Purpose
YIELD SHARES

The Essential Guide to Covered Calls and Options

1.0 INTRODUCTION

A covered call is an investing strategy where an investor sells (i.e., "writes") call options while owning an equivalent amount of the underlying stock.

In essence, ETFs that employ covered call writing strategies can be effective ways to generate monthly yield for investors while still providing exposure to a security or asset class on a long-term basis.

Covered call strategies historically perform well in volatile markets, benefitting from the income generated from selling call options. However, by using this strategy, investors sacrifice some upside potential that could come from the underlying stock in exchange for the yield earned from selling calls.

In this whitepaper, we'll go over the basics of call options, covered calls, and when it might make sense to use a covered call strategy so you can confidently decide whether incorporating covered call ETFs in your portfolio makes sense for you.

Key Term

Selling a covered call is known as *"writing."*

For example: You may write a covered call option if you want to receive income (i.e., get yield) while you continue to own the stock.

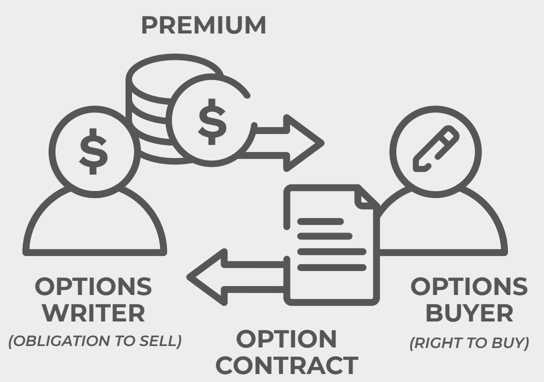
2.0 WHAT IS A CALL OPTION?

A call option is an agreement between two parties that gives the option buyer the right, but not the obligation, to buy a stock at a fixed price within a specific time period. The buyer of the call option pays a fee to the seller for that right.

Each call option has three features that are important to note:

- **Strike price:** When you buy a call option, you pay extra to have the right to buy the underlying stock at a predetermined price known as the strike price.
- **Expiration date:** The final date you can exercise your option to buy or sell the underlying stock.
- **Premium:** The small fee you pay that allows you to lock in the strike price, which is determined by (1) the difference between the stock and strike price, (2) the underlying stock's volatility, and (3) the remaining time until the expiration date.

Call Option

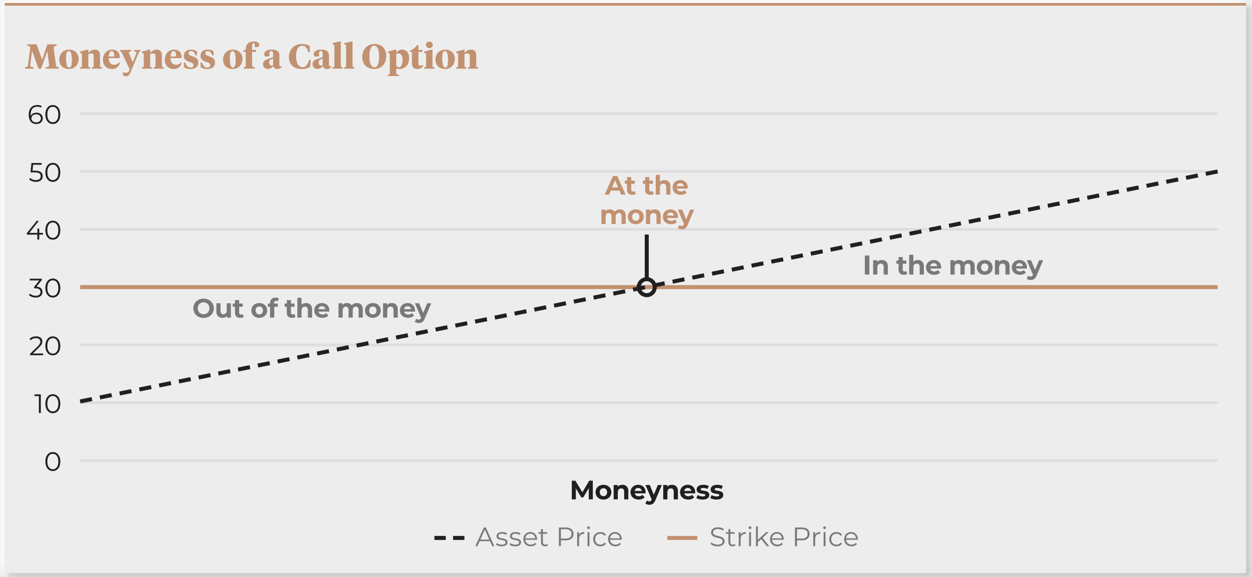


3.0 WHAT IS A COVERED CALL OPTION?

A covered call strategy involves holding a long position in a stock and then selling a call option on the asset to generate income.

