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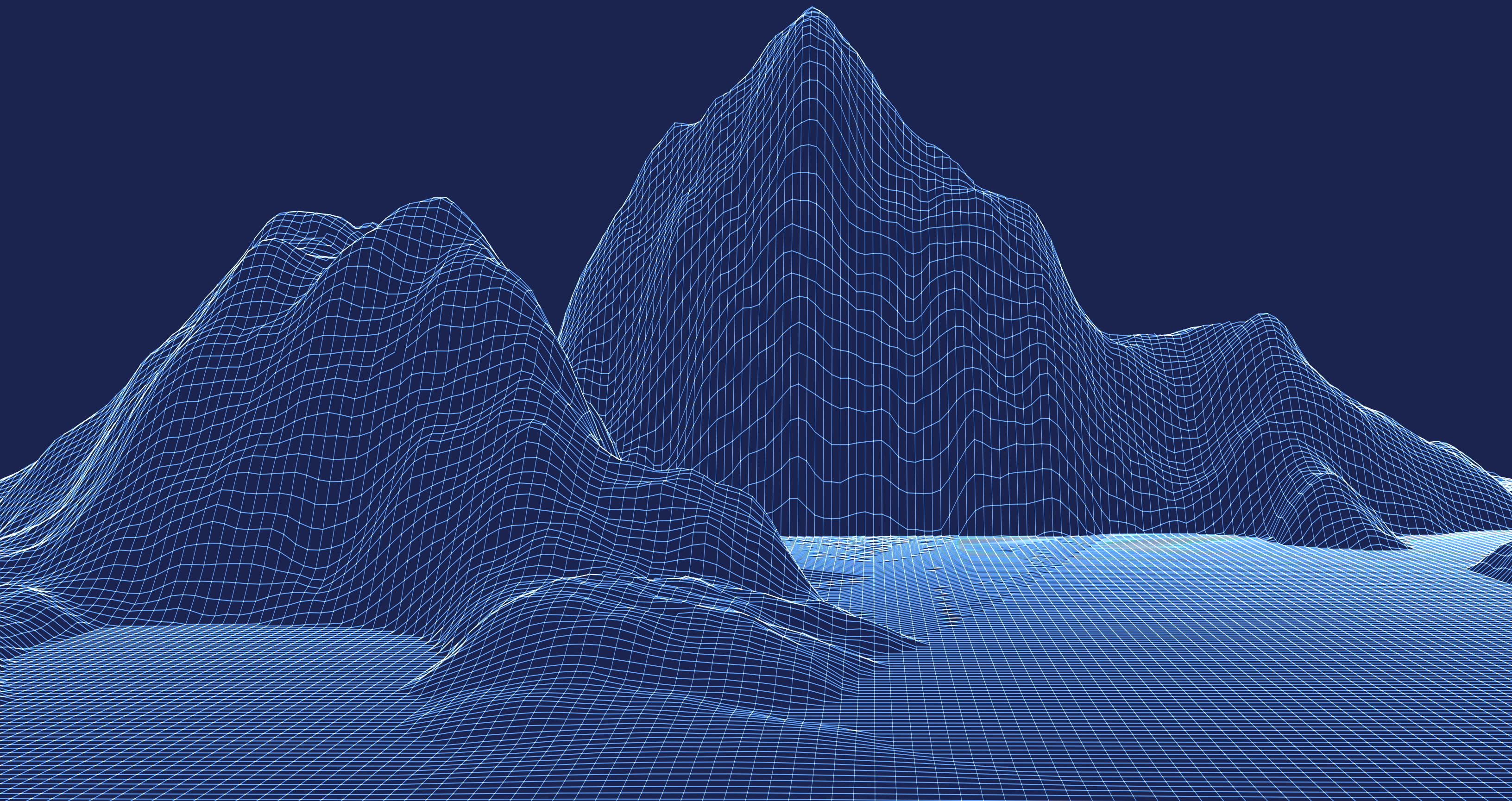
One Covered Call Strategy Seeking to Generate Income and Long-Term Growth



