

AFW ASSET MANAGEMENT, INC.

Covered Call Example

Implementation of the strategy:

- Purchase 1000 shares of Alcoa at \$32.40 per share
- Simultaneously sell 10 Jan \$32.50 call options at \$1.65. (Premium)
- You give the buyer of the call the right to buy your stock at 32.50 (Strike Price)
- For that right they pay you \$1.65 (Premium)
- Alcoa pays a Quarterly Dividend of \$0.15

Strategy in dollars:

- | | |
|--|---|
| ■ Buy 1000 Alcoa @32.40 | (\$32,400) |
| ■ Sell 10 Alcoa Jan 32.50 Call @\$1.65 | \$1,650 |
| ■ Your Alcoa Basis Equals | \$30,750 (net amount you spent for the stock) |
| ■ Alcoa Pays \$0.15 dividend | \$150 |

What does all this mean in January?

Example #1

Alcoa appreciates to \$35.64 (10%)

Investor makes 6.01% real return for 3 months

(\$32,500 exercise price + \$150 dividend minus your basis \$30,750 = \$1,900 Gain)

Example #2

Alcoa remains at \$32.40 (unchanged)

Investor makes 5.72% real return for 3 months

*($\$32,400$ current value + \$150 Dividend minus your basis $\$30,750 = \$1,800$ Gain)

** (Call not exercised – you still own the stock)

Example #3

Alcoa drops to \$29.16 (10%)

Investor loses 4.81% real return for 3 months

*($\$29,160$ current value + \$150 dividend minus your basis $\$30,750 = \$1,440$ loss)

** (Call not exercised – you still own the stock)