

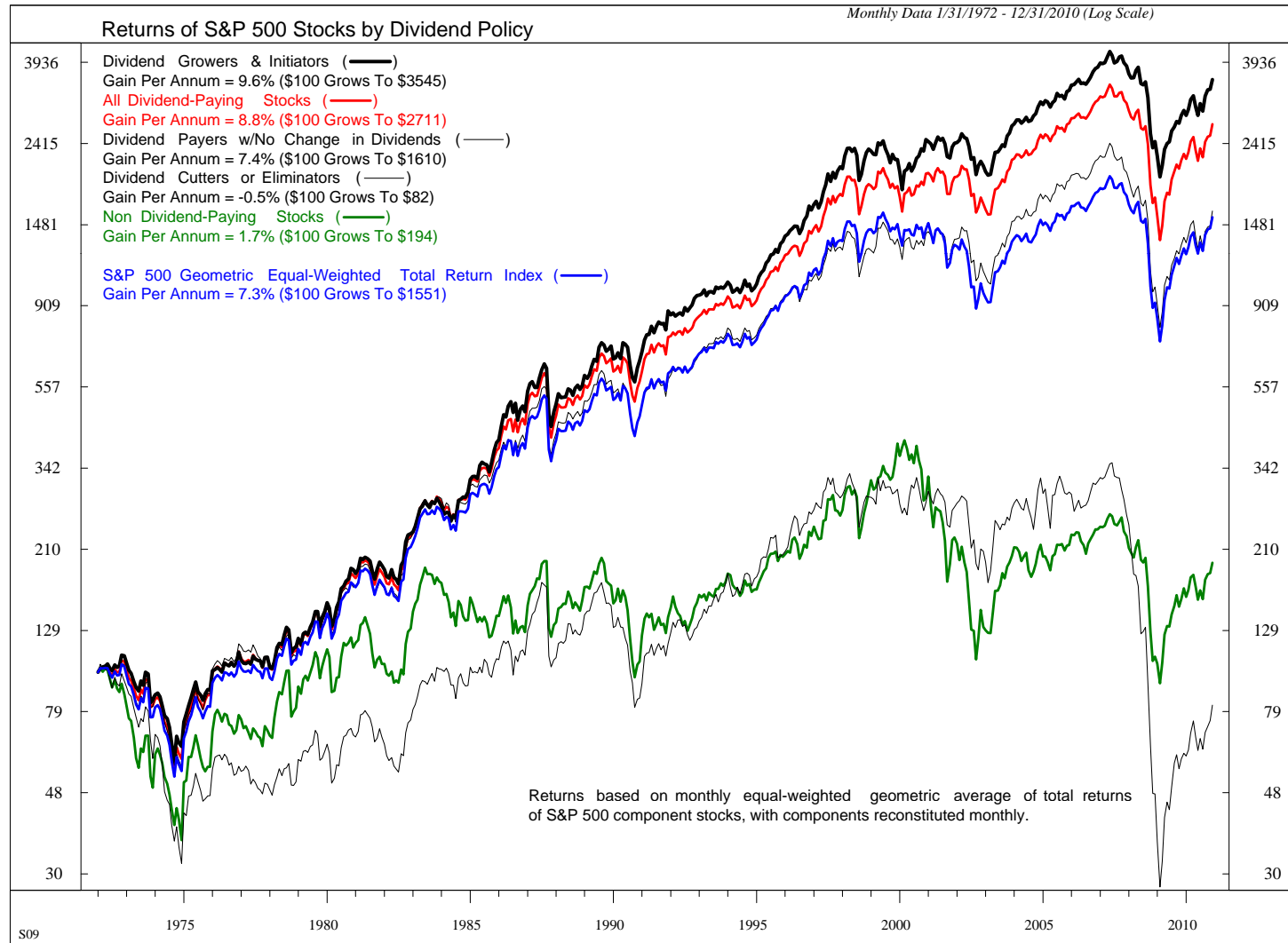
Equity strategies that earn income: stocks, ETFs and options

