



## AN ALTERNATIVE WAY TO ACHIEVE YIELD

40 Grove Street, Suite 140, Wellesley, MA 02482

Phone: 781-489-5398

Email: [info@julexcapital.com](mailto:info@julexcapital.com)

Web: [www.julexcapital.com](http://www.julexcapital.com)



## Safe Yield Is Practically Non-Existent

### Forbes

Moreover, the problem of bond yields being too low is not limited to the Treasury market. As Treasury yields have declined, so too have municipal bond yields and corporate bond yields. As recently as 15 years ago, high-quality, investment-grade corporate bonds that yielded 5.5% or more until maturity could be purchased without too much difficulty. Today, most investment-grade corporate bonds offer yields of just 1.5% until maturity or less. Currently, 75% of the global bond market pays a yield of less than 1%, while only 10% of the global bond market pays a yield of more than 3%. Unsurprisingly, those bonds that pay a yield of more than 3% today are generally classified as either 1) "deep junk" bonds, issued by companies with weak balance sheets and significant credit risk or 2) have maturities that force the owners to bear material interest rate risk. In fact, a record amount of global bonds trade with a negative yield, about \$17 trillion in total value, which means that holders are certain to receive a negative return from holding their bonds to maturity.



**Bloomberg** | *Quint* Markets Business BQ Blue Exclusive Research Reports Videos >

# World's Negative-Yielding Debt Pile Hits \$18 Trillion Record

Cormac Mullen

John Ainger

 [Bookmark](#)

Published on December 11 2020, 6:10 AM

Last Updated on December 11 2020, 4:21 PM



## FINANCIAL POST



# You can now get a 20-year mortgage in Denmark for 0%

*The once unthinkable notion of borrowing for two decades without paying interest comes as central bankers across the globe shy away from rate hikes*



**Bloomberg News**  
Frances Schwartzkopff

Jan 05, 2021 • January 5, 2021 • 1 minute read • 6 Comments



# Bottom Line: Investors Are Starved For High Quality Yield



## Possible Different Paths

- 1) Accept Low Yield
- 2) Increase duration and/or credit risk
- 3) Use another approach entirely– an option overlay on your existing portfolio



## Misconceptions About Options

- Only for ultra-HNWI
- Lots of work to monitor
- Extremely risky and highly speculative
- Require changes to current asset allocation
- Costly to implement and difficult to exit
- A hassle come tax season
- Too complicated to explain to clients



## Advisors Are Skeptical...



### What Investors Should Know About Options

"Many certified financial planners **would not touch options with a 15-foot pole,**" says Barbara Kay, who coaches financial experts around the country via her certified woman business enterprise in Wheaton, Illinois.

Geared toward the **sophisticated investor**, these **complex** securities can be **extremely risky** but offer investors the ability to speculate. Expert advisors typically recommend only investing with a small percentage of money that you can afford to lose – known as risk capital – since this type of investing carries a high risk of loss. Many companies use options to hedge against certain risks, like an insurance policy against market fluctuations or when an investor has a large concentration of company stock options.





## ...But The Reality Is That Options Overlays Can Be A Great Tool

- No changes to asset allocation or leverage necessary
- Can specify maximum acceptable weekly loss
- Can craft strategies around risk-tolerances
- Tax-advantaged gains
- No lock-up period
- Source of true uncorrelated income



