

CASE STUDY 3

COMMSEC MARGIN LOAN AND ETO TRADING COMBINED TO BOOST YOUR INVESTMENT POWER



Susan and Jeff both use a CommSec Margin Loan to increase the size of their portfolios and therefore potentially increase their returns. Susan's and Jeff's portfolios have one blue chip stock in common. While Susan is satisfied with the performance of this stock, Jeff wants to investigate trading strategies to increase its return. After learning about Exchange Traded Options*, Jeff decides to try generating extra income by writing Covered Call Options over the stock, while Susan simply continues holding the same share on her portfolio relying solely on dividends and share price movements to generate returns.

WHETHER YOU'RE JUST STARTING OUT AS AN INVESTOR OR A TRADER, OR YOU ALREADY HOLD A PORTFOLIO OF SHARES, IT OFTEN SEEMS LIKE IT WILL TAKE A LONG TIME TO ACHIEVE YOUR INVESTMENT GOALS. WITH A COMMSEC MARGIN LOAN YOU CAN INVEST NOW RATHER THAN LATER AND MULTIPLY YOUR POTENTIAL RETURNS. TO FURTHER INCREASE THOSE RETURNS, YOU CAN GENERATE EXTRA INCOME THROUGH COMBINING THE POWER OF A COMMSEC MARGIN LOAN WITH A COMMSEC OPTIONS ACCOUNT IMPLEMENTING A COVERED CALL STRATEGY OVER THE SHARES HELD IN YOUR COMMSEC MARGIN LOAN. HERE IS AN EXAMPLE.

THE CHALLENGE

Susan and Jeff have both invested \$50,000 in their chosen stock using \$25,000 of their own money and borrowing an additional \$25,000 with a CommSec Margin Loan. Both have set about maximising their returns over an eighteen month period.

THE STRATEGY

While Susan is happy to generate returns that rely on share price movements and dividends, Jeff decides to sell Covered Call Options every month, to generate extra returns. Jeff's strategy is to write covered calls at a strike price which his research has identified the underlying stock should not reach or exceed during the relevant monthly period in order to consistently generate income.

Using this strategy, Jeff accepts the risk that if the stock price becomes greater than the Call Option's strike price, the option may be exercised. This would result in Jeff being obliged to sell the stock at the pre-defined strike price, forgoing any future potential returns on the stock.

THE RESULT

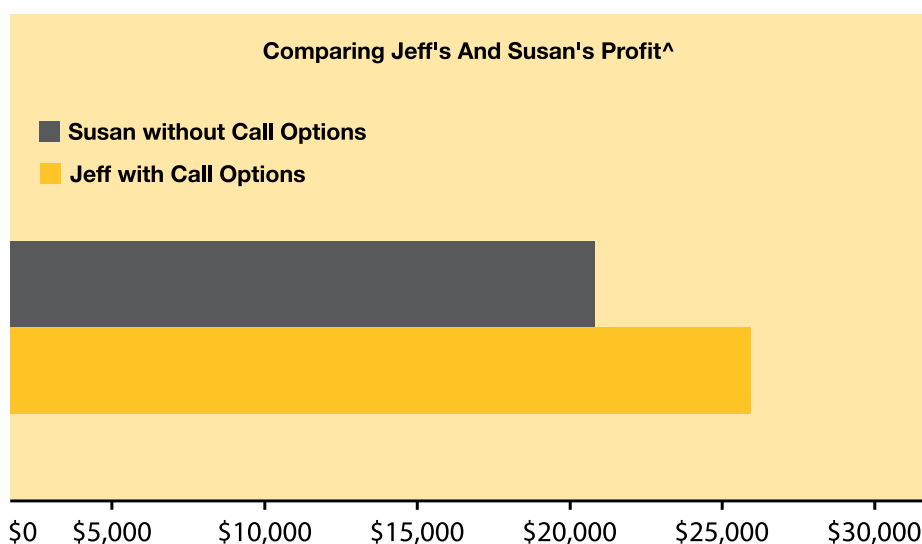
After 18 months, Susan's investment increased in value to \$76,415, giving her an unrealised profit of \$20,918. Over the same period, Jeff's investment value also increased to \$76,415, however, Jeff received an additional \$6,029 by writing Covered Calls.

