

The Covered Call Analyzer

How To Use This Site

Investment Enhancing Systems, Inc. (IES) is celebrating its sixteenth anniversary. Our mission is to "*Provide the individual investor with investing concepts and investment tools that are easy to use, inexpensive and produce professional results*".

What this site is intended to do for our subscribers:

The **primary purpose of this site is to educate our subscribers** in the use of covered call strategies. Some think all options are risky and should be avoided by conservative investors. Covered calls are conservative (they can be traded in IRA accounts) and profitable. Covered calls are not a get-rich-quick strategy. We want our subscribers to **learn and then earn**. This strategy takes patience and sticking to the rules, but as you can see from our results, patience and sticking to the rules pays off. Option commissions play a big part in the returns realized. They tend to be higher than commissions on the stock trade. Subscribers usually look for low-cost online brokers to handle their covered call portfolios.

How do we **find our stocks and calls to populate our portfolios**? Stocks from the NYSE, NASDAQ and AMEX are considered by the **Analyzer**, resulting in thousands of calculations. We run the Covered Call **Analyzer** using our default parameters to find our picks. The **Analyzer** uses proprietary algorithms that find equity and some ETF call options that have been run up by insiders and professional traders and analysts. These professionals generally know something that is going to drive a stock price up, and they buy call options rather than buy the stock. Our subscribers can run the **Analyzer** at any time, using their own parameters, to generate their own portfolios.

IES **runs the Analyzer** only on expiration weekend (the Saturday after the third Friday of the month). We use the closing prices from the Friday before expiration to update our suggested portfolios. We only consider out-of-the-money calls, one month out, for stock buy/writes. Our subscribers can then take the weekend to analyze these portfolios or run the **Analyzer** themselves if they want to consider different parameters. They then make their trades on Monday morning using our suggested portfolio buy/writes or their own **Analyzer** "finds". The prices will have changed after the opening on Monday morning, but since stock prices and their option prices move in tandem, the expected return probably won't change much. However, prices when the trades are actually made should be checked to confirm that there hasn't been significant changes in the stock or call price.

We update our portfolios each month on expiration weekend with the intent of showing our subscribers what we did with those stocks and covered calls that were the basis of our portfolios last month. The comments in our results pages show whether:

- 1) the stock got called
- 2) we exercised the get-out price and sold the stock after buying back the calls at a lower price
- 3) the stock didn't get called and we sold more calls for the next month
- 4) the stock is being "held", waiting for better call premiums
- 5) the stock was sold to close out the position
- 6) what return was realized

>We have found that the best premiums are usually realized about thirty days before the next expiration. We also don't want our stock positions to be tied up for long periods of time with far-out call contracts. With options, time is a wasting asset and as you get closer to expiration, the premiums for out-of-the-money calls tend to diminish.

Data is uploaded to the server about one hour after the close on each trading day. This allows our subscribers to run the **Analyzer** any evening and select the trades they may want to make the next day.

Our objective is to get the stock called at a higher strike price on the next month expiration date. Most of our subscribers don't check their investments daily. We don't want our subscribers worrying about price fluctuations during the month. Generally they wait until the next expiration weekend and see what happened - what got called and what didn't. They then spend a few hours on that expiration weekend determining what to do with the cash generated by the stock called or sold at the get-out price and if they should sell new calls on the stocks that didn't get called. Many subscribers follow our portfolios and make their trades accordingly and follow up with our comments on what happened the next month. The only thing they have to worry about between expiration weekends is the get-out price

Many of our subscribers **start by using "play money"**. That means they make assumed stock purchases and covered call sales on paper, but don't actually make the trades. They review our various portfolios, or run the **Analyzer** with their own parameters, and pick stocks that they might be comfortable with. Then, instead of calling their broker or going on line to an online broker, they go online to a financial service (like Yahoo.Finance, MarketWatch or MSN Investing) on Monday morning to get actual prices for the selected stock and the premiums for the calls and write these down or use our MS Excel Analyzer Helper spreadsheet to keep track of how they perform. After several months, if they are comfortable with the strategy, they will begin making real trades and start making real money.

In order to be successful, you need **diversity**. This means that the portfolio should have enough different individual stocks in it to offset a major downturn in any single stock. Our \$10,000 Aggressive Portfolio tries to make money with only five stocks with value of about \$2,000 each. If a stock goes to our get-out price (-15%) and is sold, with only a few stocks in the portfolio, it's hard to dig out of the hole it creates. It's better to have five stocks (\$2,000 each) in a \$10,000 portfolio than two stocks (\$5,000 each).