# Possible Roles For Options In A Portfolio

- 1) Hedge Risk
- 2) Increase Returns
- 3) Generate income



# Selling Options To Generate Income



What Investors Should Know About Options

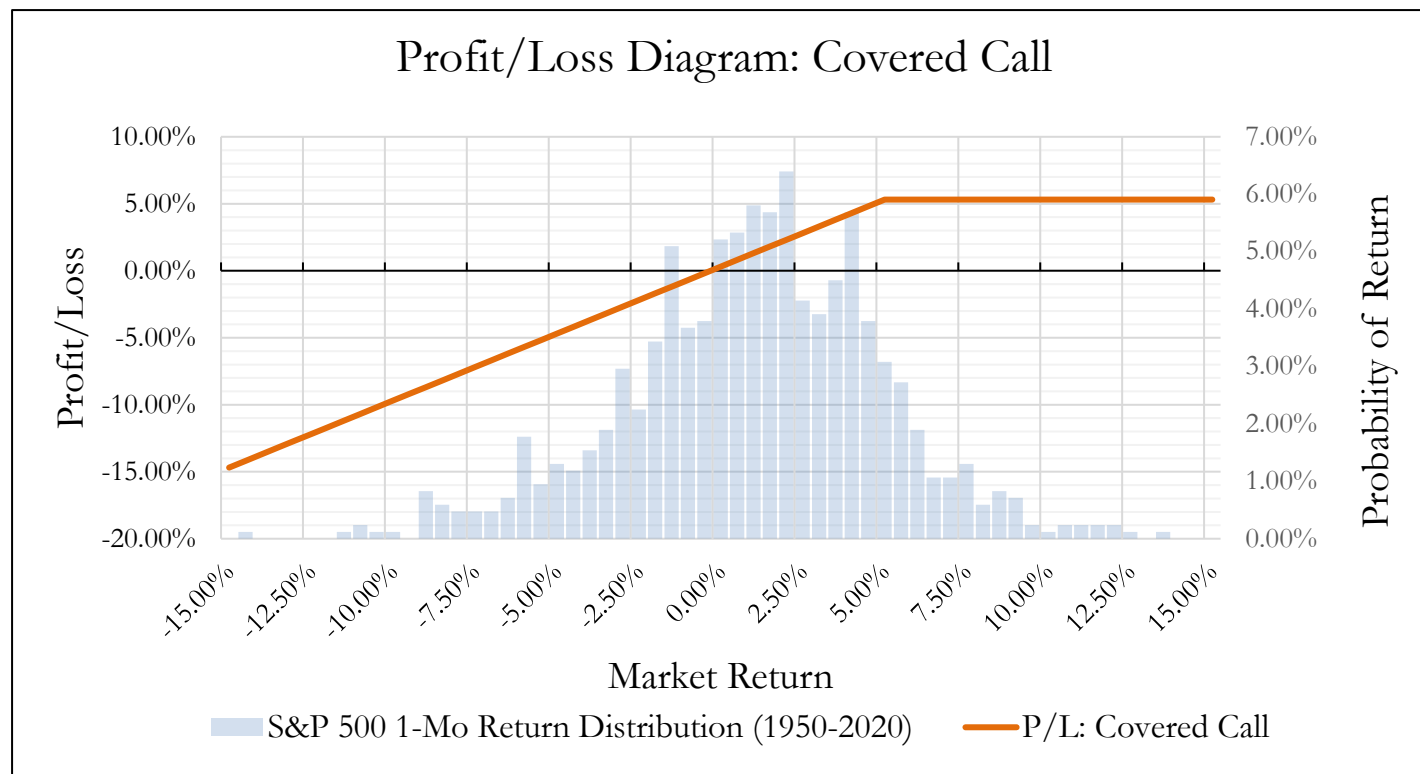
**Cautionary advice.** Like many financial experts, Erik Kroll, a certified financial planner with Milwaukee's Hilltop Financial Advisors, says options aren't necessarily bad, they just don't have a place in most portfolios and should typically be avoided, especially if an investor has a [well-diversified portfolio](#) that covers much of the market.

One of the biggest downsides is that investors don't own anything except a bet on what the price will do. "Once an option expires, if you were on the wrong side of the bet, you lost all your money and you own nothing," says Kroll, and that comes with extra costs and can diminish returns.