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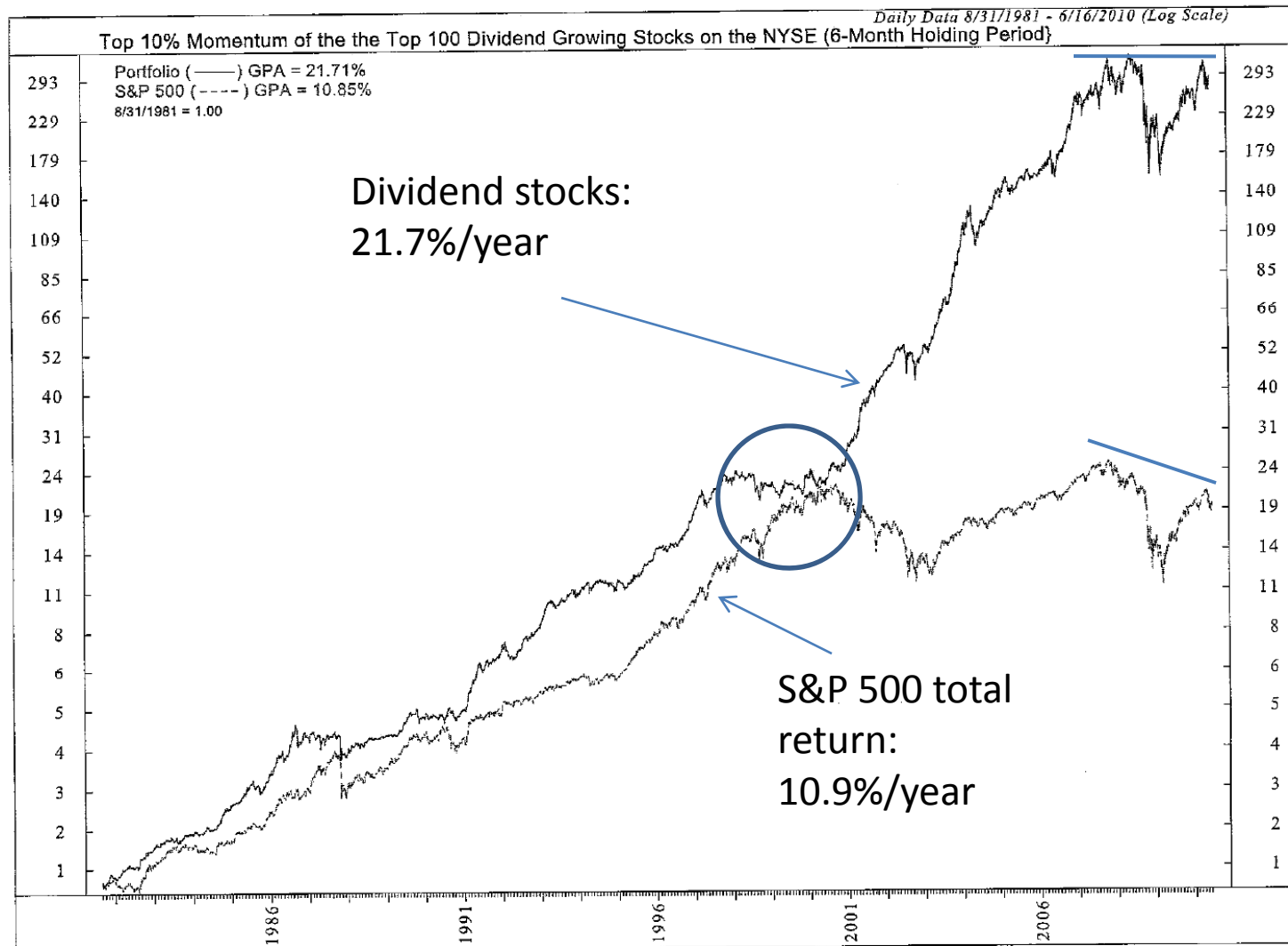
Outline

- Advantages of high-dividend stocks
- High-dividend ETFs: DEM, SDY, DNH
- Covered call writing
- High yield bond fund trading
- Economic and market outlook