If the money available is too low to purchase an individual stock, you may not be able to buy the minimum 100 shares for a single call contract, or the call commissions may swamp out the return. There has to be a balance between the number of individual stocks (diversity) in the portfolio and the dollars available to purchase each stock.

Our \$100,000 Retirement Portfolio starts with ten (10) stocks with value of about \$10,000 each. Our \$25,000 Conservative Portfolio starts with eight (8) or nine (9) stocks of about \$3,000 each. Our \$25,000 Aggressive Portfolio also starts with eight (8) or nine (9) stocks of about \$3,000 each. Our \$10,000 Aggressive Stock Portfolio starts with Five(5) or six (6) stocks with value of about \$2,000 each. If we have to exercise the get-out-price on one or two stocks, it's not as hard to dig out. We start these portfolios at the beginning of each fiscal year on the January expiration weekend. You don't have to start at the beginning of the year. See Starting your own portfolio mid-year below.

A get-out price should be established and stuck to. We have set our default get-out at a 15% drop from the purchase price. It is sometimes hard for some investors to sell a stock when it drops because they think it will "come back". It is important that our subscribers establish a get-out price and stick to it. **To be successful you have to do this.** Many of our subscribers use an online service (like Yahoo.Finance, MarketWatch or MSN Investing) to set up monitored portfolios that will alert them when one of their stocks is getting close to the get-out price. This means that they don't have to monitor their portfolio prices daily, because they get an alert from that service. If the get-out

price is reached, they have to buy back the calls first (at a lower price) and then sell the stock. Usually investors that think the dropping stock will come back end up taking bigger losses. Sometimes there is a stock that "tanks" so fast on bad news that it is impossible to get out at the get-out price. This happens rarely, but when it does, we hold the stock for a short time (usually about five trading days) and look for a bounce of a few percent and then get out. If the **Analyzer** finds a stock that is anticipating "news", such as a biotech or drug company awaiting approval from the FDA, we may identify it as "**RISKY**" in our portfolios. This usually occurs in our aggressive portfolios and investors should be prepared for a big reward or a big loss. Periodically, we will avoid some stock sectors or types because they are too risky (even though the **Analyzer** may find them with huge potential returns). These will be identified in BUZZ's BUZZ.

Once you are comfortable with the strategy, the rules of diversity and get-out, you may want to **start your own portfolio**. We have four portfolios that we follow. The portfolios start at the beginning of the 's expiration weekend, we start the Retirement portfolio with about ten Conservative buy/writes selected by the **Analyzer**, spending about \$10,000 for each stock. We take \$2,000 out of call premium each month for retirement income. For the \$25,000 Conservative and Aggressive Portfolio, we select eight (8) or nine (9) Conservative or Aggressive buy/writes selected by the **Analyzer**, spending about \$4,000 for each stock without going over \$25,000. For the \$10,000 Aggressive Portfolio, we select five or six Aggressive buy/writes selected by the **Analyzer**, spending about \$2,000 for each stock without going over \$10,000. When you input a dollar value in the "Money Available" field, the **Analyzer** selects stocks that will not go over this value including your commissions. This usually means you have some cash left over in each purchase that may be enough to buy another stock and sell another covered call. We update the portfolios each month on expiration weekend. We identify what was called (what we want to happen), what was sold at the get-out, and what remains in the portfolio in our "Latest Updates" for our subscribers.

So what if you don't get in at the **beginning of the year**? It's easy, but requires some patience. If you are a new subscriber in any month but January, go to the "Latest Updates", then execute the buy/writes listed at the bottom of the page – the suggestions for the current month only. Keep the balance of your cash in the account. Then next month, see what happened to your first month trades and do what we suggest; like sell more calls if the stock didn't get called. Then execute the suggested buy/writes for the new month using your cash balance, which now may include new cash from called or sold stock from last month. Each month some of the buy/writes executed several months ago will drop off the top of the "Latest Updates" page and new buy/writes will be added at the bottom. In a few months you should get caught up. All of our "Latest Updates" get rolled into our "Results" pages. If you are starting the \$100,000 Retirement Portfolio, you should probably wait until you are getting enough call premiums to allow you to take out the \$2,000 per month and not eat into your principle. We offer our Subscribers the MS Excel Analyzer Helper spreadsheet that can be used to keep track of your own personal covered call portfolios.

Good Luck and Profitable Investing!!!

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