SNIDER ADVISORS SPECIAL REPORT
July 2013 • $7.95

A Surprising Solution to Creating Sustainable Retirement Income

Myths & Misconceptions About Exchange Traded Options

Snider Advisors™

In This Report ...

Do you ever look at your parents and grandparents and wonder how they did it?

They were somehow able to improve their standard of living over that of their parents, put you and your siblings through college and retire comfortably - all while putting their savings in a passbook savings account or low-risk bonds.

For 70 million Baby Boomers struggling to achieve any single one of those things, it is enough to give you an inferiority complex. It all looked so easy.

Do you want to know the secret?

They had something you probably don't have - unless you are part of the 6% of Americans covered in any meaningful way by a defined benefit pension plan. And you almost certainly do not enjoy the benefits of lifetime retiree healthcare benefits for both you and your spouse.

They did. And it made all the difference.

Your parents and grandparents had an investment objective of growth. They needed to save enough money for major expenses - like big purchases, weddings and college - and get enough growth in their savings to keep up with inflation. That was it. Retirement income was taken care of. That is why, up until the 1980s, very few Americans participated in the stock market.

What changed?

In 1974, Congress enacted the Employee Retirement Income Security Act (ERISA). If ever there was a misnamed bill, this was it.

ERISA shifted the responsibility for funding retirement away from your employer and put it squarely on your shoulders. Without your knowledge, or permission, at the stroke of a pen, Congress changed your retirement objective from growth to income replacement.

Interestingly, it has taken Americans and their financial advisors 35 years to become fully aware of the implications. Only now are specific investment strategies, built from the ground up to solve the challenges of income replacement, beginning to emerge.

The capital appreciation model

The goal of a growth objective is capital appreciation. In other words, you buy an asset and hold it, in hopes it will go up in price. The payoff is when you sell it for a higher price than you paid for it. For stock market investors, the basis for the capital appreciation model is rooted in the fact that the stock market always goes up – over time.

But when Congress changed the rules on us, we ceased to have the benefit of time. Our time horizon is now very short. At any moment, we could experience a financially disruptive event - like loss of a job, death of a spouse, disability, or divorce, just to name a few – that would require us to replace our W-2 income with portfolio income. And then, of course, there is retirement, when the need for portfolio income becomes permanent.

The flaw in the old model is that you do not realize capital appreciation until you sell an asset. As long as markets are going up, everything works just fine. But when you know markets experience significant declines of 20% or more about once every five years, and often take many years to recover, the capital appreciation model just doesn't match up to your objective or time horizon. A change in approach is required.

The cash flow model

The goal of an income replacement objective is for the investment portfolio to generate enough cash flow to pay you, pay your taxes and keep up with inflation. Unlike capital appreciation, which requires you to sell something to profit, cash flow comes to you while you own an asset and is generally not tied to the current asset value. Examples of cash flow are rent, royalties, interest, dividends and option premiums.

If your objective is to have enough income to be able to pay all your bills, without working, indefinitely into the future, doesn't it make sense that your portfolio throw off enough cash flow to be able to pay all your bills? Otherwise, you will have to sell assets, often at a loss, increasing the chances you will outlive your assets.

Suppose you have a $1 million dollar portfolio, split 60/40 between stocks and bonds. Assuming a 5% yield on a diversified bond portfolio, that portfolio, on average, probably produces about $20,000 a year in cash flow. That is the fatal flaw in using capital appreciation to fund three decades of retirement. The typical traditional portfolio produces very little cash flow – the very thing we need most in retirement.

The goal must be double digits

If your investment objective is income replacement during retirement, the paltry 5 or 6% average yield of traditional investments in preferred stock, dividend-paying stocks and bonds simply is not enough. Once you stop working for a living, your portfolio must provide income that is sufficient to replace your paycheck, cover your yearly tax obligations and keep pace with inflation for thirty years – without running out of money before you run out of breath. It is highly likely that the only way to achieve this target is through double-digit yield.

The traditional retirement portfolio of 60 percent stocks and 40 percent bonds, at best, has a targeted rate of return of 8 percent , which means there's a built-in gap between what you need and what most retirement portfolios are set up to provide. Sooner or later, this shortfall will force you to think beyond your traditional investment toolbox, to consider a new approach.

