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# **How equity income funds can provide regular and higher income with lower volatility for investors**

**Patrick Noble**  
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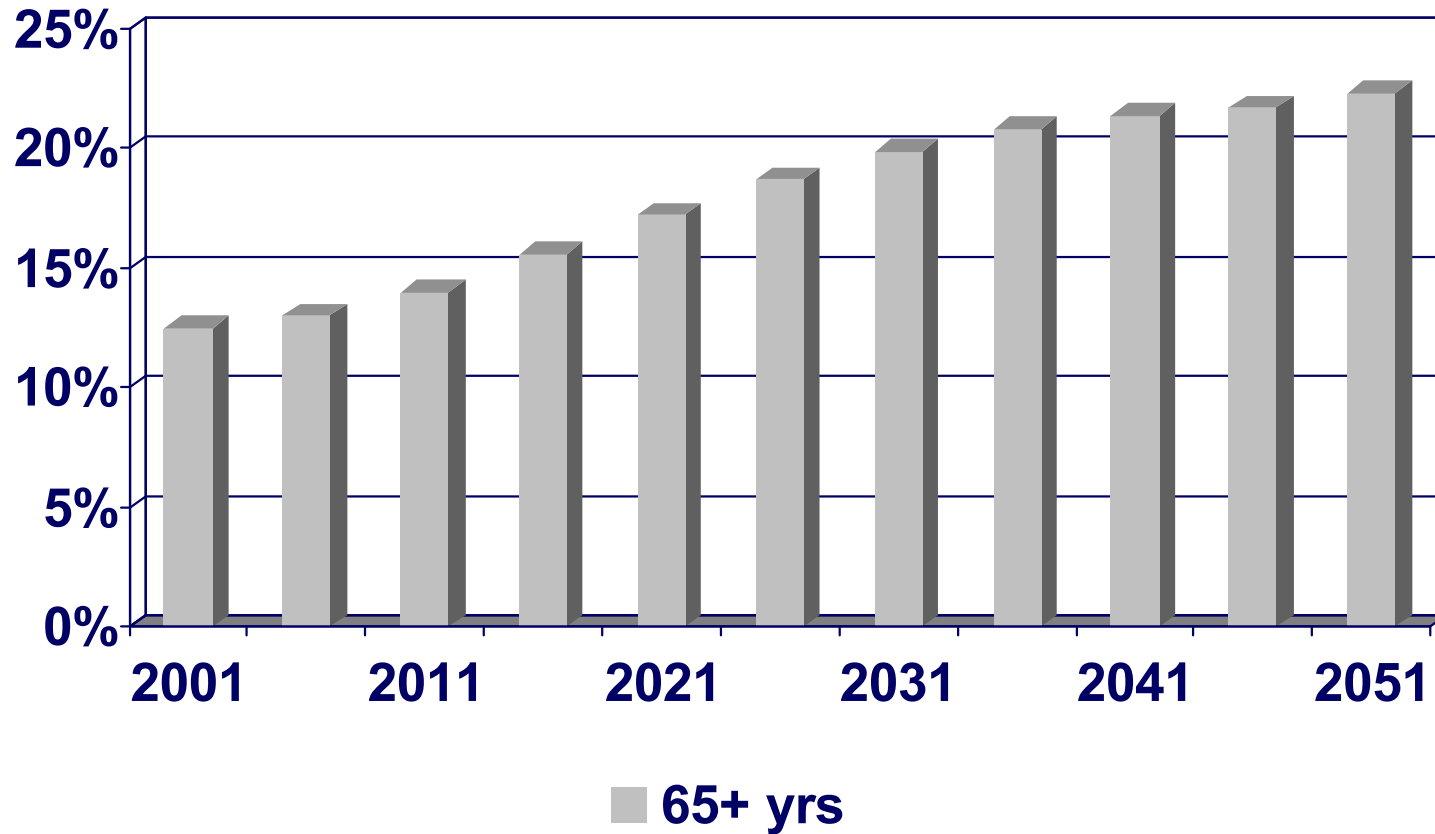
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5 Blue Street North Sydney NSW 2060 Phone 1800 500 655

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# Australia's population is ageing