To generate income, investors can take the other side of this bet



# Selling Calls For Income

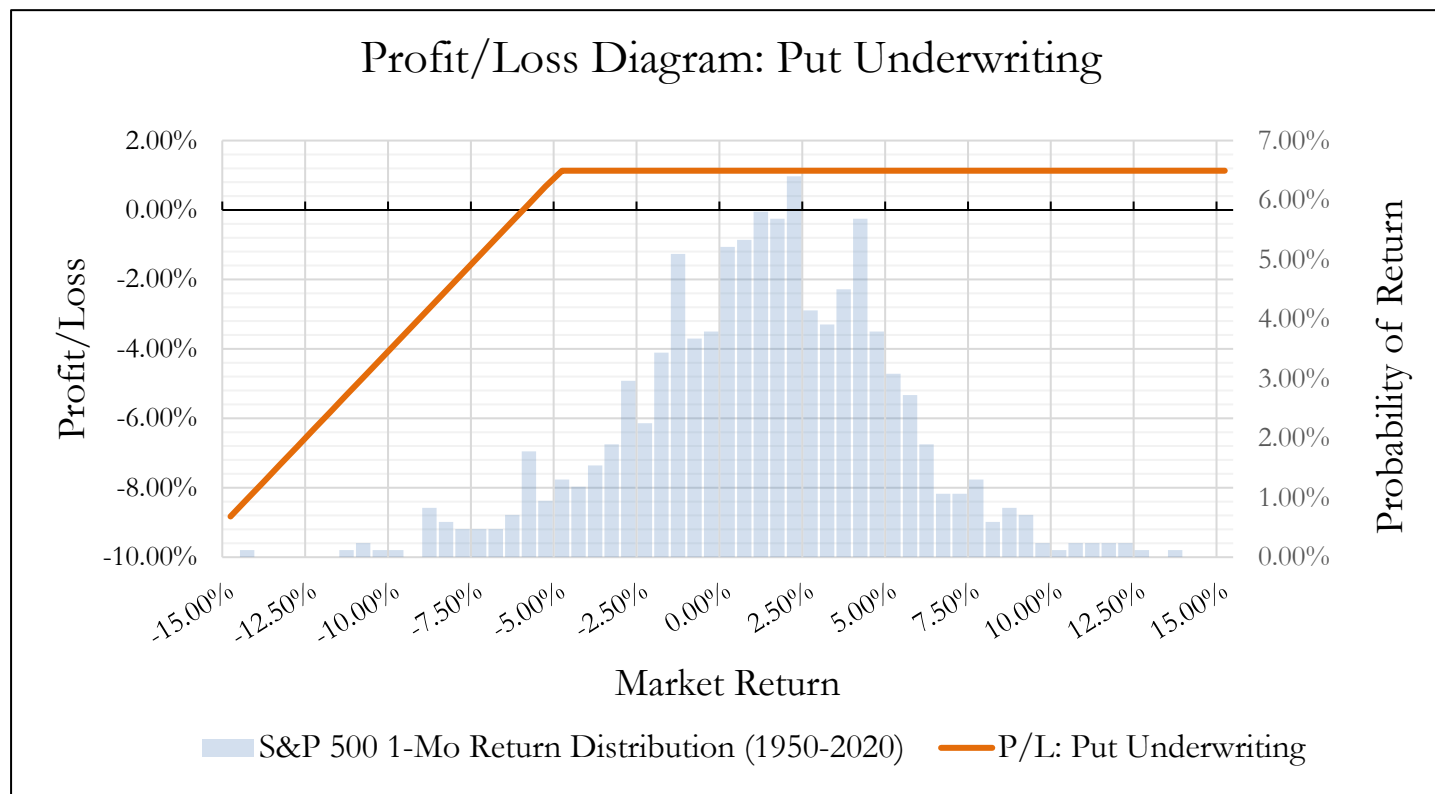


“I’m happy with a 5% return in a month. Anything more, I’ll realize the gain; anything less, I’ll keep the premium.”