Returns of S&P 500 stocks by dividend policy, 1972-2010



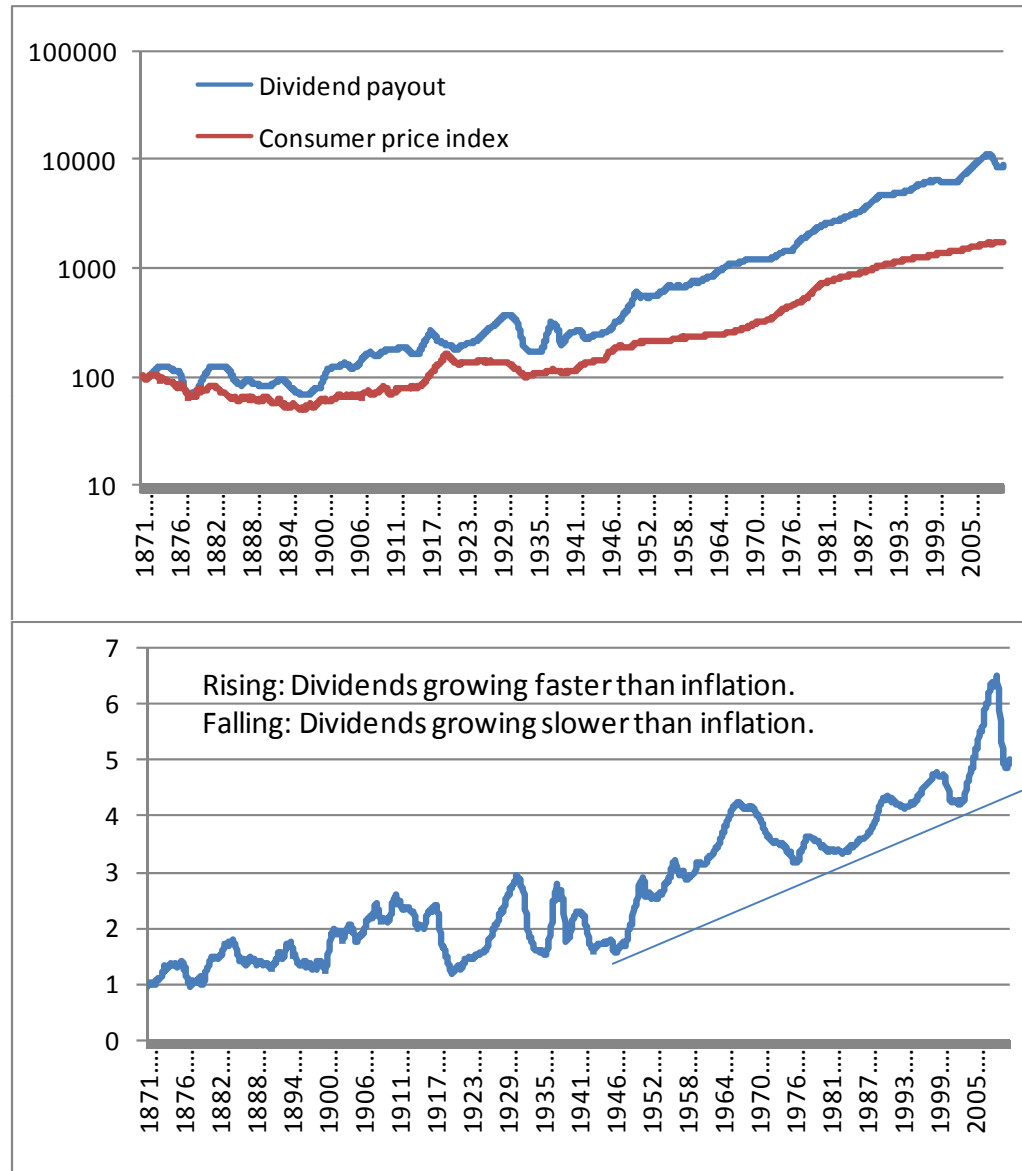
Our dividend stock selection strategy



BL31519x01_DivGrow

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Dividend growth has outpaced inflation