This new approach involves the use of exchange-traded options on common stock to generate cash flow. An option is simply a financial instrument that gives the option buyer the right, but not the obligation, to buy or sell an asset from the option seller, at a predetermined price, within a specified period of time. Option premium is passive income received from the sale of options against a held asset.

Although some investment strategies involving options can introduce high levels of risk, many conservative investors are finding that the options market can provide significant cash flow from their investments, without excessive risk.

In spite of their misplaced reputation for riskiness, there is a trend toward a more widespread understanding and acceptance of options. *The Wall Street Journal* reports on a recent survey of its customers by Charles Schwab:

> The survey showed that 61% of them consider themselves to be risk-takers, but only 40% think there are more gains to be made with options than with stocks and bonds, and only 31% agree that they like trying to outsmart the market with their option trades.
>
> Instead, a far higher number — 69% — consider option trading "a great way to generate income" and perhaps most interestingly, 56% say option trading is part of their retirement investment strategy.[1]

Misconceptions about options

That being said, some of you still believe a variety of long-standing misconceptions about options that need to be dispelled. The most widely held are: 1) options are too risky; 2) they're too complicated or you're not smart enough to use them; 3) you cannot use options inside of an IRA account; and 4) options on General Electric, for example, are no different than the exotic, highly esoteric derivatives that caused the current financial crisis.

Of course, many financial advisors have done nothing to dispel these myths. In fact, to a large degree, they have willingly helped to perpetuate them.

Misconception 1: Options are risky

Risk is just the probability of an unfavorable outcome. Everyone has a threshold at which that probability becomes unacceptable. This is known as your "risk tolerance."

Old thinking says buying and selling options is a high risk strategy. That reputation has always frustrated me — mainly because it is completely false. Granted, with more risk comes greater reward, but it is possible to manage the tradeoff between the two.

By their nature, options are not risky. Buying and selling an options contract is mathematically a zero sum game. There is one winner and one loser on each side of any one option contract. When the buyer wins a dollar, the seller loses a dollar and vice versa. So, by definition, options are not inherently risky. They are a tool — a means to an end. Nothing more.

Think about the hammer in your toolbox. It is not dangerous in and of itself. But, if used carelessly, it could do real harm. Ask anyone who has smashed the dickens out of his thumb. But you don't hear public service announcements warning you away from using hammers because they might hurt your thumb.

So, back to options. If risk is not inherent in options, why all the bad press? The problem lies in the way people are taught to use them.

Options can be risky when used to place a speculative bet on the future direction of stock price. You might just as well pile your money up in the front yard, pour gasoline all over it and strike a match. Because you are placing a bet — a highly leveraged bet, no less — on a totally random event. Would you take your life savings to a Las Vegas roulette wheel and plunk it all down on black? What do you think will happen?

It is a travesty that so many sensible investors have been suckered into crap seminars that teach them how to use options … to lose money. It's just wrong — and that is why the myth, that options are risky, still persists.

Lesson One: *Options are not inherently risky or safe, any more than credit cards are inherently evil. It is how you use them that makes them one or the other.*

Why not use options like a pro?

There are two ways to use options. One is speculation and the other is, ironically, risk management, better known as hedging. When you buy or sell an option, betting on the future direction of price for the underlying asset, that is speculation. This is akin to stock picking or market timing, with an added degree of difficulty, because the option is going to expire in fairly short order. Not only do you have to get the direction correct, it has to happen quickly.

This is what most people who are new to options attempt to do and, as you would expect, most of them do, in fact, lose money. But remember, there's a guy on the other side of the transaction making money. You could be that guy.

Professionals know options are just a tool for achieving certain objectives. Getting rich quick is not one of them. So, to recap, the right tool in a practiced hand speeds up the work process. But a power saw in the hands of a novice, could cost someone a finger — or worse. You get the point. Highly leveraged, speculative bets using options almost never work out. But using options to manage risk and create portfolio income often does.

When a financial advisor tells you options are risky, that is a smokescreen. They can be when used as a speculative investment, but they can also reduce risk and increase both the odds for profit and the percentage of return.