**Paid to sell high(er)**



# Selling Puts For Income

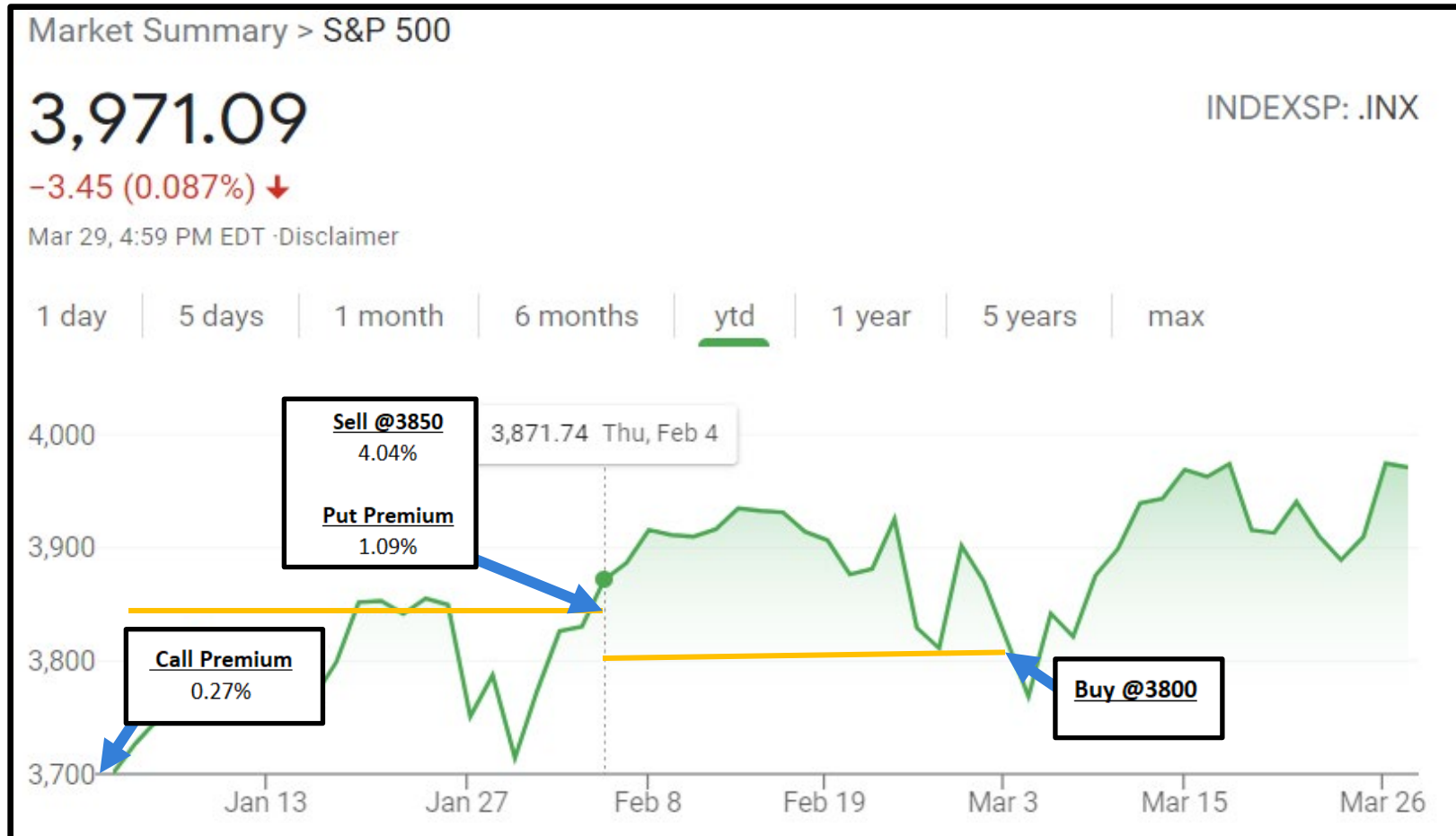


“I really like this stock, but it’s a little expensive. I’ll get paid while I wait for the price to drop.”

**Paid to buy low(er)**



# Example



Without Strategy:  
7.31%

**vs.**

With Strategy:  
9.90%



## Problems With These Strategies

- Frequent changes in allocation
- Need large amount of cash or a concentrated stock position
- No risk mitigation measures
- Not Scalable
- Large tax burden