A Covered Call Strategy that Works

■ ■ A covered call strategy is an investment approach that aims to generate high income from option premiums. This approach has grown in popularity in recent years. As a result, some ETF issuers have responded with aggressive covered call products that offer double-digit yields. In our opinion, the problem with these ETFs is that they often use leverage to support these aggressive distributions. Therefore, the ETF exposes investors to the risk of a sharp drawdown in the event of a market decline, potentially triggering margin calls. Over time, the appeal of high distributions hides NAV erosion arising from forgone upside, capital losses, and return of capital (ROC).

We feel there is a better way to earn income that exceeds most other ETFs while still positioning investors to benefit from long-term share price appreciation. Doing so means developing a strategy that manages volatility, enabling the approach to serve investors over the long term.

What is a Covered Call?

■ ■ A call option is a contract that gives the buyer the right to purchase a security at a predetermined price – the strike price – on or before a particular date. The person selling the call is obligated to sell the underlying security to the contract owner at the specified strike price.

In a covered call strategy, the person writing the call option – the seller – also owns the shares of the company in the contract. The seller receives a premium for offering the contract. This premium is a source of yield for the seller. By owning the shares while also selling call options, the seller receives not only premium income but also the potential to earn dividends and capital gains.

If the share price rises, the contract's owner might exercise their right to buy the shares at a price below their current market value. In this case, the contract's owner is obligated to sell the shares at the strike price, but they still have the premium they collected when they sold the contract.

How A Covered Call Strategy Works

Covered call strategies tend to deliver the risk and return profile of the S&P 500 during periods of steadily rising, declining, or flat markets. If the market rises quickly, a covered call strategy is likely to underperform the S&P 500.

Data from the Chicago Board Options Exchange (CBOE) and Options Clearing Corporation (OCC) suggest that the majority of call options are not exercised because they are traded out before expiration. This characteristic is important because when the option holder chooses not to exercise the option, the writer can collect the premium without having to sell the shares at a loss. Over the long term, the option writer can benefit from potential share price appreciation and dividends.

Example

Consider a portfolio that consists of 100 shares of ABC stock at a current price of $50 per share. Call options with an out-of-the-money strike price of $55 are available with a premium of $2.00 per share.

The portfolio manager sells one covered call contract on the 100 shares and receives $200 in premium income.

Scenario 1

The Stock Price Remains at $50

If the stock price remains at $50 when the option expires, the option expires worthless and is not exercised. The portfolio's value would be $5,200 (100 × $50 = $5,000 + $200 premium).

Scenario 2

The Stock Price Declines

If the stock price declines, the option premium helps offset the loss in the stock's value. For example, if the stock price falls to $48 per share at expiration, the portfolio's value would be $5,000, which represents the break-even point.

Scenario 3

The Stock Price Rises

If the stock price rises, the upside is capped because the call option may be exercised. For example, if the stock rises to $60 per share, the option is exercised, and the portfolio is obligated to sell the 100 shares at the strike price of $55 per share. Including the premium received, the portfolio's value would be $5,700. (100 × $55 = $5,500 + $200 premium = $5,700)

The portfolio would then hold cash and could reinvest in the same stock or a different security, repeating the covered call process to generate additional income.

Stock Price at Expiration	Stock Value	Option Outcome	Premium Kept	Total Portfolio Value
$40	$4,000	Expires worthless	$200	$4,200
$48 (Break-even)	$4,800	Expires worthless	$200	$5,000
$50	$5,000	Expires worthless	$200	$5,200
$55 (Strike price)	$5,500	Exercised	$200	$5,700
$60	$5,500 (sold at $55)	Exercised	$200	$5,700
$70	$5,500 (sold at $55)	Exercised	$200	$5,700

Why Are Covered Calls So Popular?