Lesson Two: *When used correctly, by someone who understands how, options are an effective tool to manage risk by hedging it — not increasing it. The most conservative, and successful, institutional investors — pension plans, insurance companies, foundations and endowments — all use options in their portfolios. Shouldn't you?*

Misconception 2: You can't trade options in an IRA account

I did not hear it myself, but I am told Ric Edelman, a big-time money manager and radio talk show host, said in his December 2, 2007 radio show that "you cannot use options in an IRA account." This was called in by one of my listeners, so if I have it wrong, I apologize in advance. But I thought it was another good example, regardless, because it is one of the most persistent, and outright wrong, of the many myths about options.

A competitor of ours (who teaches covered calls) says in his marketing materials, "What we do is so safe, the IRS allows it in your IRA." I am not a lawyer, nor do I represent the SEC or the FTC, but that is blatantly false and misleading advertising. It implies that his strategy has some special dispensation to be used in an IRA, which is pure bunk.

The fact of the matter is it isn't up to the IRS whether or not you can use options in your IRA account. It is a decision made individually by each IRA custodian.

It is true, up until about ten years ago, most brokerage firms did not allow options in an IRA and if they did, they only allowed covered calls. This is undoubtedly the basis of the myth.

Options were historically limited in IRAs for three reasons: 1) lack of widespread understanding of options by the retail investment community; 2) no financial incentive to allow options; and 3) insufficient internal processes or controls for handing option transactions inside an IRA.

Newer firms that did not have legacy computer systems and catered to the more active investor, such as optionsXpress or Interactive Brokers, were the first to create the systems allowing you to use options in your IRA, just as you would in a taxable account. More recently, firms like E*Trade, TD Ameritrade, Schwab and Fidelity have followed suit. The slowest firms to adapt have been, not surprisingly, the wire houses - Merrill Lynch, Smith Barney, Edward Jones, and the like.

Lesson Three: *Options can very definitely be used in an IRA today and not just for covered calls. If you can't, you just need to switch brokerage firms. They can be a very useful tool for generating portfolio income or for compounding growth in your IRA account, provided — and here is the big caveat — you know what you are doing.*

Misconception 3: Options are too complicated – only a pro can use them

I have heard money managers tell people options are too complicated for the average investor to grasp. Hogwash! That's pretty condescending isn't it? Learning enough to know what you are doing with options is not the huge hurdle it is made out to be.

You can and should learn how to use options as part of your wealth building strategy. The information is available to you if you are willing to devote the time to learn. How do I know? I did it myself.

Look, I'm not saying it is easy. I am saying I know it can be done because I did it. To succeed in turbulent financial times, you are most certainly going to have to do things differently. That's why independent, critical thinkers are the ones who will generally come out on the other side well positioned. It takes grit; but it's your life savings!

The key is to seek out someone to teach you to use options wisely. In addition to workshops and coaches, there are a multitude of books and web sites devoted to the subject. There is no question that you have to be committed if you set out to learn this on your own. However, if you are serious about making money — and keeping it — options are an absolute must for your money-making toolbox.

Lesson Four: *If someone tells you options are too complicated for you to learn, there are three possible reasons: 1) they don't understand options themselves; 2) they don't want you to understand using options to protect their income; or 3) both of the above!*

The conflict of interest in teaching you about options

The professional money management community has no real vested interest in teaching people how to use options properly. So, while all of the large institutions view options as a natural vehicle for managing portfolio risk, the professional money management community has no interest in teaching you how to do it because that is how they make their money. As long as you remain helpless, you must rely on them – and continue to pay them for lousy results.

Most options-trading books and seminars aren't much better. They focus on speculative option strategies which have a high likelihood of failure, thus perpetuating the myth.

Managing risk is not glamorous. Like peddling snake oil, it is much easier to sell books and seminars with promises of fantastic results, such as the opportunity to make a lot of money with a small amount of capital. It is easy to teach people an almost sure way to lose their money when you don't care about them or stick around to see the results.