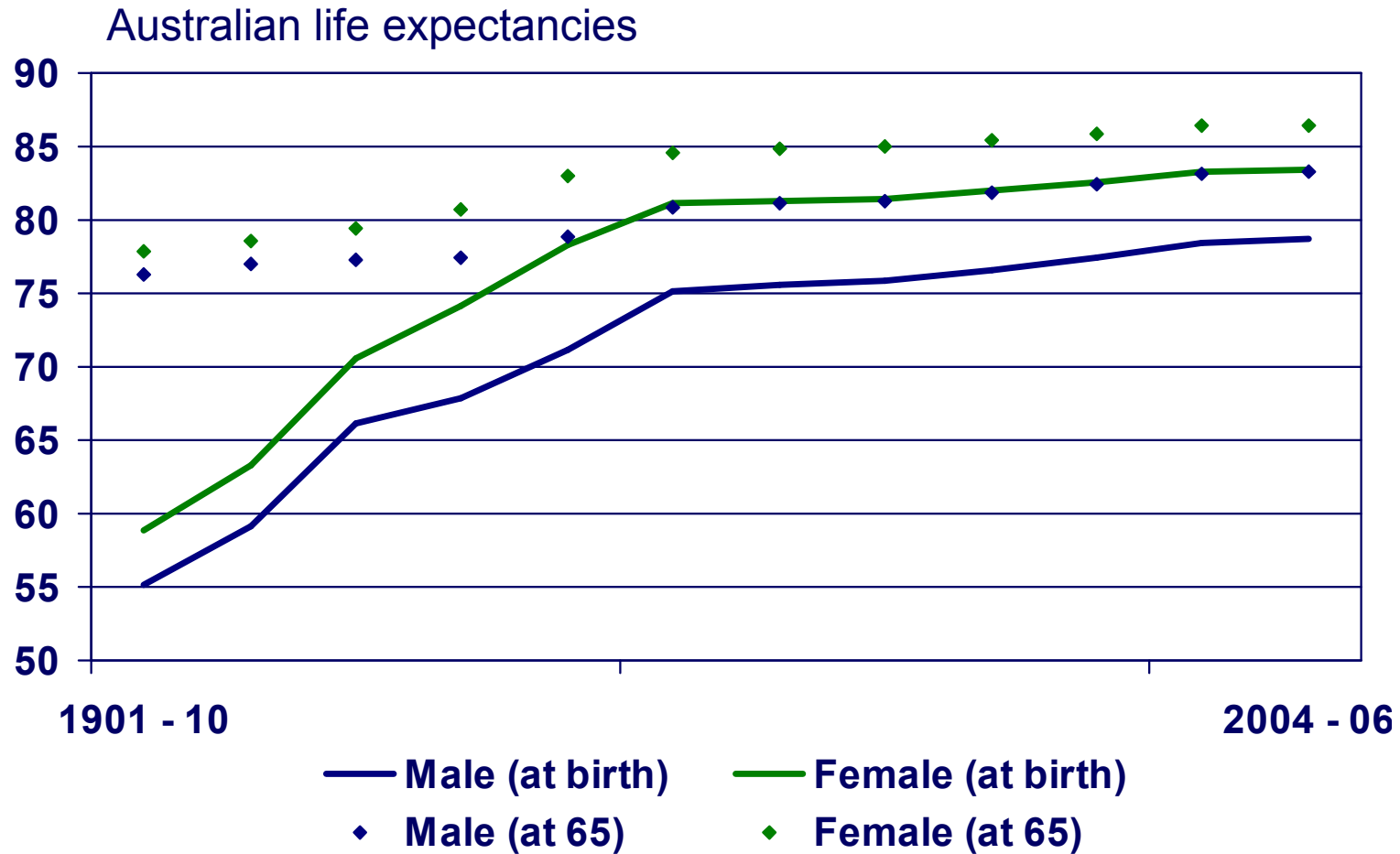
Percentage of population older than 65



Source: Australian Bureau of Statistics



# And living longer



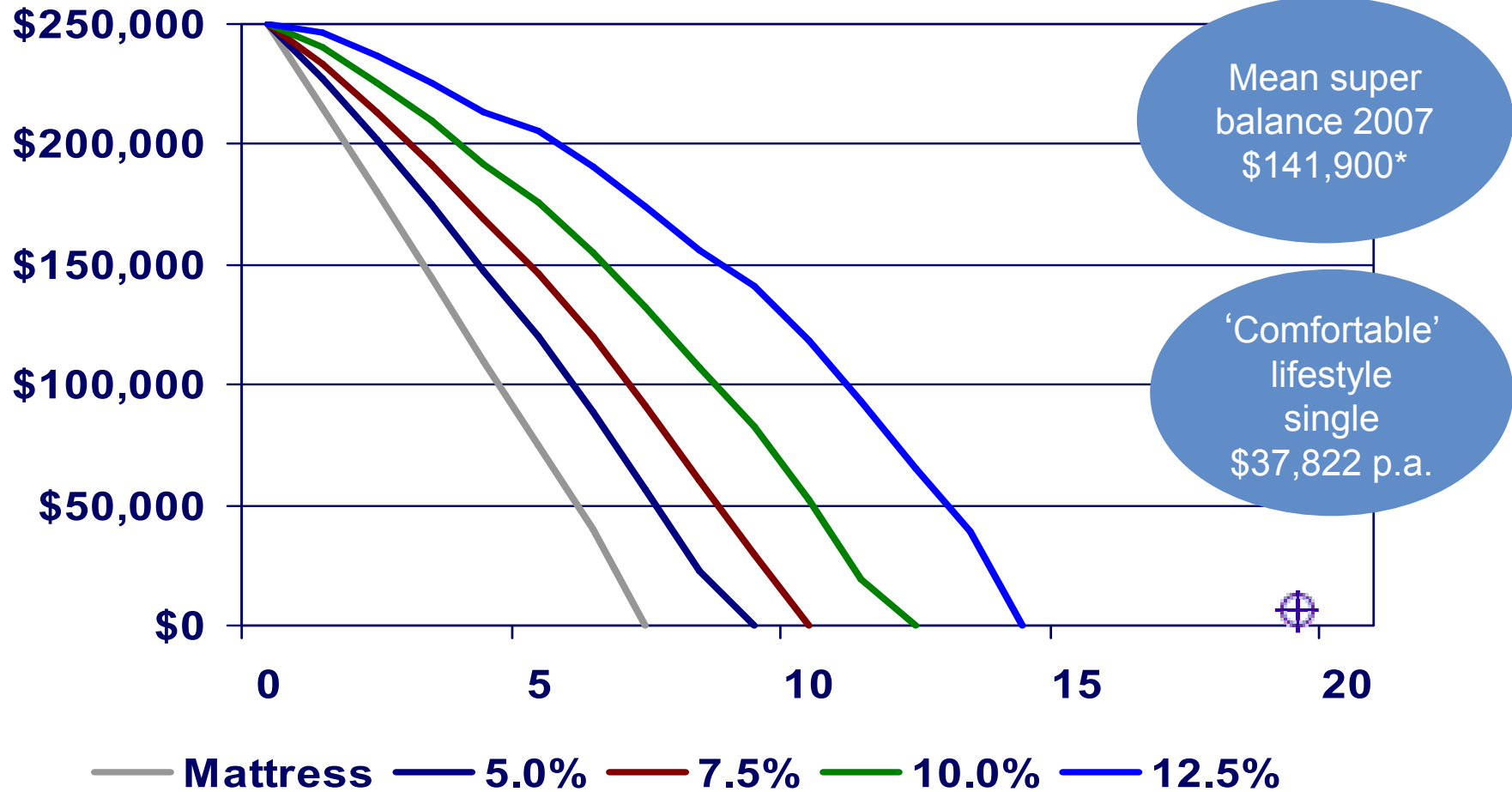
Source: Australian Bureau of Statistics



# Not so super



Retirement income and longevity



Drawdown of \$35,000 per annum

\* Mean accumulation balance for 55 – 64 year olds

Source: The Westpac ASFA Retirement Standard; APRA

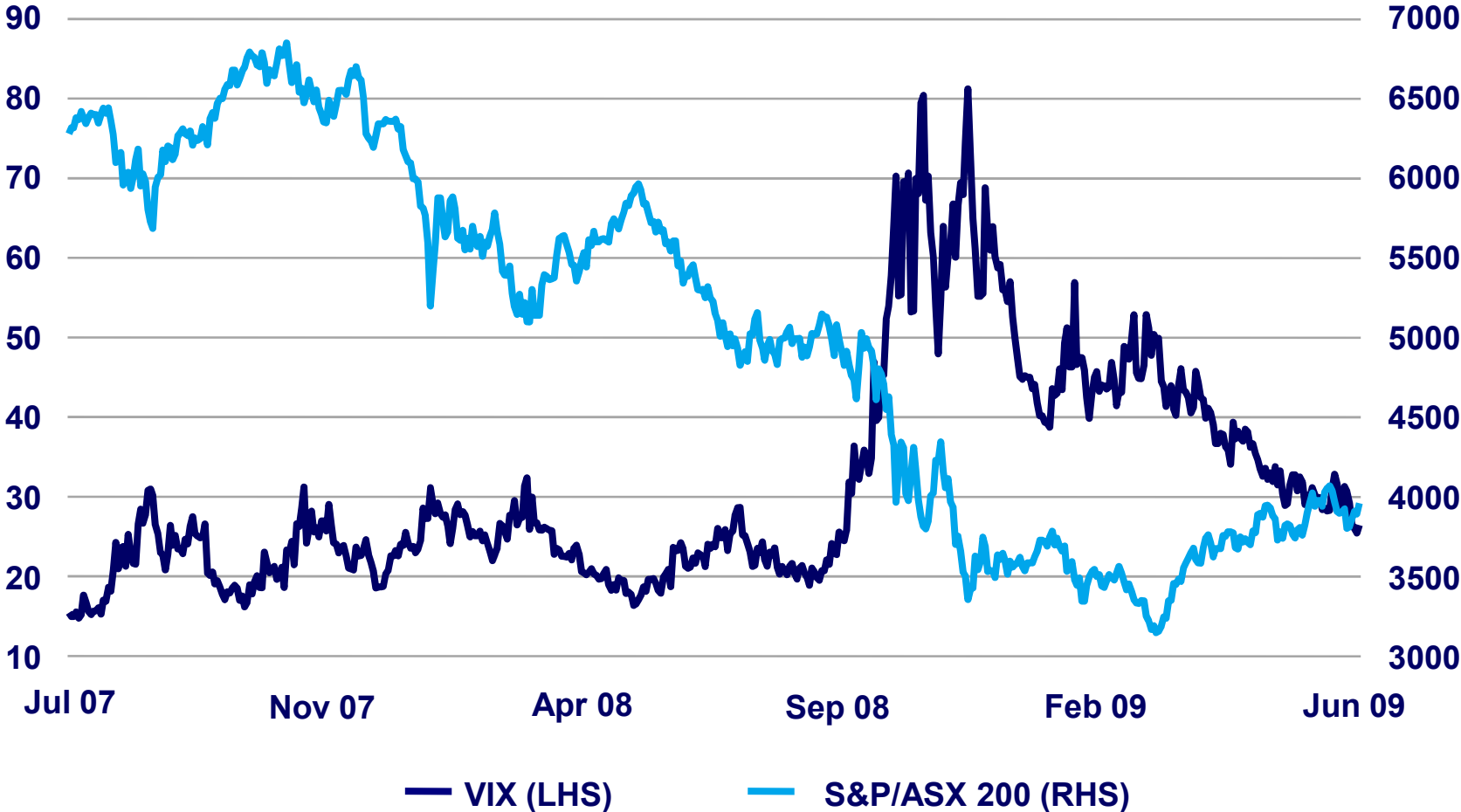
# Many caught off guard by crisis



- Poor risk management processes
- High levels of leverage
- Obscure and complex structures
- Liquidity problems



# Falling share prices and high volatility



Source: Bloomberg, Zurich Investments



# Income challenge - Investment issues



- Income, what are the options?
  - Will normalised interest rates circa 5.5% be sufficient?
  - Rising bond yields; inflation or deflation?
  - Volatile equity markets and dividend cuts
- Downside protection relevant for all investor portfolios





# Strategies for volatile markets



## Well known strategies

Diversification

Re-balance  
portfolios to  
defensive  
allocations

Stay focused  
on the long  
term

## Less familiar strategy

Use exchange  
traded options  
to get a  
defined risk  
reward  
outcome

# Options basics



## Exchange components of risk and return

Call  
option

The buyer of a call option has the right to purchase shares at a set price in the future in return for paying a premium to the seller (also known as the writer).

Put  
option

A buyer of a put option receives the right to sell shares at a set price in the future. By purchasing a put option, investors receive some downside protection should the shares fall below the (higher) specified price.

Source: ASX; Denning Pryce



# Options can be used in many ways



Speculative

- Unlisted
- No shares held
- Magnify returns
- Magnify losses
- Gearing

Conservative

- Listed
- Held over shares
- Smooth returns
- Protect against losses
- Enhance income



# Meeting the challenges with options



- 1 Generate income in all market conditions
- 2 Provide some downside protection in falling markets
- 3 Deliver conservative growth