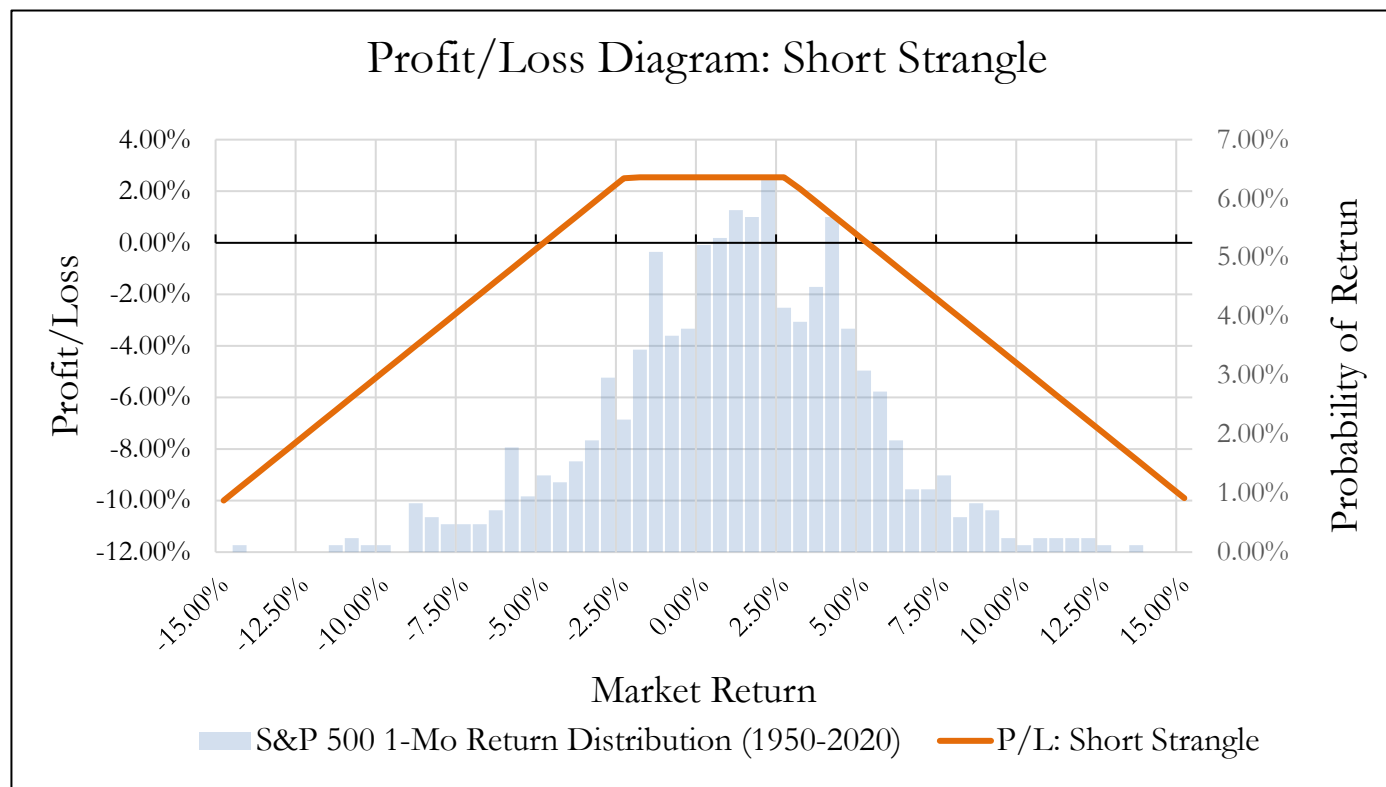
- 1) Combine the two ideas
- 2) Use the client's existing portfolio as collateral for an S&P 500 *overlay*. Index options are tax advantaged.
- 3) Add a level of risk management so can never lose more than  $x\%$  a week





## Part 1: Combine Idea of Selling Options For Income

- Why not sell both puts and calls at the same time to increase income?



This greatly increases income, but there is substantial upside risk if you don't own the underlying security



## Part 2: Using Portfolio As Collateral For Overlay

- Ex. Client has a \$100,000 well-diversified portfolio consisting of 30% US Stocks, 30% International Stocks, 30% US Corporate Bonds, 5% Treasuries, 2.5% International Bonds, and 2.5% Gold.
- Use the \$100,000 as collateral to *sell* \$100,000 worth of options, generating income for the client.

Objections:

Won't this add leverage to the portfolio?

Won't this meaningfully add more exposure to the S&P 500?