Data from Morningstar Direct shows that covered calls have become increasingly popular, as evidenced by the growth in assets flowing into exchange-traded funds focused on derivative income strategies. In January of 2020, derivative income assets and net flows totaled about $7 billion. That number reached $150 billion at the end of July, 2025.[1] The trend is clear. Investors want income.

Some ETF issuers are ready to answer that call. These ETFs advertise sky-high distribution rates. These distribution rates are calculated by multiplying the ETF's cash distributions in the latest month by 12, then dividing the result by the fund's NAV. This number can be misleading because the income generated by selling options can change dramatically as the underlying stock price rises and falls. This volatility is especially concerning when the ETF in question is a single stock.

These extravagant yields are likely part of the reason why covered call strategies have become so popular. However, many investors like this approach for more practical reasons. A carefully executed covered call strategy can offer a stock-like portfolio with bond-like income. This configuration allows investors to participate in the average annualized stock market return of about 10% while also capturing premium income.

The pursuit of income has become a greater focus since September 2024, when the Federal Reserve began cutting the Federal Funds rate. Since then, they have enacted six cuts totaling 175 bps. For some investors, money markets are becoming less attractive for generating income. In response, many investors are turning to the strong yields in covered calls to replace the substantial income previously generated by their money market holdings.

The Benefits and Risks of Covered Calls

Benefits of a Covered Call

1. EXTRA INCOME
You receive an option premium right away, which can boost returns if the stock stays flat or rises only a little.

2. PARTIAL DOWNSIDE CUSHION
The premium collected mitigates losses if the stock price drops.

3. LOWER RISK THAN MANY OPTIONS STRATEGIES
Because you already own the stock, you're not exposed to unlimited losses from selling a call.

4. WORKS WELL IN SIDEWAYS MARKETS
If the stock doesn't move much, the option may expire worthless, and you keep both the stock and the premium.

5. PREDICTABLE OUTCOME RANGE
You know your maximum profit and main risks upfront.

Risks and Drawbacks of a Covered Call

1. CAPPED UPSIDE
If the stock rises sharply, your gains are limited because you may have to sell the stock at the strike price.

2. STILL EXPOSED TO STOCK LOSSES
If the stock falls a lot, the option premium usually won't fully protect you.

3. OPPORTUNITY COST
You might miss out on significant gains compared to simply holding the stock.

4. ASSIGNMENT RISK
The stock can be called away (sold) earlier than expected, especially around dividend dates.

5. TAX AND COMPLEXITY CONSIDERATIONS
Option premiums and stock sales can have tax effects, and options add complexity compared to owning stock alone.

How Covered Call Strategies Offer Reduced Volatility and Drawdowns Compared to the S&P 500

Investors can get a sense of how a covered call strategy works relative to the S&P 500 by looking at the CBOE S&P 500® BuyWrite℠ Index (BXM℠).

As the CBOE explains, "The BXM Index measures the pre-tax total rate of return of a hypothetical 'covered call' strategy applied to the S&P 500 Index. This strategy consists of a hypothetical portfolio consisting of a "long" position indexed to the S&P 500 Index, on which are deemed sold a succession of one month, at-the-money call options on the S&P 500 Index."[2]

	Annualized Volatility	Maxium Drawdown	Beta	Sharpe Ratio
Cboe S&P500 BuyWrite Index	10.7%	-35.8%	0.62	0.54
S&P500 Total Return Index	15.2%	-50.9%	1.0	0.56

Source: Cboe

When measured against the S&P 500, the BXM℠ offers:

1. REDUCED VOLATILITY
The annualized standard deviation of the BXM Index was less than that of the S&P 500 Index since mid-1986.

2. LESS INTENSE MAXIMUM DRAWDOWNS
The worst peak-to-trough drawdown was less severe for the BXM Index vs. the S&P 500 Index.