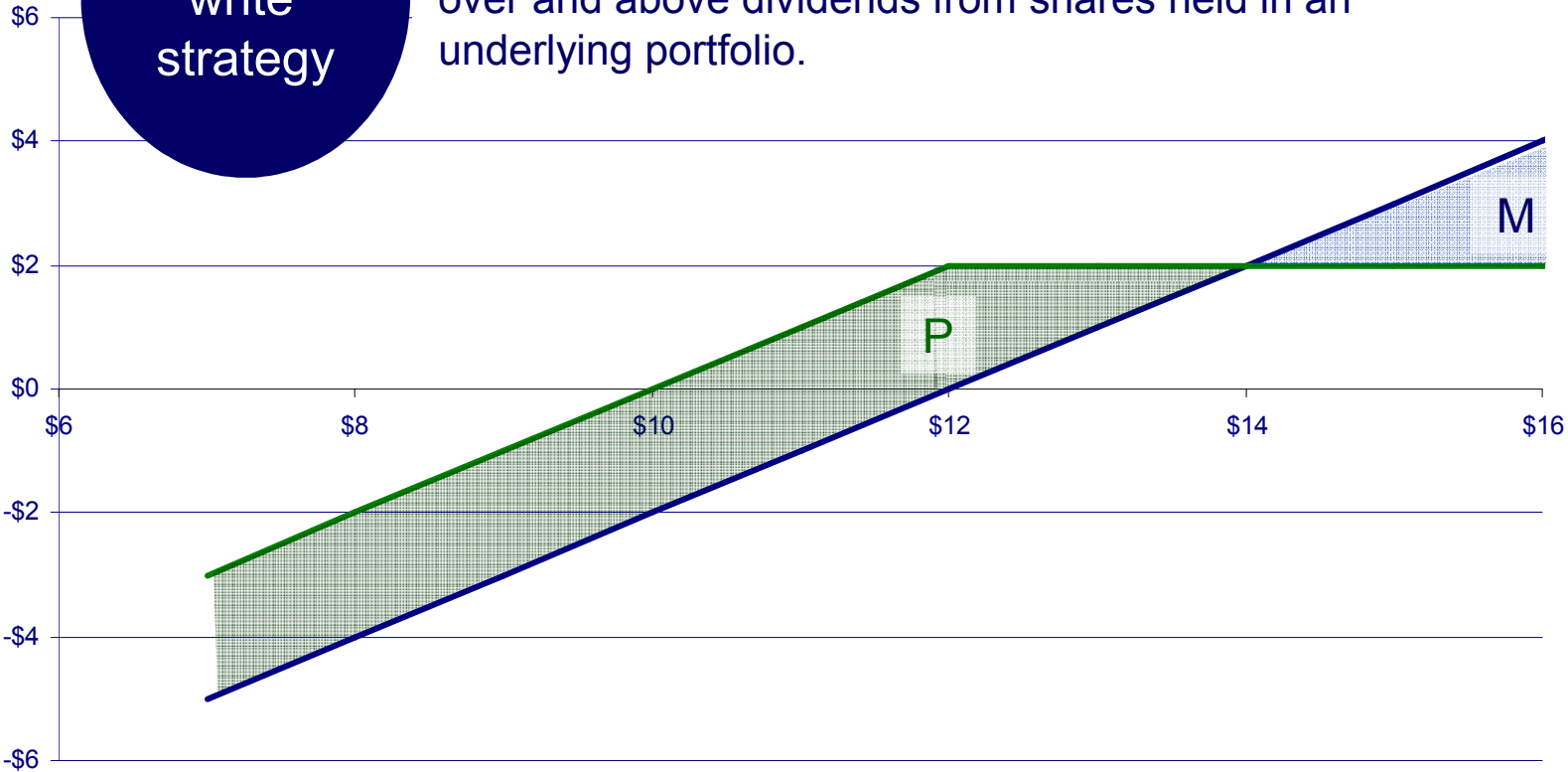


# The Covered Call or Buy Write strategy



'Buy write' strategy

Involves selling call options to generate additional income over and above dividends from shares held in an underlying portfolio.



Source: Denning Pryce; Zurich Investments



# The Buy Write - Historical outcomes



	Buy Write Portfolio	All Ords/ S&P/ASX 200 Accum Index	Buy Write Portfolio Performance Relative to Index	Bank Bills
Quarterly Returns				
Number of quarters	60	60	60	60
Mean	2.96%	2.40%	0.56%	1.98%
Median	2.47%	1.93%	0.65%	1.52%
Standard Deviation	5.78%	6.15%	0.74%	1.00%
Annual Returns				
	11.86%	9.59%	2.23%	7.93%

December 1987 to December 2002

Source: SIRCA



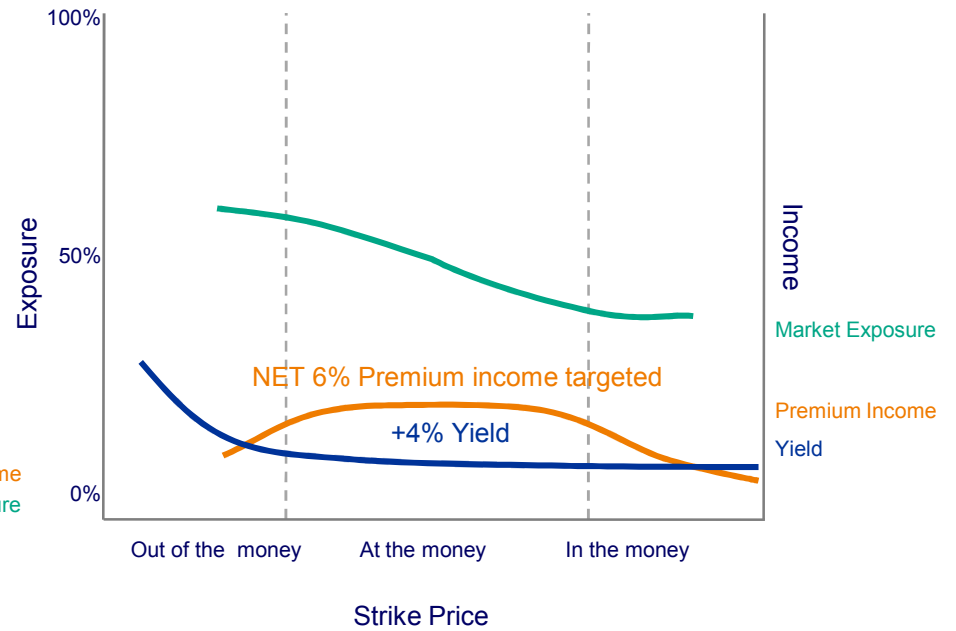
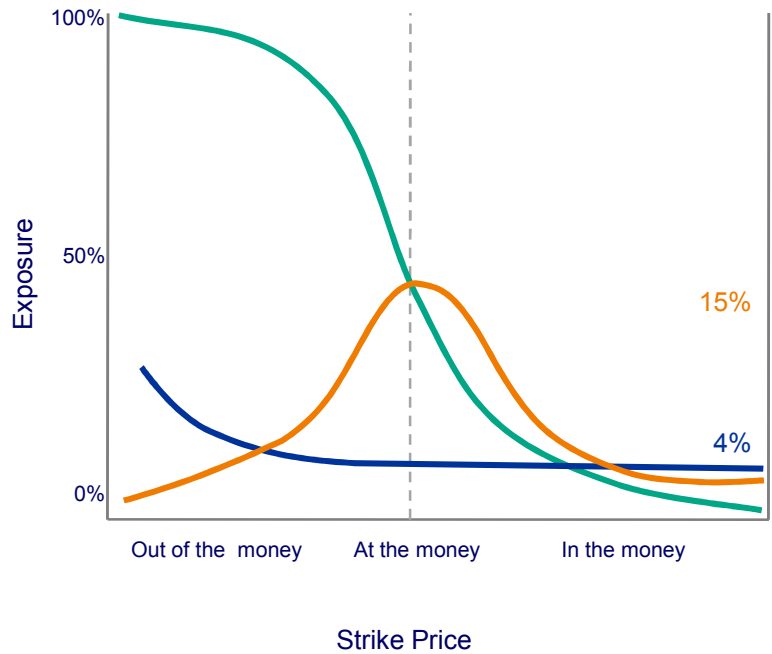
# Considerations



- Exchange Traded versus Over The Counter options
- Does active stock selection reconcile with a Buy Write?
- Strategy should provide targeted exposure and appropriate return ratio (combination of capital and income)
- Appropriate protection to the downside