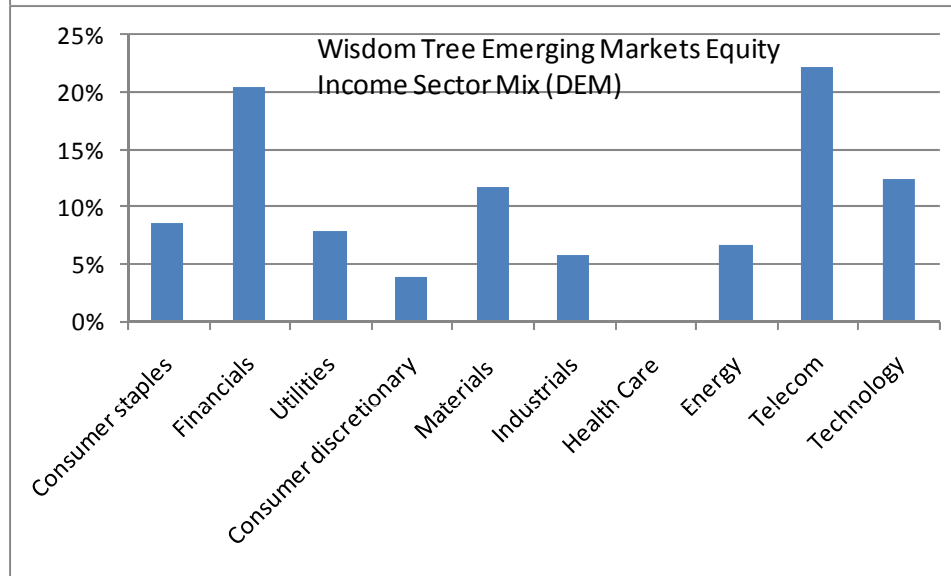
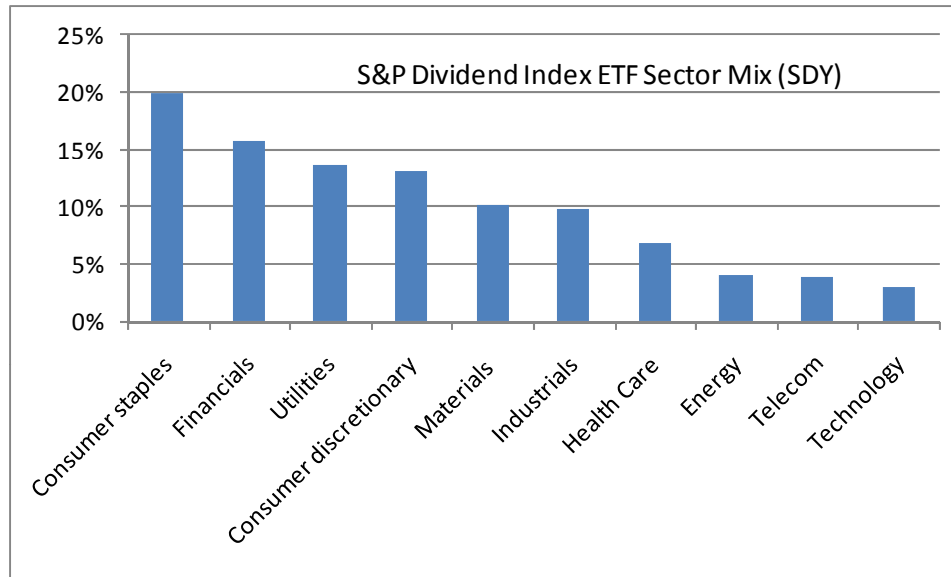


