Champion Advisors LLC
Wealth Management

COVERED CALL OPTIONS STRATEGY

<u>OBJECTIVE:</u> A long-term investment approach that produces income for clients by selling covered calls on a primarily quarterly basis on large-cap equity holdings, and gainfully reinvests income earned from the dividends received and covered calls sold to increase the earning value of the holdings.

Champion Advisors looks to take funds that are normally held within a large-cap investment fund as part of the client's portfolio and utilize them to purchase shares of well-established, dividend paying, large-cap domestic companies traded on U.S. exchanges that offer options. The goal is to maximize income through dividend payments received and premiums earned from the sale of covered calls.

While this strategy is considered a lower risk alternative type of investment, there are tax implications that can be realized on the income produced. This, in addition to the clients' risk tolerance for purchase evaluation, is assessed prior to instigating the strategy.

<u>ASSUMPTIONS:</u>

1. Attempt to sell covered calls on a quarterly basis – not all companies offer options for every month throughout the year, so some variation in the resale or assignment is expected. Moreover, selling covered calls quarterly reduces the amount of time required to follow performance.

2. A set list of stocks is used for the process. Specific companies that a client may wish to include in their portfolio outside of this list are incorporated as requested.

3. Check suitability of new purchases by evaluating:
    a. Diversification strategies in the marketplace
    b. Maximum expired premium return expected
    c. Maximum assigned premium return if it occurs
    d. Annual dividend of the covering stock

4. Options that expire on the date of expiration will be resold for that stock, unless evaluation deems the funds currently held can be better applied to a different holding. If the evaluation determines that a holding is to be sold, it is the intent to minimize loss, maximize gain and minimize taxes if applicable.

5. Options that exceed the assigned stock strike price will cause the held stock to be assigned on the date of expiration. Following the evaluation, income from this sale will be either applied to repurchase the stock or repurchase another stock, per the evaluation.

6. If a stock is held with a loss, by reselling covered calls, it may be possible to make up the difference on that loss until it can be disposed of (if, by this time, the market on the shares has not improved).

PROCESS:

1. Determine funds to be allocated within the Client's portfolio to the Options Strategy, following a rigorous evaluation of the Client's needs and desires regarding his/her portfolio.

    - The portfolio as a whole could include funds that may be invested in various other areas of the market, such as small and value, emerging, and international markets. The amount to be invested in this strategy is established prior to inception and is typically the portion of the portfolio that would be invested in a large-cap value fund. However, Champion would not replace the large-cap fund entirely, unless directed by the Client to do so.

2. Based on the available funds, a determination of how many stocks included will be made and the allocation for each stock will be established.

    - It is Champion's intention to maintain approximately equal holdings in each sector that is owned, unless directed otherwise. During each evaluation process, rebalancing may occur to maintain an equilibrium that satisfies the Client's long term investment objectives.

3. Diversification, premium returns, and dividend payouts on the complete list of stocks are evaluated, and appropriate shares are chosen for purchase. Options may not be purchased on "odd lots" of stocks owned. Thus, the primary intention will be to only purchase even lots (100 share portions) of stocks.

4. Depending on market conditions, Strike Prices are chosen based on the current market value and the upward/downward movement (market trend) that is predominant.

    - For portfolios that are currently in the Options Strategy, an analysis of the stocks' current prices and options premiums are compared to the original cost basis and the premiums already incurred to select the appropriate Strike Price in accordance with the market trend and estimated extrapolated value of the stock.

5. Upon the date of expiration, the following could occur:

    - **Option Expires** – covered calls are resold, or stocks are evaluated for (profitability) in the portfolio.

- **Option Assigned** – the long position on the stock is sold at the Strike Price; funds from the sale of the shares are added to any dividends that have been made over the period and are evaluated for new purchases.

OTHER APPLICATIONS:

While the primary focus of this strategy is to hold stocks for the long-term to maximize the potential returns through premiums and dividend payouts, client-specific actions can also be taken based on a client's personal needs.

- CHAMPION can implement the sale of puts to purchase stock during a down market at the price which the client is comfortable paying for that holding.

- Selling "in-the-money" calls intended for assignment to make additional profit on a sale as opposed to selling outright when the desired outcome is to get out of the position regarding a particular stock.

CONCLUSIONS:

Champion Advisors wishes to add a potentially viable income-producing alternative to simple investing by providing clients a way to make income on their current holdings in addition to dividends received and simple stock growth in the marketplace. This strategy is a low-risk way to bring diversity to one's portfolio, while still maintaining the relative liquidity of an equity portfolio. By using this strategy in retirement accounts, it is possible to avoid the additional capital gains taxes incurred, and, in times of a down market, the premiums could offset some of the loss that is realized.

Terminology:

- **Covered Calls** – sell of call based on underlying long position
- **Expiration Date** – Date of call assignment/expiration
- **Call expired** – Call does not get assigned and client retains long position
- **Call assigned** – Call gets assigned and client obligated to sell position at the strike price
- **Strike Price** – Price at which client is willing to sell underlying stock
- **In-the-money** – Price that is currently at approximately the current market value or just under (used when basis is far below the current market value to maximize premium or when the desired outcome is to have the option assigned)
- **Premium** – cash generated from the sale of the covered call