# Targeting income and exposure

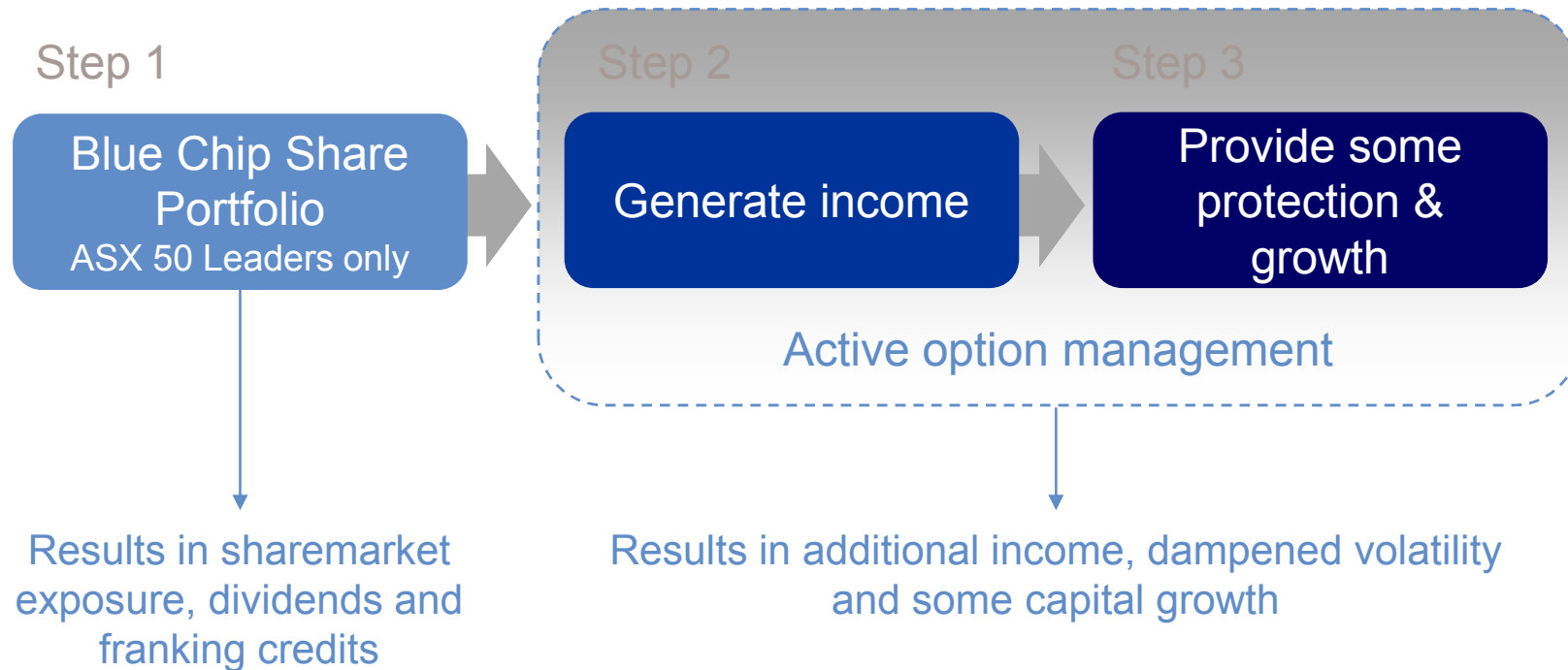


Source: Denning Pryce; Zurich Investments

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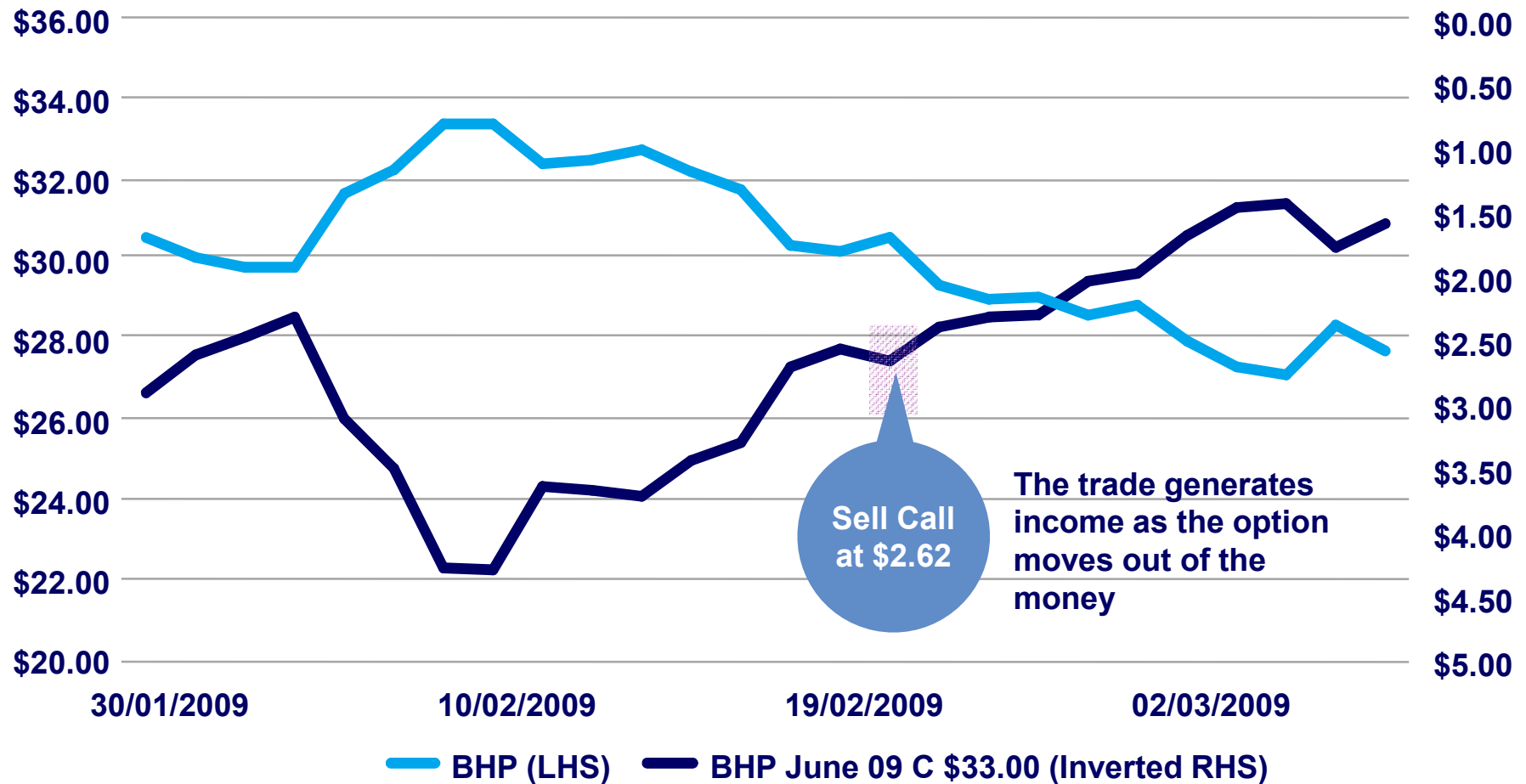
# Executing an option strategy