Source:
www.irrationalalexuberance.com

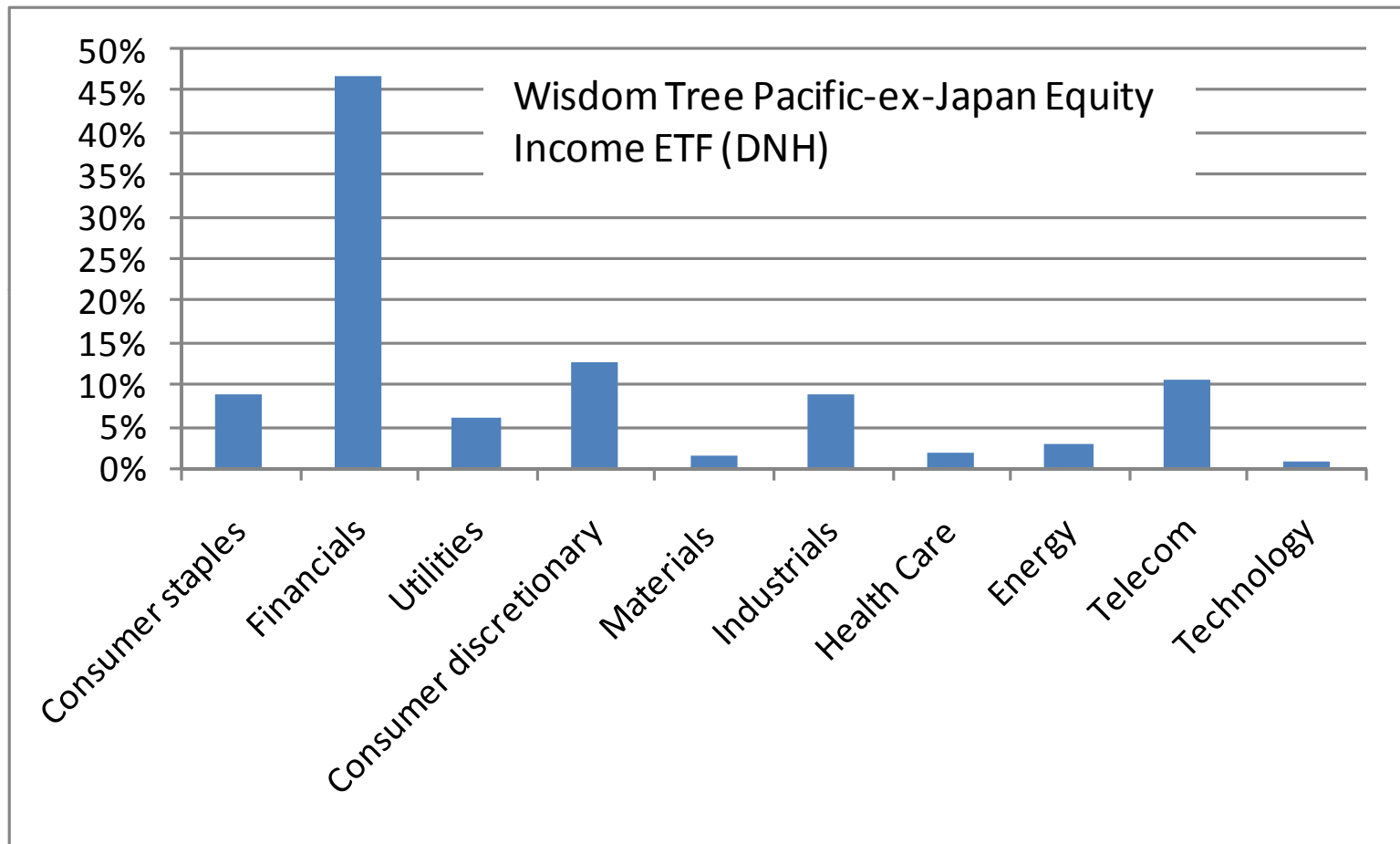
Recommended high-dividend ETFs

- SPDR S&P Dividend Index ETF (SDY)—yield 3.4% (versus 2.4% for DIA)
- Wisdom Tree Emerging Market Equity Income (DEM)—yield 3.9%
- Wisdom Tree Pacific ex-Japan Equity Income Fund (DNH)—yield 5.9%

Sector mix in dividend ETFs



Sector mix in dividend ETFs

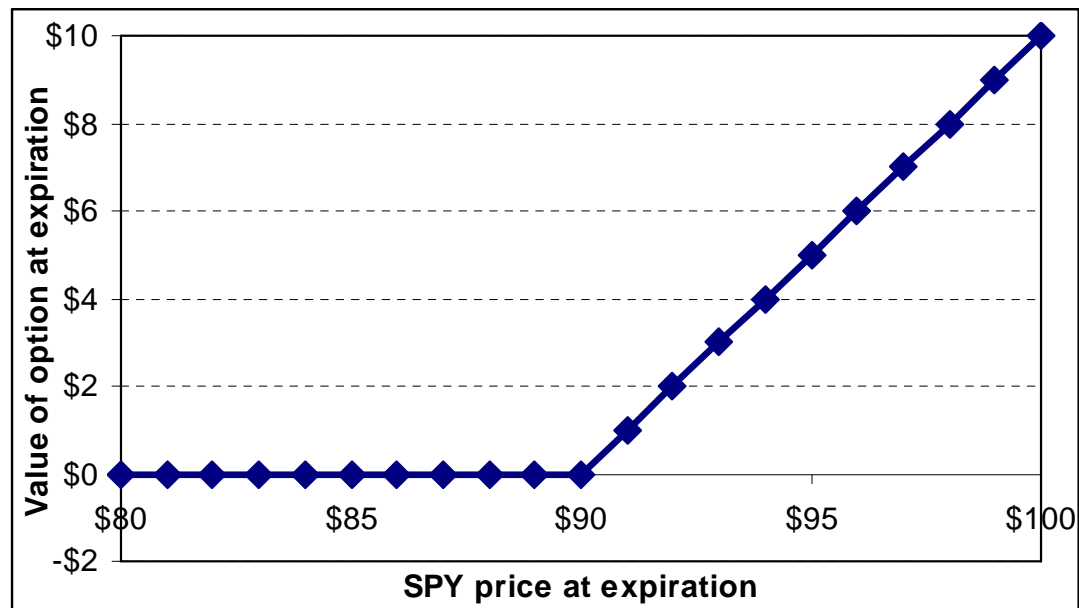


Why write covered calls?