Lesson Five: *Options are an important tool to have in your toolbox for managing risk and/or creating cash flow from your portfolio. For more information about learning to use options the right way, please call us for access to our free online options training course, "Options Basics."*

Misconception 4: The "anything-not-created-here-is-bad syndrome"

For the longest time, retail brokerage firms shunned options. Brokers never had to learn about them in any detail and mindlessly parroted the conventional wisdom that options were risky. Compared to stocks and bonds, options are relatively new, hence their slow acceptance rate. Tragically, some financial professionals still profess their ignorance to their clients when they repeat this mantra! Forward thinking advisors will embrace new methods. Or, at least, look into them before warning off their clients due to their own fear and ignorance.

Lately, options have become one of the fastest growing investment segments. Brokerage firms, always looking to add new products to drive commissions, have been scurrying to catch up to the demand. Advisors who don't are probably candidates for the least-likely-to-succeed title. Shouldn't you rethink what you are getting for the commissions you are paying them?

Lesson Six: *When it comes to choosing a financial advisor, don't put too much stock in a framed certificate on the wall. Many so-called advisors are nothing more than salesmen who will push whatever investment scheme that makes them the most commission. Make sure you do your due diligence, and always keep in mind that the person who is best qualified to manage your money, with no conflict of interest – is you.*

Misconception 5: Options created the financial crisis

Guilt by association can be a powerful negative force. The exotic derivatives that brought down the financial system – mortgage-backed, highly-bundled, over-leveraged derivatives have nothing in common with a basic exchange traded option on Exxon Mobil. Except, that is, for their common label, derivative.

The fact is, there are many reputable, wholesome financial entities that use options every single day:

"Mutual funds are not the only ones using options. In recent years hundreds of U.S. corporations have engaged in programs to repurchase tens of billions of dollars worth of shares of their own stock. A number of those corporations have used options strategies in conjunction with their stock buyback programs in an attempt to reduce the overall costs of the buyback or meet other corporate cash-flow goals."[2]

"Pension fund money managers have been using options as part of their overall management strategy for over two decades, and a 1997 survey found 128 pension funds were using options primarily to hedge or manage risk within the portfolio."[3]

"Closer to our own backyard, Mark Cuban used options to keep the "b" in front of billionaire after he and his partner sold Broadcast.com to Yahoo for $5.7 billion dollars, mostly in Yahoo stock."[4] Cuban was smart enough to hedge his 14.6 million shares of Yahoo with a combination of options known as "a collar". The collar preserved most of the then $95 share price[5], and allowed him to keep all of his billions, even as the price of his Yahoo shares plummeted.

While Cuban and his partner, Todd Wagner, have publicly declined to give explicit details of the collar, an analysis by Steve Mann, an assistant professor of finance at Texas Christian University, indicates that Cuban and Wagner could have limited their downside risk to 10 percent while retaining the ability to double their money if the share price rose during a three-year period. "Some people talk about the danger of derivatives," Mann said. "But this tool allowed these guys to be set for life."[6]

Lesson Seven: *The first recorded option contract pre-dates the birth of Jesus. They are not a new idea. Unlike the exotic derivatives you may read about related to the mortgage mess, exchange traded options are regulated, backed by the OCC, and have been trading on public exchanges since the 1970s.*

Break out of the "traditional" view of options

When you use a tool, use it appropriately — no driving screws with a hammer.

Traditional investment vehicles have been underperforming the market for over a decade – that's a given. Now it's time to wake up, if not smell the coffee: we can't keep doing the same old thing and expecting a different result. It's time to investigate other tools for your investment toolbox.

Options are perhaps the most flexible and useful investment tool available, but they are not quite as cut and dried as buying a stock. If you do not have a good understanding of how to use options strategies, the results will almost always be a loss.

The easiest part of options to grasp, for almost anyone, is the simple buying of puts and calls. Unfortunately, this is pure speculation and loses money most of the time. Most individuals who attempt to learn options usually get this far and stop. This is not the way big institutions use options, which explains why they are on the winning side most of the time.