The call option is a contract that gives one party (the purchaser) the right to carry out a specified transaction on a specified stock with another party (the seller or option writer).

A covered call strategy allows the option writer to create additional income from the underlying securities in the portfolio.



For illustrative purposes only.

4.0 WHAT ARE THE BENEFITS OF USING COVERED CALL OPTIONS?

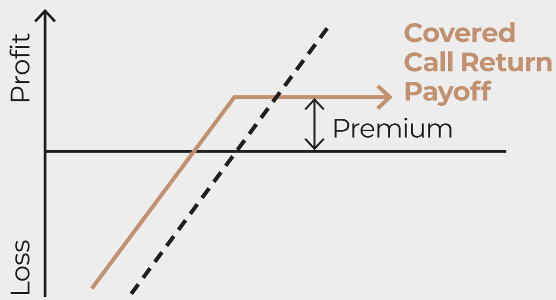
Covered call strategies allow investors to earn immediate income from the underlying portfolio that should be relatively higher than what would have been generated by simply holding the securities themselves.

It does not mean that a higher return will necessarily be generated through the covered call strategy; instead, it means an investor can use this strategy to generate monthly income from a stock portfolio either to meet a potential income target or to diversify their sources of income in their broader asset allocation.

The premiums earned from covered call strategies are a function of market volatility. When volatility is high, option premiums rise as well. The higher premium can dampen some of the portfolio volatility.

Earn yield with covered call strategies.

COVERED CALL



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5.0 WHAT MIGHT YOU EXPECT USING COVERED CALLS IN DIFFERENT MARKET ENVIRONMENTS?

How covered calls historically perform

Bear Market

⊕ Outperforms

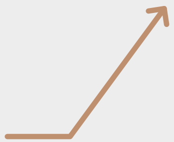
Range-Bound Market

⊕ Outperforms

Moderate Bull Market

⊕ Outperforms

Powerful Bull Market



⊖ Underperforms

For illustrative purposes only.

In general, covered call options are typically favoured for use in bear and sideways markets or in environments where yields are low and volatility is high. This is because covered calls provide regular yield (e.g., on a quarterly or monthly basis) but limit an investor's upside depending on how high percentage of a call option was exercised.

For example, writing a call option on 100% of a holding maximizes your income but stops you from participating in capturing growth if the stock moves higher.

The percentage of a call option written on a holding in covered call ETF strategies varies.

Whether a call option is worth anything, or makes sense to exercise, can be summarized with the term "moneyness."

To illustrate, a call option where the asset price is lower than the strike price is referred as "out of the money." This means the asset price isn't high enough to justify exercising the option. When the asset price equals the strike price, the option is "at the money," and lastly, when the asset price is above the strike price, the option is "in the money."

Overall, covered calls often make most sense to exercise when times are bearish and volatile as the premium can offset unrealized losses, while spikes in volatility might increase options premiums, leading to a strong performance from these strategies.

However, no matter the market environment, covered calls provide an alternative source of income to supplement traditional 60/40 portfolios.

6.0 THE BOTTOM LINE

If you are seeking to maximize your yield while keeping long-term exposure to your favorite securities and you believe market conditions will be bearish and volatile over your intended holding period, then employing a covered call investing strategy might make sense for you.

Likewise, if capturing sky-high growth is not your top priority, whether because you believe the market isn't prime for that or because you're happy with the growth sleeve in your portfolio, but you're looking for yield, covered call ETFs might be a good fit.

Incorporating covered call strategies alongside standard investments in a security is also a good fit for some investors as the two strategies together can complement a portfolio and offer opportunity for growth as well as yield.

Before investing, you should always consult a financial advisor so they can give you more tailored advice as to what makes sense for you based on your investment goals. However, if in the meantime, you'd like to learn more about how to incorporate covered call ETFs into your portfolio, we encourage you to explore Purpose Yield Shares, the world's first individual stock ETFs that use covered call strategies and moderate leverage to help investors maximize yield on stocks like Amazon and Apple.

Let's talk!

1-888-557-5020 | sales@purposeinvest.com

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