- Historically has kept up with the stock market
- Historically has been safer than the stock market
- Generates investment income.

What is a stock option

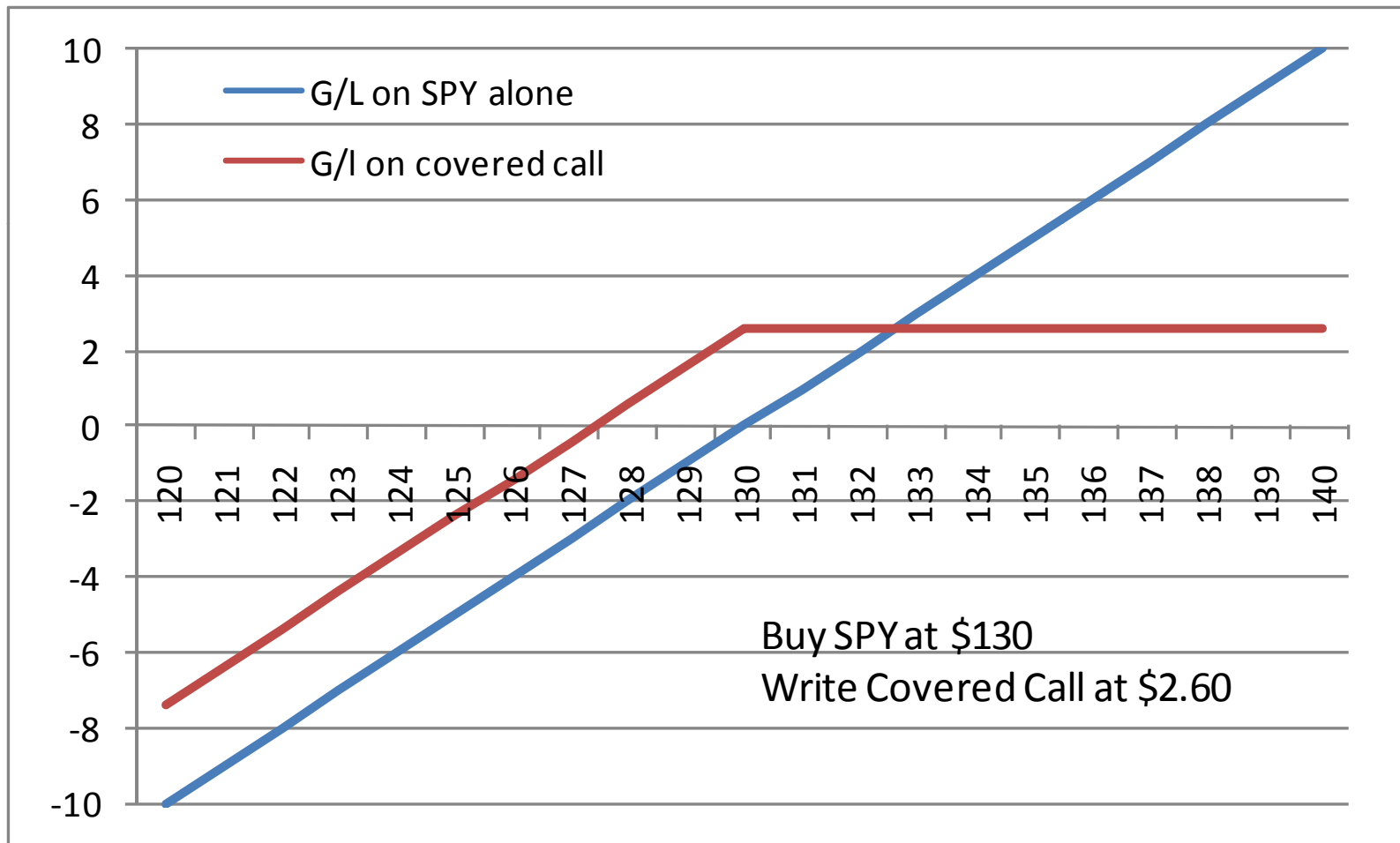
- Call option: The right but not the obligation to buy a stock or ETF at an agreed-upon price (*strike price*) on or before the *expiration date*.