Lesson Eight: *My advice to you is to follow the "smart money." There is a reason mutual funds, pension funds, insurance companies, corporations and high net worth clients all use options. Find a coach or mentor to teach you to use options properly as a tool for creating cash flow and/or hedging risk.*

What to look for

Strategies using options to generate income can be as simple as selling covered calls, while others add strict rules and processes to manage income, emotion and risk. If you are looking to add an income-producing strategy using options, compare the risk/reward profiles of every strategy and pick one that matches your objectives, risk tolerance, time horizon and temperament.

Some of the things to look for when evaluating options-based income strategies include:

Ease of use. Some strategies require the investor to make detailed charts and issue guesses based on possible trends, while others offer a simpler, systematic approach that leaves no room for interpretation.

Ability to do it yourself. Does the strategy give you the ability to implement yourself, in your own brokerage account, or do you have to let someone manage your account for you? What are the fees involved? Studies show investment success is more closely tied to low recurring investment costs than any other factor. Total transparency, which comes from managing your own portfolio, is the best way to guard against conflict of interest.

Time commitment. Will you need to constantly watch your stock holdings, or can you spend the day away from your computer screen? Do you need to take action or review your account daily, or can you check in just once a month? Taking a more hands-on, time-intensive approach does not necessarily result in better performance. Studies show the opposite is often true.

Focus on risk management. Does the strategy employ tools and techniques to limit your risk exposure? Remember your job is to manage and optimize the trade-offs between risk and reward – to make certain that every unit of risk produces the maximum benefit, that the risks are those you can most afford to take and the rewards are those that will be most beneficial. Make sure risk is handled with intention.

Full disclosure. You should also remember that all investments have risk – even U.S. Treasuries. Are those risks discussed in an understandable and forthright manner? If an investment is being presented as all upside and no downside, the person presenting it is not being honest. Run!

Verifiable track record. Does the strategy have a reproducible result, or is it just a set of tools and suggestions with theoretical outcomes? Does the strategy's support team make its performance record available and does that record include every single trade since inception?

Quality customer support. Who do you call when you have a question? Is there a team of dedicated, licensed advisors who can walk you through a process, or are you left to figure things out on your own?

Lesson Nine: *There are many claims made. Make sure they are for real. Remember there are no magic bullets or get rich quick schemes – only get poor quick schemes. Do your due diligence.*

The Snider Investment Method®

And now a word from our sponsor …

The Snider Investment Method is a long-term investment strategy that uses a combination of stock, options and cash, along with specific techniques that must be applied in a specific sequence. The overall goal is to exchange the long term 8% to 10% expected rate of return of the U.S. stock market for a more immediate and tangible 12% yield or cash flow.

The Snider Investment Method is designed to provide the following advantages:

Higher income (yield) than other investments. The goal is to average a yield of 1% each month from your portfolio. If you don't need the money right away, you can reinvest it for compounding growth.

Management of risk. The Snider Method includes a number of carefully researched risk-management features – some of which are our own invention. Unfortunately, we could not eliminate the risk completely, without eliminating most of the desired cash flow. Remember, there is no such thing as a free lunch in investing. However, the result of our years of research is, we think, a thoughtful balance between the need for double-digit yield and an aversion to unnecessary risk.

Reduced fees when you do it yourself. You may choose to use our asset management or consulting services for a fee. However, when you manage your money yourself, you don't have to pay these fees, meaning more money stays in your pocket to compound over time.

Your interests come first. When you manage your own account, there is no conflict of interest. You don't have to wonder if your advisor is trading against you or recommending products because they pay the highest commission.

Eliminate the guesswork. You follow a simple checklist that tells you exactly what to do each step of the way so there's no guesswork and less room for error. Instructions are as detailed as "click here, write this number there."

No Investment Experience Required. Snider Method investors vary in financial expertise from seasoned professionals to outright novices who have never bought a stock before. Anyone can do it. You just have to want to.

Time savings. Snider Method investors trade just one day each month and don't need to be tied to a computer every day the market is open to watch their portfolios.

No Additional Courses Needed. All the necessary information is provided in one comprehensive investment course. Students receive comprehensive training, a workbook and a checklist so they can start using the Snider Method the day after they graduate.

Where you can learn more

For more information on Snider Advisors, the Snider Investment Method, or cash flow investing in general, please call 1-888-6-SNIDER (888-676-4337), or email support@snideradvisors.com. You can also read more on www.SniderAdvisors.com.