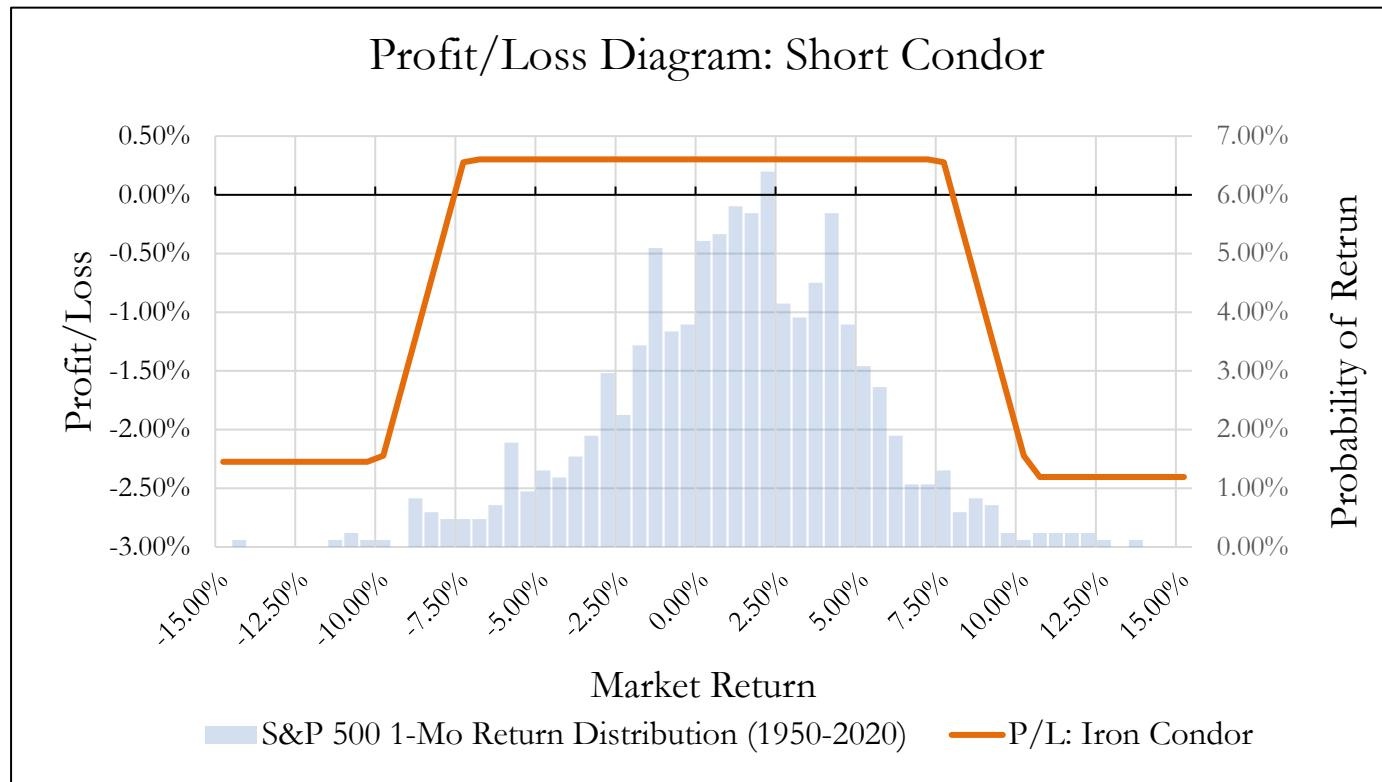
Can't this lead to large losses?

**No** ...provided we introduce the risk measure in the next step



## Part 3: Add Risk Mitigation Step

- *Buy* further out-of-the-money puts/calls to cap possible losses



To add or reduce risk, simply change two variables: the width between the sold options, and the width between the legs on the put/call spread.



## Result?

- Know *exactly* the range of outcomes for every trade
  - Max gain
  - Max loss
  - Break-even points
- No change in underlying assets
- No lock-up period
- Gains are additive to the performance of the underlying portfolio.



# Reviewing Misnomers/Objections

## Expectation

- Extremely risky and highly speculative
- Only for ultra-HNWI
- Lots of work to monitor
- Requires changes to current asset allocation
- Difficult to exit
- A hassle come tax season

## Reality

Can specify max risk. No directional speculation needed.

Minimum account size of just \$250k

“Set it and forget it”