Covered call writing in a nutshell

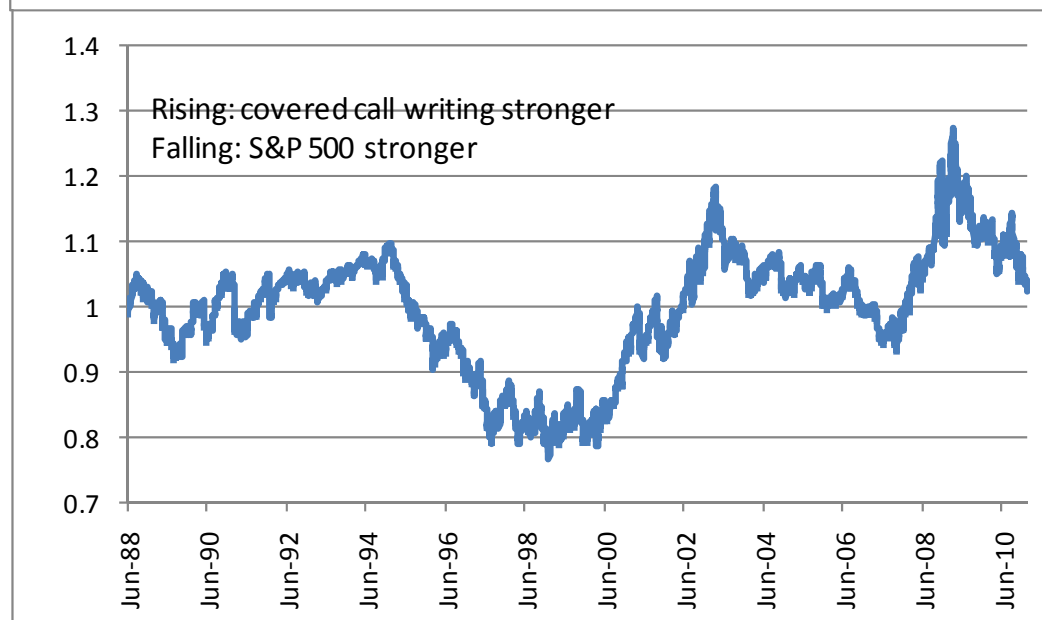
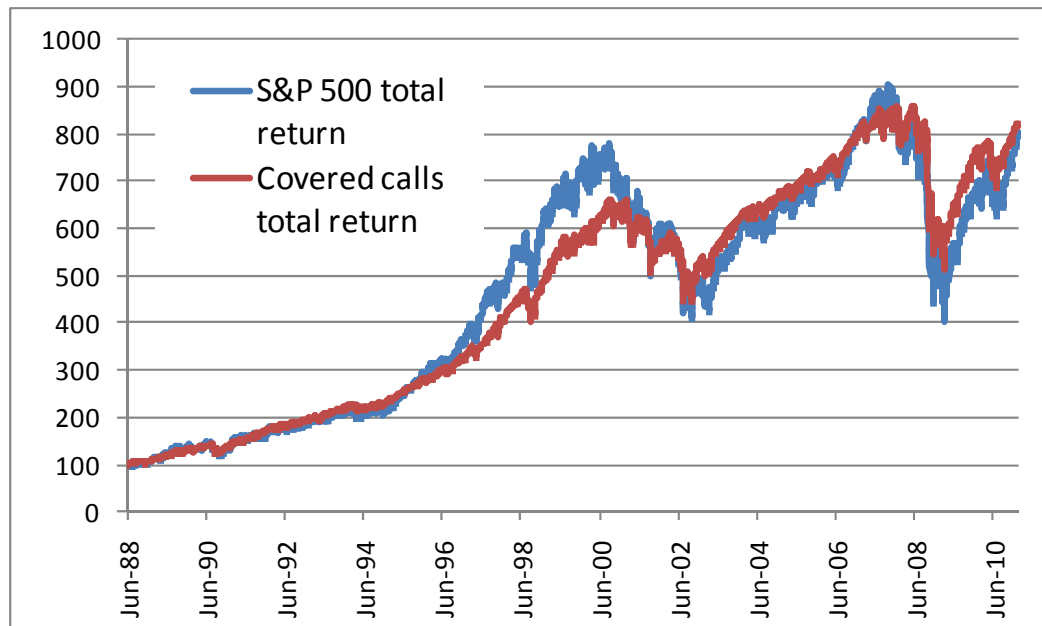
- If you exercise a call option you have bought—you buy 100 shares of stock at the agreed-upon (strike) price.
- If you sold an option to another investor and she exercises it—you must deliver 100 shares at the strike price.
- If you do not already own the shares and you sell an option, you stand to lose \$1 per share for every dollar the shares rise above the strike price.
- If you already own shares and sell an option to someone else to buy those shares from you, you have *written a covered call*.