3. POTENTIALLY ENHANCED DIVERSIFICATION
The BXM Index's beta to the S&P 500 Index was lower than that of the S&P 500 Index. This figure suggests that the BXM Index may offer diversification in some portfolios.

A Look at Covered Call Strategies Across Different Markets

Covered call strategies are particularly effective when the stock market posts negative returns, and when S&P 500 returns range from 0%-10%.

Since 2004, the S&P 500 Index posted negative total returns three times. In two of these years, 2008 and 2022, the CBOE BuyWrite Index outperformed the S&P 500 Index. In the third year, 2018, the CBOE BuyWrite Index just barely missed outperforming the S&P 500 by 0.39 percentage points.

Additionally, there were four years when the S&P 500 delivered returns between 0% and 10%. The CBOE BuyWrite Index outperformed the S&P 500 Index in three of those four years. These numbers demonstrate how a covered call strategy can act as a hedge during periods of low or negative returns in the broader market.

Down Markets

In down markets, covered call strategies tend to outperform a simple buy-and-hold equity position, though losses can still occur. The option premium received provides a partial buffer against declining prices, helping reduce overall drawdowns and volatility. This cushion is most effective during mild or gradual market declines. In sharp or prolonged sell-offs, however, the protection offered by option income is limited, since the strategy remains fully exposed to the underlying asset's downside. Covered calls, therefore, mitigate, but do not eliminate, equity risk in falling markets.

Flat Markets

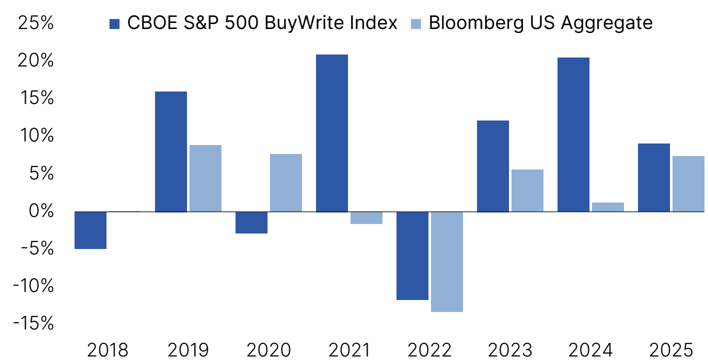
Flat or range-bound markets are typically the most favorable environment for covered call strategies. When prices move sideways, call options often expire worthless, allowing investors to keep both the underlying asset and the premium income. Over time, these repeated premiums can generate meaningful returns even when capital appreciation is minimal. In such conditions, covered call strategies frequently outperform traditional equity investments by effectively monetizing time decay and market volatility.

Up Markets

In rising markets, covered call strategies often lag the underlying equity's performance. As prices increase beyond the call's strike price, gains are capped because the upside is partially or fully given up in exchange for the earlier premium. While option income still contributes positively, it typically cannot match the returns of a strong bull market. As a result, covered calls tend to underperform in sustained, rapidly rising markets.

The BuyWrite Index (BXM) Outperformed Bonds Most Years

A Covered Call Strategy Delivered Better Return in Six of the Last Eight Years



Putting a Covered Call Strategy to Work

The SWP Growth and Income ETF

The SWP Growth & Income ETF (SWP) focuses on high-quality, income- generating stocks, coupled with an active covered call* overlay. Our multi-part strategy positions investors to earn a competitive return while experiencing less volatility than the broader market.

This approach also gives investors the chance to move beyond an ordinary "buy the market" strategy, in which the 10 largest US stocks now account for nearly 40% of the S&P 500's value, leaving investors too reliant on the success of just a few companies. The S&P 500** is no longer a diversified index with broad market exposure; instead, it has become a concentrated portfolio of technology companies. SWP is designed to offer the potential to earn income that exceeds that of most other ETFs while still positioning investors to benefit from long-term share price appreciation.