Jeff's profit, which is comprised of realised and unrealised gains, is \$26,946. Jeff's strategy of writing Covered Call on the stock held on his Margin Loan has outperformed Susan's strategy by 29%.^

Risk Disclosure: Remember, whilst borrowing to invest can multiply your investment returns, it may also multiply your losses if the value of your investment falls. Margin loans and exchange traded options can involve significant risk. Only investors who fully understand the risks associated with margin loans and options should consider these products. This example is for illustrative purposes only. Options prices used are theoretical and derived using a standard options pricing model. The names and identifying features do not reflect any particular person or real outcomes. The information should not be taken to represent actual performance and should not be interpreted as an indication or guarantee of future performance. CommSec Margin Lending facilities are provided by Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 (the Bank) and administered by its wholly owned but non-guaranteed subsidiary Commonwealth Securities Limited ABN 60 067 254 399 AFSL 238814 (CommSec). This information is not advice and has been prepared without taking account of your objectives, financial and taxation situation or needs. For this reason you should, before acting on this information, consider the appropriateness of the information having regard to your objectives, financial and taxation situation and needs and, if necessary, seek appropriate professional advice. Information on taxation is based on the continuation of current laws and their interpretation. No warranty or guarantee is given by the Bank or its subsidiaries for the repayment of capital invested or the payment of income with respect to any investment listed as a security. Applications are subject to the Bank's credit approval. Fees and charges apply. Full terms and conditions are available on application. Please consider the Product Disclosure Statements available from commsec.com.au before making any decisions about Margin Loan and Exchange Traded Options (Options). Options are issued by CommSec. Past performance is not an indicator of future performance.

*To trade Exchange Traded Options, a CommSec options trading account is required. More information about options trading is available on the CommSec website or calling the CommSec Options desk on 1800 245 698.

	Susan - without Call Options	Jeff - with Call Options
Investor's Own Capital	\$25,000	\$25,000
CommSec Margin Loan	\$25,000	\$25,000
Total Initial Investment	\$50,000	\$50,000
Investment Value After 18 Months	\$76,541	\$76,541
Dividends Received (reinvested)	\$5,415	\$5,415
Call Option Premium Received	Nil	\$6,029
Interest Paid	\$5,624	\$5,624
Profit After 18 Months	\$20,918	\$26,946
Return on Investor's Own Capital	84%	108%



This graph compares total profit (unrealised for the stock) obtained by Jeff, net of any interest and options trading costs involved in writing Covered Call options, against Susan's return achieved through holding the stock without selling Covered Call options.

Whilst not all option trades were profitable, over 18 months Jeff's Covered Call writing strategy delivered \$6,029 in extra income. The premiums received from writing Covered Calls bring Jeff's total profit for the 18 month period to \$26,946, while Susan's strategy of holding the stock returns \$20,918 in unrealised profits.

[^]Assumptions: This example is hypothetical and for illustrative purposes only, actual results may vary significantly. Interest has been calculated using a variable rate ranging between 7.85 p.a. and 9.60% p.a. over an 18 month period. This example assumes interest is paid by direct debit at the end of each month. Although the stock chosen for this example is hypothetical, this case study has been modelled on a real stock trading on the ASX using its price and dividend behaviour over an 18 month period. Unrealised capital gain on the stock has been calculated by deducting the total initial investment and less accumulated interest costs. Dividends have been reinvested. Brokerage, as well as any taxation benefits or implications arising from investing in the stock (including franking credits and interest expense deductions) have not been taken into account in calculating the results.

In this example call options were sold 4-5% (approximately \$1.75-\$2.25) out of the money and either expired worthless, were rolled into a higher strike price on expiry day or were bought back as soon as they were \$0.50 in the money. Options premiums have been derived from theoretical option prices calculated using the Black and Scholes options pricing model. Total option premiums received are net of brokerage costs and ASX fees. Potential taxes on option trade profits/losses have not been taken into account. Neither Commonwealth Bank nor CommSec specifically recommend the stock or the options used in this example. The information should not be taken to represent actual performance and should not be interpreted as an indication or guarantee of future performance.

WHY CHOOSE A COMMSEC MARGIN LOAN?

- ✓ Experience in investment lending since 1995
- ✓ No ongoing fees and free to open for most applicant types; no cost to open or maintain a CommSec ETO account
- ✓ Competitive Interest Rates
- ✓ Industry Leading Integrated Trading & Lending Platform, plus mobile & tablet apps
- ✓ Automated notifications, Online Self Service functionality, & SMART™ Risk Management Tools

- ✓ Large range of lendable securities
- ✓ Experienced account managers and options representatives available to assist you when you need them
- ✓ Integrated Margin Lending and ETO trading

For all enquiries contact us by telephone on **13 17 09** (8am-6pm Sydney time) or by emailing marginloan@commsec.com.au