-part course to learn more about using covered calls to generate consistent cash flow. We also offer asset management solutions for investors looking for a hands-off solution.

5 Tips for New Covered Call Writers

This is an extra resource to go along with the original article:
How to Write Covered Calls With Better Yields

Writing covered calls is a great investment strategy to produce income in retirement, but if you've never written one before you may not know the best ways to do it. Here are some tips for writing higher-yielding covered calls.

Tip 1: Choose stocks with medium volatility

Volatility – the likelihood a stock will move – is important when writing covered calls. You want a stock to move, but you want it to move predictably. High volatility stocks could move quickly in your favor, but could also move against it. Low volatility stocks may not move as much as you need and have lower premiums. Stick to medium volatility stocks with track records of positive movements through the market.

Tip 2: Pay attention to time decay

All options lose value as time passes, so covered call writers need to decide which expiration date to write on the call. Near-term options will allow you to take advantage of rapid time decay, while longer-term options will reduce transaction frequency (and costs). Stock volatility may play a role in whether or not you decide to write near-term or long-term calls. Low-volatility stocks may not offer enough time to make the trade worthwhile if you write a near-term date, for example.

Tip 3: Avoid options with low open interest

Open interest is the number of option contracts that are open or outstanding for a particular strike and expiration. Options with large open interest have a large market of buyers and sellers, meaning that it will be traded at an efficient price. You don't want to be in an option series that has low open interest, because if you need to exit early you are unlikely to get a fair price. Any series you choose should have at least 1,000 contracts of open interest.

Tip 4: Plan in case of downward movement

Selling a call doesn't lock you into your position until expiration. You can always buy back the call and remove your obligation to deliver stock. If the stock has dropped since you sold the call, you may be able to buy the call back at a lower cost than the initial sale price, making a profit on the option position. The buy-back also removes your obligation to deliver stock if assigned. If you choose, you can then dump your long stock position, preventing further losses if the stock continues to drop.

Tip 5: Plan in case of rapidly upward movement

If you write a covered call and your underlying stock shoots skyward, exceeding the option's strike price, you will be forced to sell your shares at the strike price. While you could purchase back your covered call, it will likely cost you significantly more than the original premium. Even though you may part with the stock, you still receive benefits from the call option. When you sell a covered call, you should be willing to sell the shares at the strike price.

Any time you plan to use options, including covered calls on your investments, it is critically important to have a comprehensive plan. To learn more about our long-term investment strategy that includes covered calls as a primary component, check our Strategy web page.

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How to Select a Broker for Covered Calls

Covered calls are a great low-risk strategy to generate a predictable income from an existing portfolio. By selling call options against stocks that you own, you can generate an income above and beyond equity dividends and recoup some losses if the stock declines in value. The only "cost" is opportunity cost if the stock rises above the strike price.

Many retirement investors don't have experience with covered calls and others may not even have a brokerage account setup. Unlike stocks, options require a special agreement with your broker and have their own commission and fee schedules. Some brokers even provide unique tools and research to help you identify profitable option trades.

In this chapter, we will look at how to choose the best brokerage account for covered call options.

What Is a Good Broker?

Choosing the right broker depends on your individual circumstances, but there are some attributes that good brokers share.

High-quality option brokers share several characteristics:

- **Low Fees & Minimums:** Fees can have a significant impact on long-term performance. At the same time, some brokers may require you to deposit tens of thousands of dollars, which can be a dealbreaker for smaller investors.

- **Options Focus:** Many brokers offer some options trading functionality, but it helps to sign up with a broker with option-specific capabilities. That way, you can benefit from better tooling, pricing, and resources.

- **Customer Service:** Sooner or later, you will need help from your broker with some type of complication or problem. When this happens, you will want a good, knowledgeable support team to resolve your issue.

- **Reputation & Financial Stability:** This is very likely your life savings or a good portion of it. Trusting it to an app developer may not be the best idea. Depending on the securities and type of account, a broker will have insurance through the FDIC and SIPC. Most carry additional insurance through a private provider to add extra protection for their account holders.

- **Trade Execution:** This is one of the most important but hard to define benefits of a good broker. Their ability to execute trades at a better price can add up to thousands of dollars over the years. This factor is even more important when trading options.

Commissions & Fees

There's no doubt that commissions and fees have a significant impact on investment performance. For example, a trader placing 12 covered call trades per year might pay $250 in fees. Cutting this cost in half will save you thousands of dollars over many years and the savings will be invested for compound growth.

Brokerage accounts charge a variety of different fees, but the most obvious fees are commissions. Commissions are charged each time a trade is executed—including both buying and selling transactions. Most investors are familiar with stock commissions, but option commissions typically involve two fees—a per-trade fee and a per-contract fee.