Our Approach

■ ■ The SWP Growth & Income ETF aims to generate long-term capital appreciation and current income by investing at least 80% of its net assets in income-producing equity securities. By focusing on dividend-paying companies, the Fund can exhibit lower volatility over the long term and generate higher risk-adjusted returns.

We employ a hybrid investment approach to construct the Fund, combining macroeconomic, technical, and fundamental analysis. Our macro analysis takes a "big picture" view of the factors that could influence the market and the equities we are considering. Our technical analysis uses intermarket analysis and relative strength to gain insight into future price movements in specific stocks. Lastly, our fundamental analysis examines each equity's intrinsic value to understand if it's trading above or below our estimated fair value. This structure offers several advantages, including daily transparency, minimal taxable events, avoiding capital gains distributions, and intraday liquidity.

In practice, this approach means that the SWP Growth & Income ETF usually holds about 50 stocks and sells calls on about 35 of them or 70% of the portfolio. The ETF covers about 85% of those underlying 35 positions meaning that SWP doesn't completely hedge the underlying stock position.

SWP sells calls on individual companies rather than peers who use index options. This approach aims for higher income potential, and a more targeted approach. It also enables SWP to take an active approach in managing call writing based on market conditions. In some scenarios, certain names are about 5% out of the money (OTM), in other instances, some are approximately 20% OTM. At times, market conditions are such that SWP writes no calls.

Where Does SWP Fit into An Investor's Portfolio?

■ ■ SWP is a solution for long-term investors who want to minimize the impact of a possible market downturn while seeking to generate substantial income and growth that can serve them for many years to come.

This strategy—seeking growth and income with managed volatility—is especially beneficial for investors entering or nearing retirement.

Today, the retirement phase of life is longer than ever. A retiree aged 65 can expect to live another 20 years, so their investments need to last and provide a growing income.

That's why SWP takes an active approach aimed at mitigating the effects of market drawdowns. By prioritizing stock dividends, income from covered call premiums, and share price appreciation, the Fund seeks to provide investors with a degree of stability during periods of market volatility given the total return approach.

Why SWP?

■ ■ Long-term investors need a new approach as passive "buy the market" strategies become riskier due to the disproportionate influence just a few companies have on the index. Over an extended period, the risk of a downturn is significant. Therefore, investors need to mitigate this exposure while pursuing both growth and income, known as total return.

The SWP Growth & Income ETF (SWP) seeks to accomplish these goals by combining the power of high-quality, income-generating equities with a comprehensive, three-part hybrid investment approach and an active covered call overlay. We use the covered call strategy judiciously so that investors may benefit from strong income without experiencing the NAV erosion seen with more aggressive strategies.

Aggressive covered call ETFs that offer an extremely high dividend usually come at the cost of share price growth. In other words, the burden of delivering a high distribution rate can lead to negative price returns, resulting in a deterioration in share price over the long term. SWP strikes a balance between share price growth and an attractive dividend. We believe that active stock-picking with a tactical covered call overlay can help investors reach their goals with fewer bumps in the road. Our goal is to provide reduced volatility with a compelling return profile over a full market cycle.

If you're interested in learning more about the potential benefits of incorporating high quality, growth orientated dividend-paying stocks into your investment strategy, book a 30-minute virtual meeting with our Chief Investment Officer, Nate Fischer.

Definitions

* **Covered Call** - Covered Call - Covered calls are considered a lower-risk option strategy that involves selling call options on a stock that an investor already owns. If the market price of the stock increases, then the investor may have to buy back the call option at a loss or have the underlying stock called away, thus depriving the investor of any further upside potential.

** **S&P500** - The S&P 500 is a stock market index weighted by market capitalization that is made up of 500 of the largest public companies in the United States.

References

1 *Wall Street's Record Rise Spurs Growth of Covered Call Strategies. Reuters, 2025*

2 *Cboe S&P 500® BuyWrite℠ Index (BXM℠) Fact Sheet, 2025*

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Past performance is no guarantee of future results.

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