For a complete discussion of the Snider Investment Method, including risks, benefits, suitability and performance, please see the Snider Method Owner's Manual available on our website or by calling Snider Advisors at 888-6-SNIDER (888-676-4337). Please read carefully before investing.

You can download a complete discussion of the Risks and Characteristics of Standardized Options, written by the Options Clearing Corporation, from the OCC website.

Some information in this report has been gathered from external sources. We believe they are reliable, but Snider Advisors assumes no responsibility for the accuracy of this information. No statement in this report should be construed as a recommendation to buy or sell a security or to provide investment advice unless specifically stated as such.

The intent of this document is to help expand your financial education. Although the information included may be relevant to your particular situation, it is not meant to be personalized advice. When it comes to investing, insurance, and financial planning, it is important to speak to a professional and get advice that is tailored to your unique, individual situation.

All investments involve risk including possible loss of principal. Please see our Performance Discussion and Owner's Manual - they are an important part of this discussion. In particular, the yield measurement we use is different than the total return measurement often used by other advisers. These documents will spell out the differences. Information on how an investment has done in the past doesn't not tell you exactly how it will do in the future.

The 1% yield if the Snider Investment Method is a goal and not a guarantee. The yield calculation is different than the total return calculation typically shown by most in the investment industry. The percentage yield is realized gains as a percentage of the amount invested. The yield is approximately equal to the total return if and when a position closes. While the position is open, there is typically some amount of unrealized loss. The total return measurement would include losses and so would be lower than the yield. While the rules of the Snider Method prohibit selling stocks at a loss, this does not limit or prevent the accumulation of unrealized losses. Nor does it guarantee that a position will eventually close or that unrealized losses won't persist indefinitely.

About Snider Advisors

Snider Advisors is a boutique State Registered Investment Advisor founded by Kim Snider. Helping our clients become better investors has been priority number one since we opened our doors in September of 2002.

The cornerstone of our business is the Snider Investment Method, a long-term investment strategy designed to produce monthly portfolio income. We manage approximately $70 million directly for clients.

Each person on our staff is a licensed registered investment advisor representative, who is well-versed in the issues that surround today's investors and are experts in the Snider Investment Method.

Snider Advisors considers personal financial management a life skill everyone should be taught. Our company was built on belief that a good financial education is the best way to avoid being taken advantage of. That's why, unlike other financial advisors, we combine financial education and coaching with the products and services we offer.

The Snider Investment Method

The Snider Method is our proprietary investment strategy, developed over more than a decade, for creating portfolio income at a higher rate than you can expect from cash equivalents, dividends or bonds. You can learn how use the Snider Method in your own portfolio or we can manage it for you.

Financial Education

Our personal finance courses cover what they should have taught you about personal finances...but didn't. Courses include retirement planning, the Snider Method workshop, insurance, estate planning, and more. We teach you the same strategies we use to manage our own money, our family's money, and our clients' money.

Asset Management

Asset Management is the fee-only implementation of our investment strategy. We manage approximately $70 million directly for clients, using the Snider Investment Method and low-cost exchange traded funds (ETFs).

Insurance

Years of helping clients maneuver through the ups-and-downs of both life and the stock market allowed us to see that the piece of the financial puzzle so many people are missing is properly insuring the risks they cannot afford to take. That's why we offer insurance solutions to properly manage risks throughout the different stages of life.

Fee-Only Financial Planning

We can give you as much or as little independent advice as you want or need. From helping you formulate a holistic financial plan, to rolling up our sleeves and helping you with your Snider Method trades, to offering a second opinion, let our expert team be your guide.

End Notes

SOURCE:

1 Mohammed Hadi, "Options Find Favor With Investors Seeking Strategies for Retirement." Wall Street Journal; January 3, 2007; C2. (registration required)

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4 "Yahoo! Acquires Broadcast.com for $5.7 Billion." InternetNews.com; November 5, 2003. http://www.internetnews.com/bus-news/article.php/90621

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6 Schnurman, Mitchell. Collaring Their Gains; ibid, p. 1