Option trades typically involve paying a fixed fee per trade, ranging from $3.00 to $7.00, and a variable fee based on the number of contracts, ranging from $0.15 to $0.75 per contract. A trade consisting of five contracts could therefore cost between $3.75 and $10.75, depending on the commissions charged by your specific broker.

There are also several other types of fees that brokers may assess, including service fees, regulatory fees, and market fees. It's important to consider all of these different fees when choosing the right brokerage.

Service Fees

- Statement Fees
- Account Transfer Fees
- Wire Transfer Fees

Regulatory Fees

- Section 31 Fees
- Options Regulatory Fees
- Trading Activity Fees

Service Fees

- Level I and II Quotes
- Research Subscription Fees

Trading Features

Brokerages offer both software and research subscriptions to help traders identify potential opportunities. If you're using an option strategy like The Snider Method, you don't have to worry about these features since there's already a well-defined strategy in place to identify opportunities. But traders starting from scratch might need these tools.

The most helpful trading software for covered call option trading are option screeners. These screeners help traders automatically identify opportunities based on a specific set of criteria. For example, Snider Advisors has a free screener that you can use to find both weekly and monthly covered call positions. Check it out here: https://www.snideradvisors.com/free-covered-call-screener/.

Research subscriptions could also be valuable for active traders. In addition to daily market reviews, these subscriptions help traders find more subjective opportunities in the market. TDAmeritrade's MarketEdge, for example, provides a daily analysis on 4,000 stocks. It's important to weigh the cost of commissions with the features that you need to find trading opportunities.

Popular Brokers

There are many different brokerages for options traders. Most of the dedicated providers, such as optionsXpress (acquired by Charles Schwab) and OptionHouse (acquired by eTrade), have been acquired by larger companies, which has limited the choices.

The Bottom Line

Covered calls are a great way to generate income from an existing stock portfolio. When choosing a broker to execute these strategies, traders should consider both commissions and account features. The good news is that there are many different options available. If you use a strategy like The Snider Method, you can confidently select low-cost brokerages to realize the best of both worlds—low costs and a reliable strategy to generate an income during retirement.

For more information, take our free online course to learn more about covered call options and how The Snider Method can help you generate a reliable retirement income.

Snider Advisors has an economic incentive for recommending that clients open an account with Ally. Specifically, Snider Advisors receives a flat referral payment for each new account it refers to Ally. More detailed information about the relationship and our fiduciary responsibility can be found in our ADV Part 2A. Clients may contact Snider Advisors with any questions about the terms of the Agreement with Ally.

Snider Advisors

COVERED CALL COST WORKSHEET

This is an extra resource to go along with the original article:

How to Select a Broker for Covered Calls

BROKER COMPARISON

Trading Costs	Broker #1	Broker #2	Broker #3
Stock Commission			
Option Commission			
Per Contract Fee			
Assignment Fee			
Inactivity Fee			

Other Costs	Broker #1	Broker #2	Broker #3
Paper Statements			
Maintenance Fees			
Transfer Fees			
Termination Fees			

Other Factors	Broker #1	Broker #2	Broker #3
Interest on Cash			
Account Minimum			

EXAMPLE TRADE

	Broker #1	Broker #2	Broker #3
Stock Commission			
Option Commission + (Per Contract Fees x Numbers of Contracts)			
Assignment and/or Commission & Fees Upon Sale			
Total Trade Cost			

The intent of this handout is to help expand your financial education.
All investors should consult a qualified professional before trading in any security.

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Tips for Managing Covered Call Positions

Covered calls are a great way to generate extra income from a stock portfolio. While the strategy is fairly straightforward, there are many nuances that can make managing a covered call position challenging—especially when the stock pays dividends or if the price is approaching the strike price near expiration.

In this chapter, we will take a closer look at covered calls, various possible outcomes, and actions that you can take to address any issues that arise over time.

Covered Calls 101

Covered calls are a great way to generate income from existing stocks that you own. The option buyer will pay you a cash premium for the right to purchase stock from you at a set price until the option expires. If the option expires, you keep the premium and the stock. If the option is exercised, you keep the premium and sell the stock at the agreed upon price.

Let's look at an example:

Suppose that you own 100 shares of Acme Co. at $10 per share. You sell one covered call with a strike price of $12 that expires in one month with a $1.25 premium. You immediately receive $125 in cash (100 shares x $1.25) minus any commissions on the trade, which varies depending on your broker.

There are three possible scenarios:

- The stock rallies above $12 and your shares are "called away", which means that you must sell them at $12 to the option buyer. You will earn a 32.5 percent return on the position (20 percent gain in the stock plus the premium), but you lose out on any upside beyond that amount.

- The stock falls below $12 and you keep your shares but have unrealized losses on the stock. The good news is that the option premium helps offset these losses.