Source: Denning Pryce; Zurich Investments

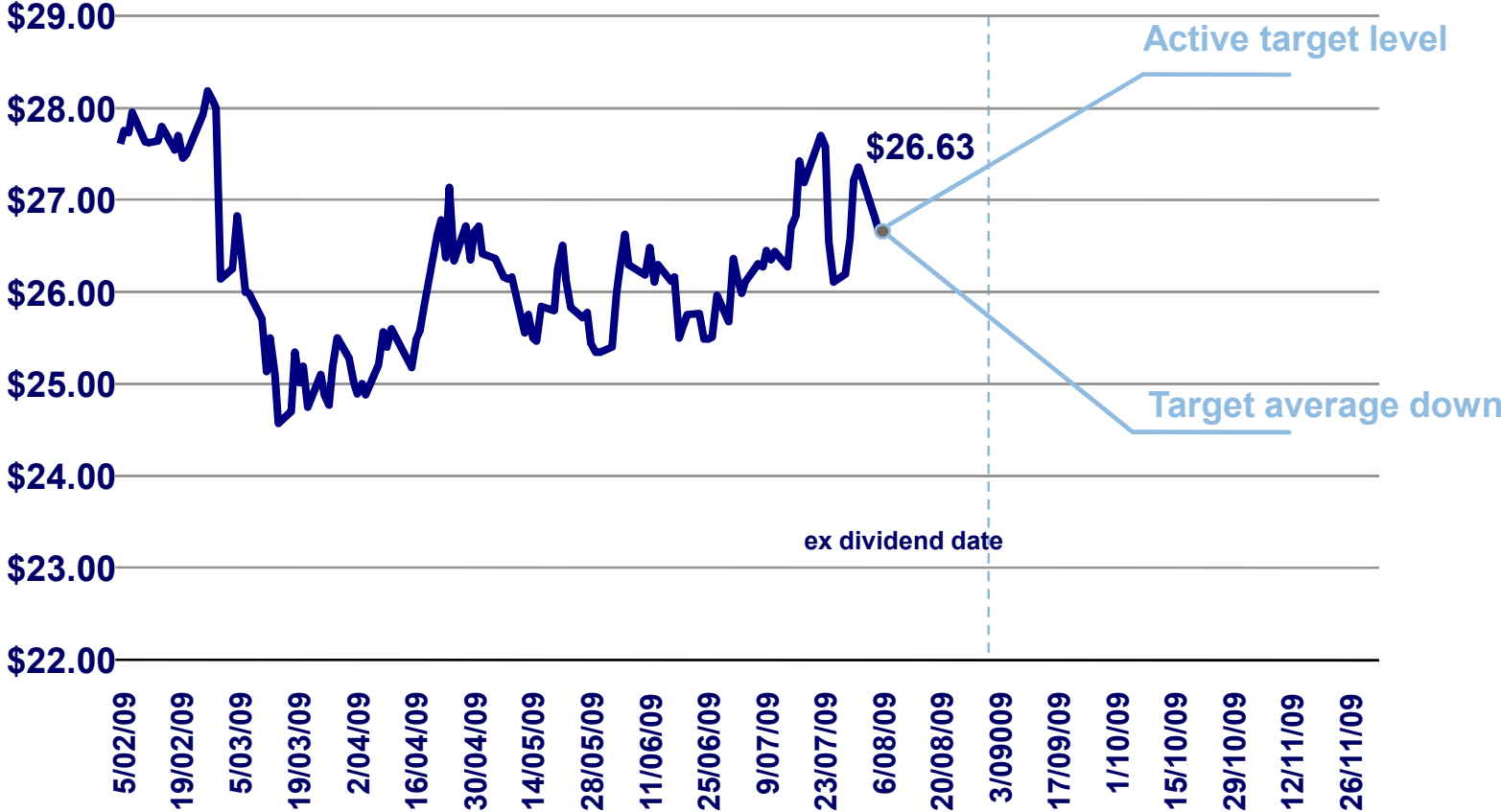


# Generating income: BHP Call options



Source: Bloomberg, Zurich Investments

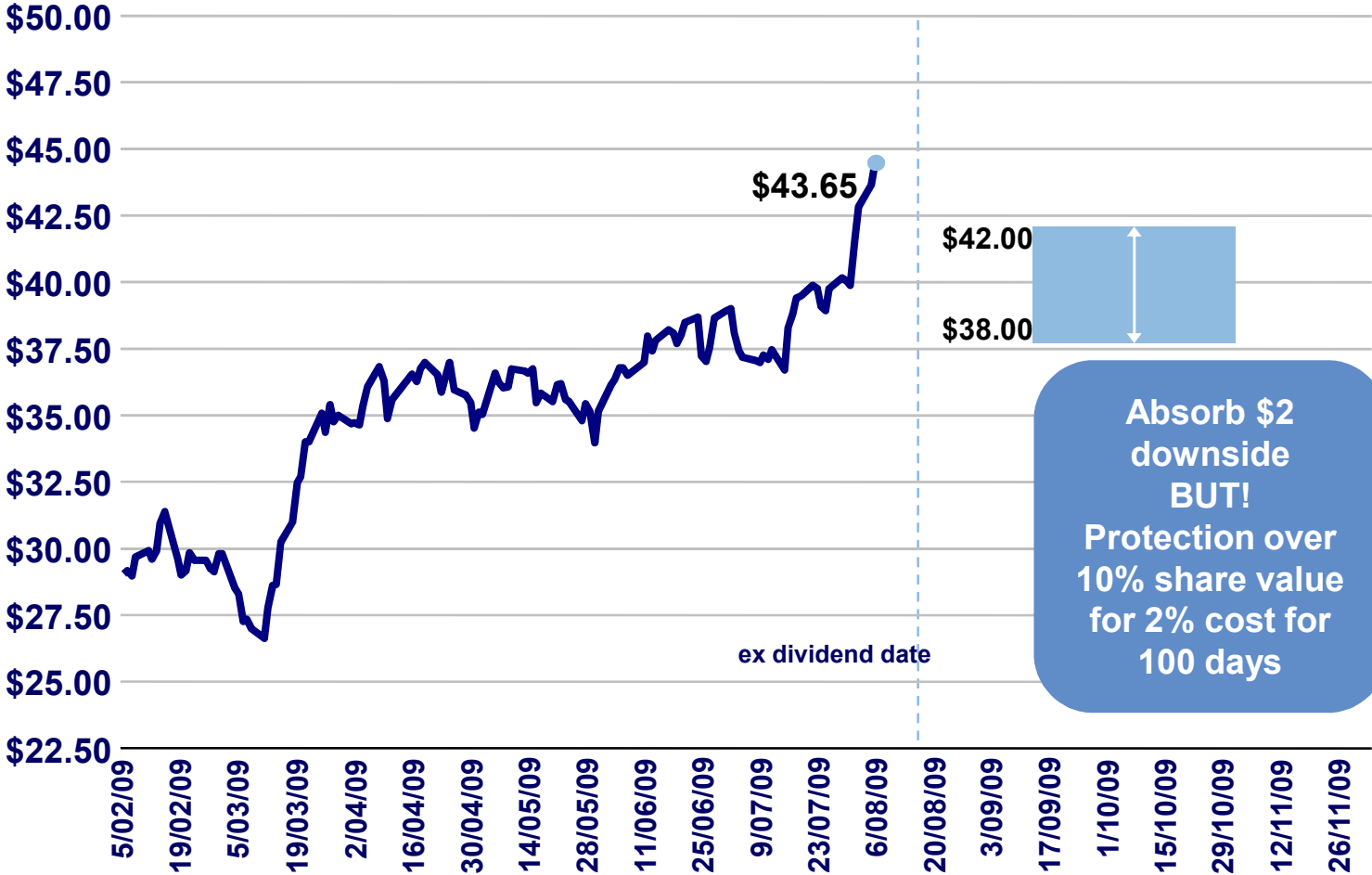
# Woolworths for income



Source: Bloomberg, Zurich Investments



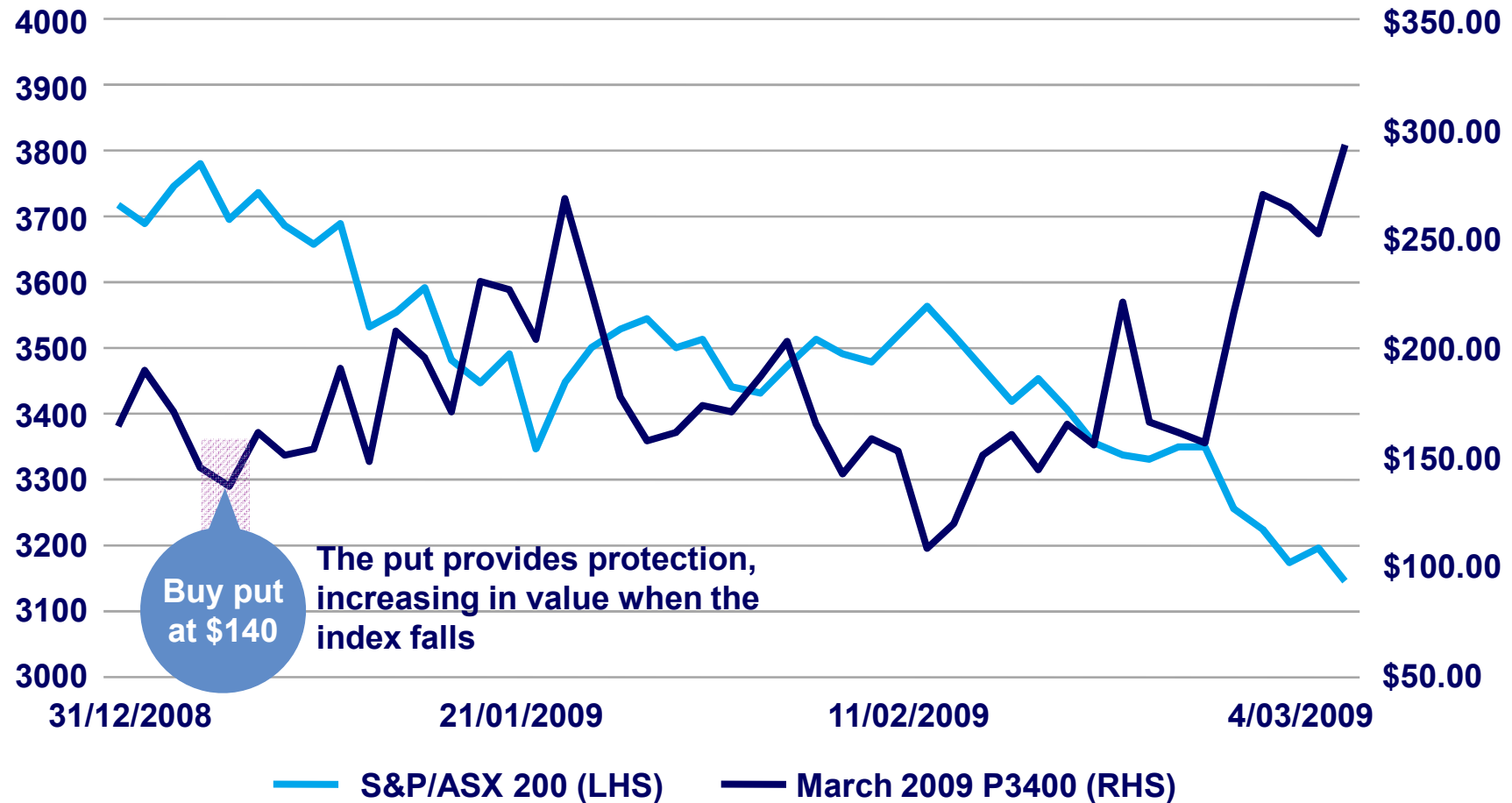
# CBA Put strategy



Source: Bloomberg, Zurich Investments



# Managing downside: Index Put options



Source: Bloomberg, Zurich Investments