Not if you use an overlay

Can exit at any time

Index options are tax-advantaged



## How Does Client and Advisor Benefit?

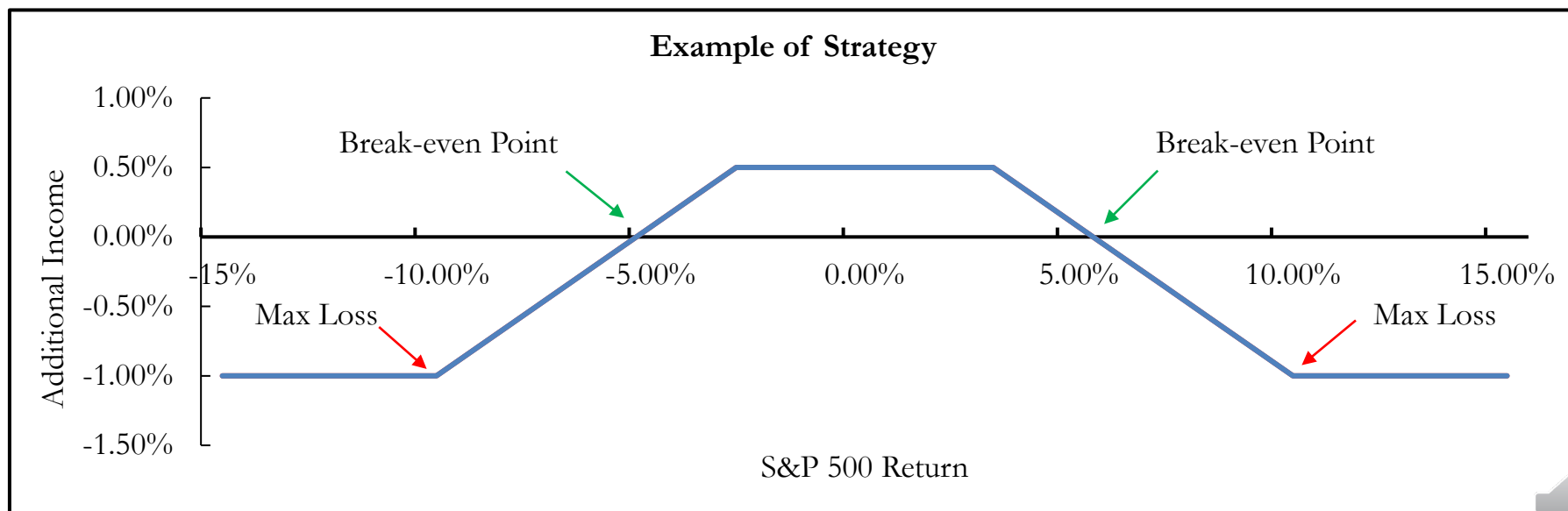
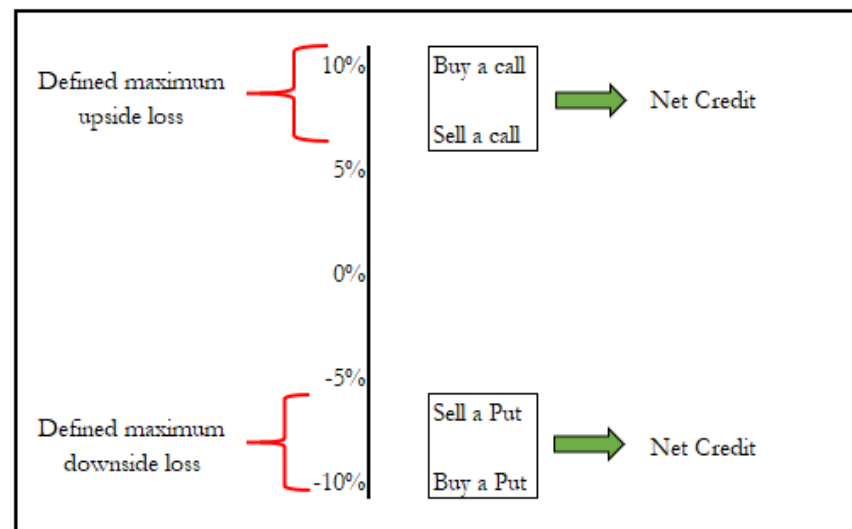
- Clients generate **relatively safe current income**.
- Clients expand efficient frontier.
- Advisors **increase revenue without having to expand their book** of business or put clients into high-cost vehicles.
- Both get improved clarity from the quantitative nature of the strategy (manager should be able to easily answer questions regarding profitability, frequency of profitable trades, etc. The **opposite of a black box**).



# Enhanced Yield Overlay (EY)

**Objective:** Provide tax-advantaged incremental income (target 2-3% on any marginable asset (equity, fixed income, cash)).

**Attributes:** Defined weekly downside risk and expected average annual net yield of 2-3%, taxed at 60% long-term and 40% short-term capital gains.