- The stock trades just below $12 at expiration, which means you get to keep your shares and the premium. This is the most profitable and best-case scenario since the stock appreciated in value and you can keep the premium.

Managing Covered Calls

Covered calls are managed differently depending on how they're used in a portfolio. If you are using them to exit an existing stock position, you may simply choose an option and execute the trade. There's no need to spend time picking stocks or managing the position if your goal is to sell the stock. But most investors use covered calls to generate an income.

In this case, there are four steps to covered call writing:

1. **Selecting a Stock:** Covered calls can be written against most blue-chip stocks but selecting the right stocks can help maximize income generation and minimize risk.

2. **Selecting an Option:** Choosing the right option also helps maximize the profitability of a trade, while minimizing the risk of the option being called away.

3. **Executing the Trade:** Most trades are executed just prior to expiration on the third Friday of each month, but there may be exceptions for special situations.

4. **Managing the Position:** Many traders place limit orders to buy back call options in stages, or it may be necessary to roll out options that are at risk of being called away.

Managing covered call positions can be challenging given the wide range of possible scenarios. If you're looking for a simple approach, Snider Advisors provides a framework for selecting the right stocks and options, as well as managing the trade to maximize profitability and minimize risk.

How to Handle Problems

Suppose that a covered call position is at risk of being called away because the stock price is rapidly moving towards the strike price. You might not want this to happen because it could lead to realized capital gains. Or, you might not want to deal with the pain of repurchasing the stock for the portfolio.

There are several possible actions that you can take:

You could take **no action** and let the stock be called away at or before expiration. In most cases, you could still realize a net profit on the position, if the call option was out-of-the-money. The downside is that an unrealized gain can become a realized gain for tax purposes for the year.

You could **close out** or **unwind** the position by buying back the covered call and either retaining or selling the stock. Often, this is a good option if there's an ex-dividend date approaching (close out) or if the stock price moves sharply higher and you want to lock in gains (unwind).

Or, you could **rollout** the position by buying back the covered call and then selling a new call at a later date, higher strike price, or both. These strategies work best when the price is approaching the strike price and you'd like to keep the stock, and you may adjust the next strike price based on sentiment.

These are all different options for managing a covered call position that may not be going in your favor. The right decision depends on your sentiment on the underlying stock (bullish or bearish) and your income goals.

The Bottom Line

Covered calls are a great way to generate income from a stock portfolio. While everyone hopes that the trade goes according to plan, there are some cases where you may be at risk of having to deliver stock. The good news is that you can take several actions in these cases to adjust your position.

If you're overwhelmed by managing covered calls, you may want to consider Snider Advisor's well-defined approach to the strategy. Sign up for a free course today to learn more about how to generate an income from a stock portfolio without spending all your time creating and managing positions.

COVERED CALL

Position Management Worksheet

This is an extra resource to go along with the original article:
Tips for Managing Covered Call Positions

NO ACTION REQUIRED:

- **Expire Worthless**
  How it works: Your option expires worthless at expiration. You keep the premium.
  When it works: The stock's price is less than the strike price at expiration.

- **Assignment**
  How it works: Your broker automatically sells your shares at the strike price of the option at or before expiration. You keep the premium.
  When it works: The stock's price exceeds the strike price and you don't care if the stock gets called away.

CLOSE SOME OR ALL OF THE POSITION:

- **Close Out the Call**
  How it works: "Buy to Close" the covered call you originally sold and retain the stock. Depending on the price of the option, it could cost you more than the premium you received when you placed the covered call trade.
  When it works: If your option is in-the-money and you don't want to sell your stock, you must buy back the option. In an ideal situation, the stock's price is only slightly above your stock's price.

- **Unwind**
  How it works: "Buy to Close" the covered call and sell your shares of stock.
  When it works: You want to lock in profits or avoid losses. By closing out the entire position you eliminate all market risk.

ROLLING THE OPTION:

- **Rollout**
  How it works: "Buy to Close" an expiring covered call and "Sell to Open" the same strike covered call at an expiration in the future. You collect the additional time premium in the future option.
  When it works: When you want to avoid the stock being called away and want to continue to utilize the shares to sell calls in the future.

- **Rollout and Up**
  How it works: "Buy to Close" an expiring covered call and "Sell to Open" a covered call with a higher strike price and expiration in the future.
  When it works: When you want to avoid the stock being called away and want to give the stock more room to appreciate in the future.

- **Rollout and Down**
  How it works: "Buy to Close" an expiring covered call and "Sell to Open" a covered call with a lower strike price and expiration in the future.
  When it works: The stock's price has declined or you are willing to sell your shares at the lower strike price. You will collect more premium by selling a call at a lower strike price.

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Disclosure

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