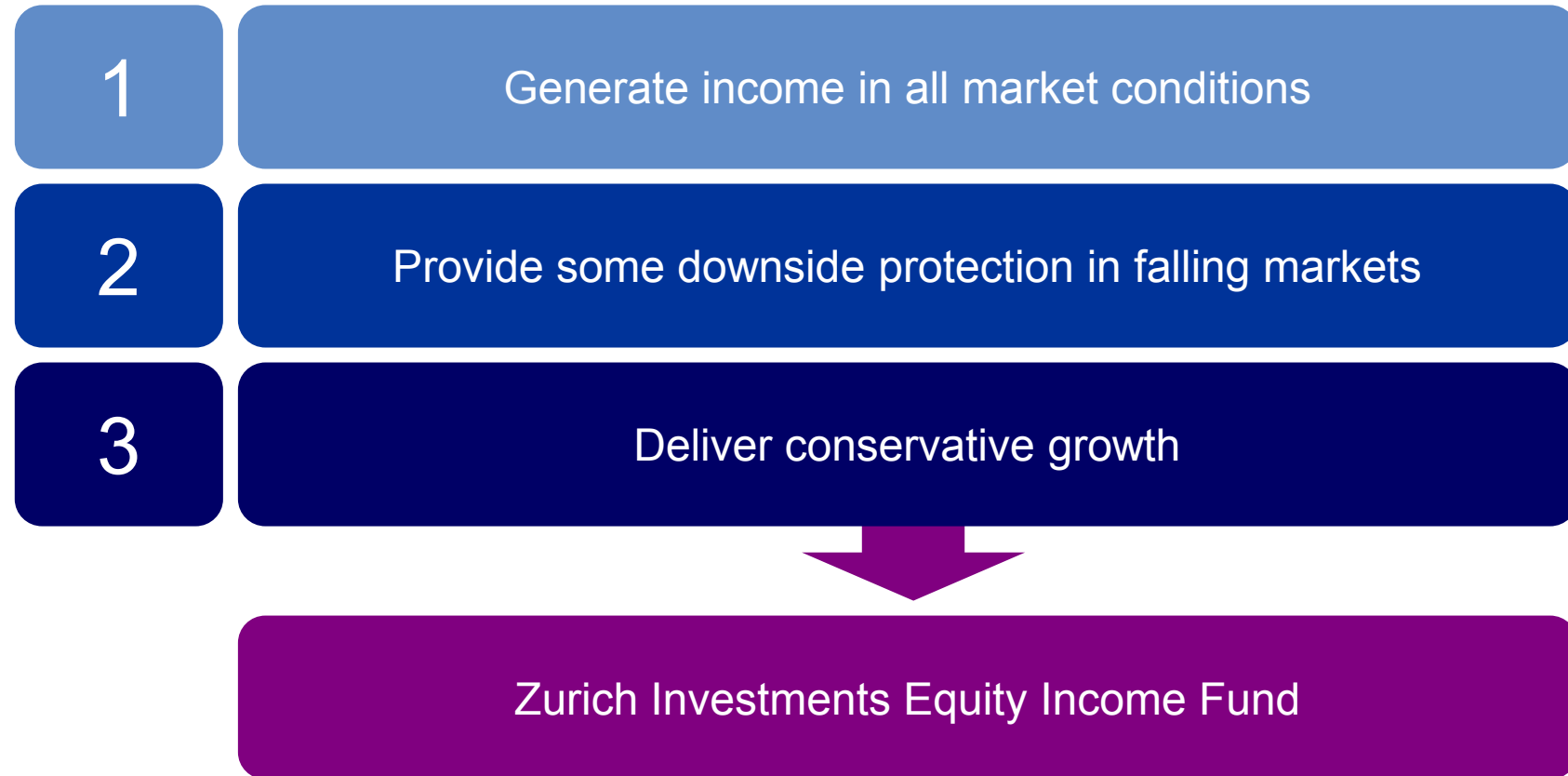
# Summary



- Use all the tools at your disposal
- Look beyond conventional strategies to help meet your clients' objectives
- Options strategies can work in all market conditions to provide additional income and lower risk



# Meeting the challenges with options



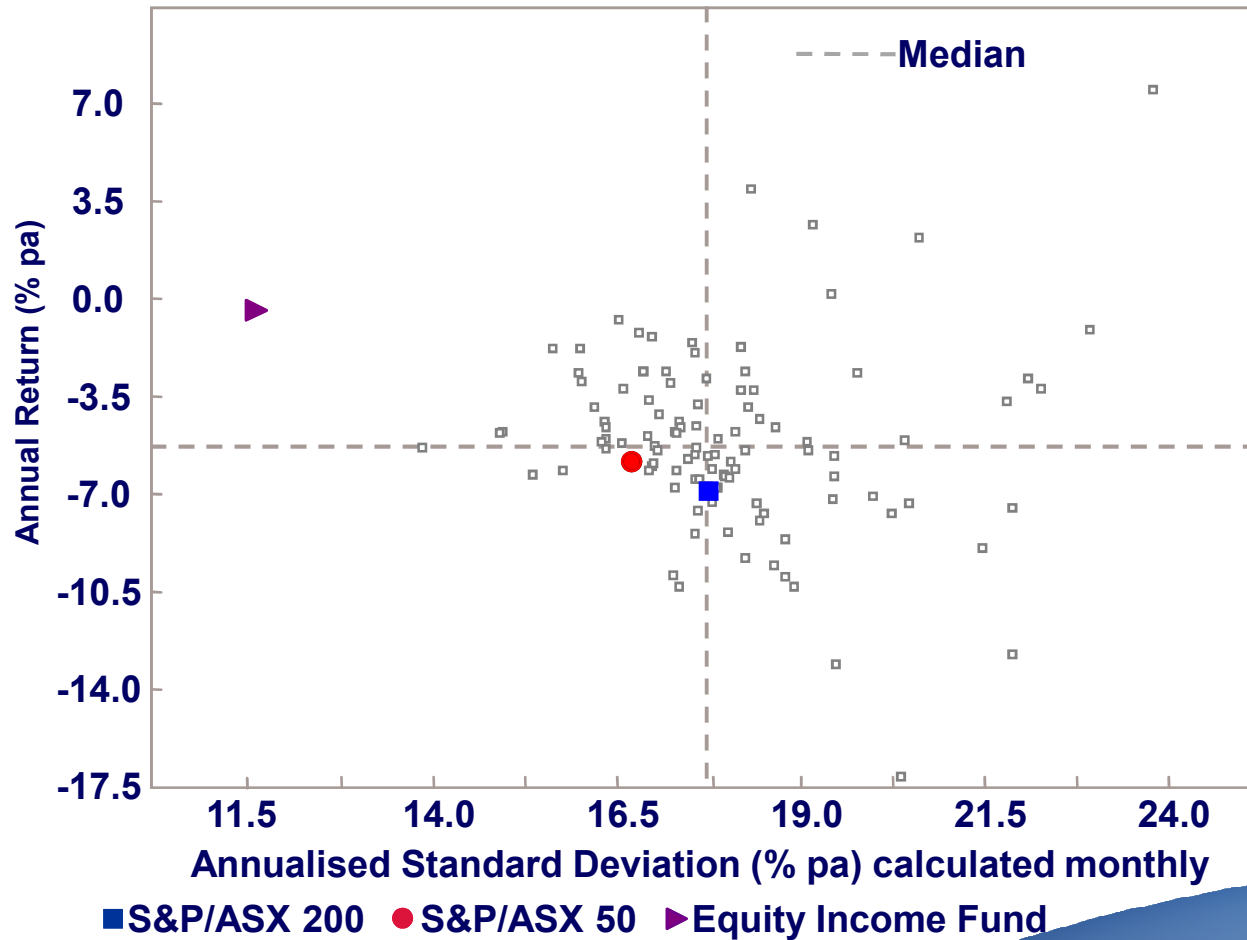
# A strategy for all seasons



S&P/ASX 200 All Australian

Annualised Risk and Return for 2 years and 8 months ended June 2009  
(before tax and before fees)

Comparison with the Mercer Australian Shares Universe



**Targets a running yield of 10% pa**

**Low volatility**  
1 year semi deviation  
11.93%

**Cushion market falls**  
1 year excess return  
14.4%

Source: Mercer, Zurich Investments





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Thank you