# Enhanced Yield Back Tested Returns – Calendar Year

Year	Portfolio Returns
2009	5.11%
2010	3.70%
2011	3.01%
2012	8.53%
2013	4.48%
2014	3.71%
2015	3.17%
2016	5.25%
2017	5.67%
2018	-3.10%
2019	2.92%
2020	-1.16%
Annualized	3.59%

- **Uncorrelated Returns:** 10-year trailing correlation with Barclay's Aggregate Bond Index of -9.01% (just 35.11% with S&P 500).
- **Expands Efficient Frontier:** Can generate similar return at a lower risk level.

Trailing Periods Through 12/31/2020	Average Return	Standard Deviation
10 year	3.20%	3.41%
5 year	1.85%	3.26%
3 year	-0.48%	3.94%
1 year	-1.16%	5.74%

Note: Past performance is not a guarantee of future returns; returns are hypothetical based on back testing. All information posted is believed to come from reliable sources. We do not warrant the accuracy or completeness of information made available and therefore will not be liable for any losses incurred. Trailing Returns are annualized and based on compounded monthly performance of realized and unrealized performance. 2020 YTD returns are through 12/31/2020 and include unrealized performance.





# Disclosures

This information in this presentation is for the purpose of information exchange. This is not a solicitation or offer to buy or sell any security. You must do your own due diligence and consult a professional investment advisor before making any investment decisions. The use of a proprietary technique, model or algorithm does not guarantee any specific or profitable results. **Past performance is not indicative of future returns.** The performance data presented are gross returns, unless otherwise noted. The risk of loss in trading securities can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. All information posted is believed to come from reliable sources. We do not warrant the accuracy or completeness of information made available and therefore will not be liable for any losses incurred.

The investment performance shown is HYPOTHETICAL. It is based on the back tests of historical data. Hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program.

One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the presentation of hypothetical performance results and all of which can adversely affect actual trading results.

The composition of a benchmark index may not reflect the manner in which a Julex portfolio is constructed in relation to expected or achieved returns, investment holdings, portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility, or tracking error targets, all of which are subject to change over time.

No representation or warranty is made to the reasonableness of the assumptions made or that all assumptions used to construct the performance provided have been stated or fully considered.

Please see the “Characteristics and Risks of Standardized Options,” available at [www.cboe.com/Resources/Intro.aspx](http://www.cboe.com/Resources/Intro.aspx)

Standard & Poor's®, S&P®, and S&P 500® are registered trademarks of The McGraw-Hill Companies, Inc. and are licensed for use by CBOE. All other trademarks are the property of their respective owners.



# Risk Considerations

- There are several factors to take into consideration when evaluating the risks of options strategies:
  - If the S&P 500® Index becomes more volatile, causing more of the short calls and puts to settle in-the-money, there will be a negative impact on performance.
  - If liquidity and pricing transparency in the weekly expirations diminish, there could be negative impact on performance. In extreme situations, we may be unable to implement the strategy.
  - Transaction costs could be significant in multi-leg options strategies, including spreads, as they involve multiple commission charges.
  - Margin requirements for option writers are complicated and not the same for each type of underlying security. They are subject to change and can vary from brokerage firm to brokerage firm. As they have significant impact to the risk/reward profiles of each trade, writers of options (whether they be calls or puts alone or as part of multiple position strategies such as spreads, straddles, or strangles) should determine the applicable margin requirements from their brokerage firms and be sure that they are able to meet those requirements in case the market turns against them.
  - Taxable clients should consult a tax adviser to determine how options transactions and any sales of underlying stock will affect their tax situation. Tax-exempt investors should ensure that counsel is comfortable that the strategy is allowed and, if not, what steps need to be implemented to amend the plan document.
  - The investor should also confer with their custodian to ensure the full understanding of the options settlement process and collateralization requirements.



## **How Can We Be Sure Tactical Allocation Isn't A False Promise?**

Friday, April 16<sup>th</sup> at 11am



## For More Information Contact



**Jeff Megar, CFA**  
**Email: [jeff.megar@julexcapital.com](mailto:jeff.megar@julexcapital.com)**  
**Office: 781-772-1378**



**Bob Peatman**  
**Email: [bob.peatman@julexcapital.com](mailto:bob.peatman@julexcapital.com)**  
**Cell: 617-875-9316**