Profit/Loss from covered call writing compared to holding an ETF

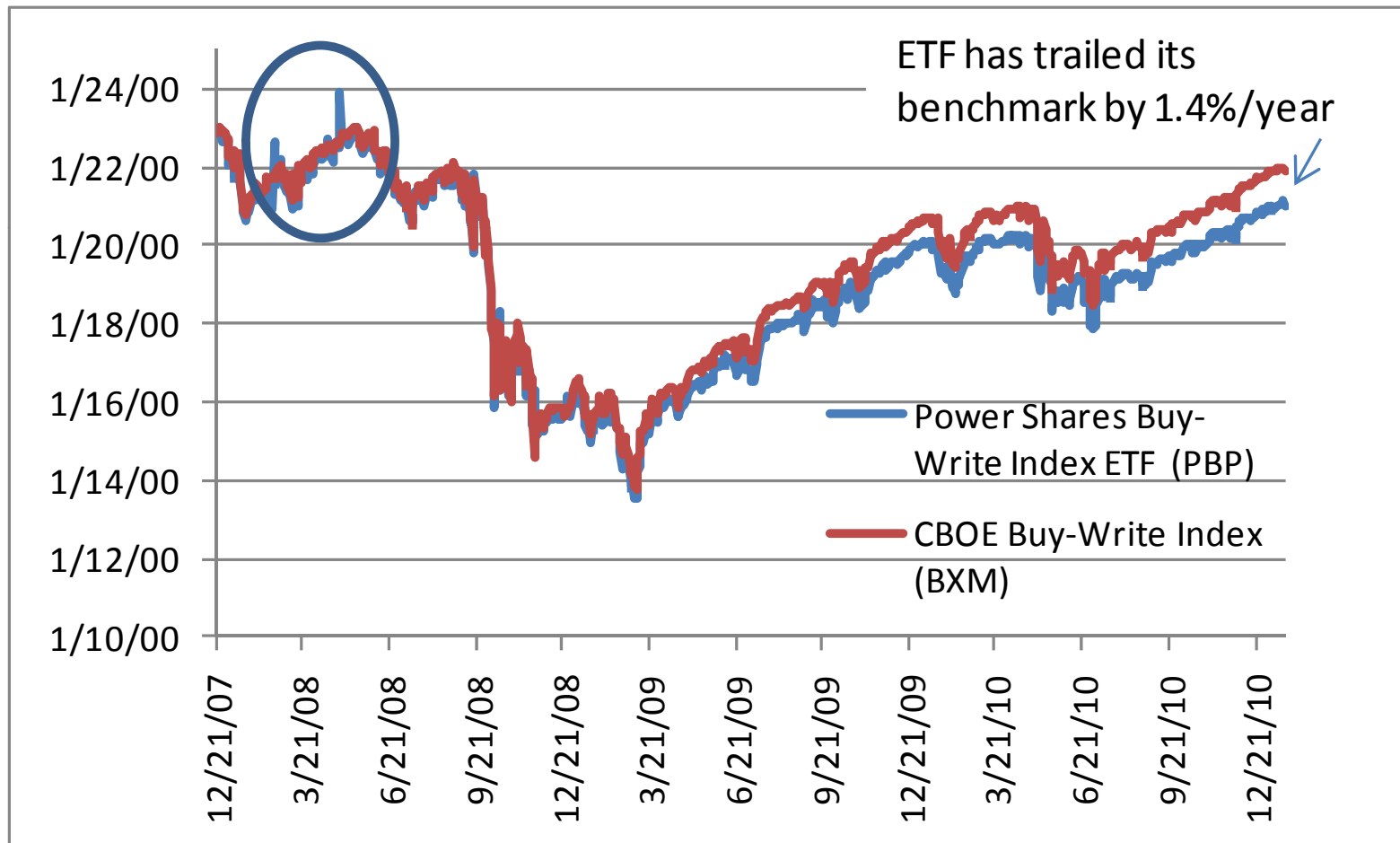


1988-2011:

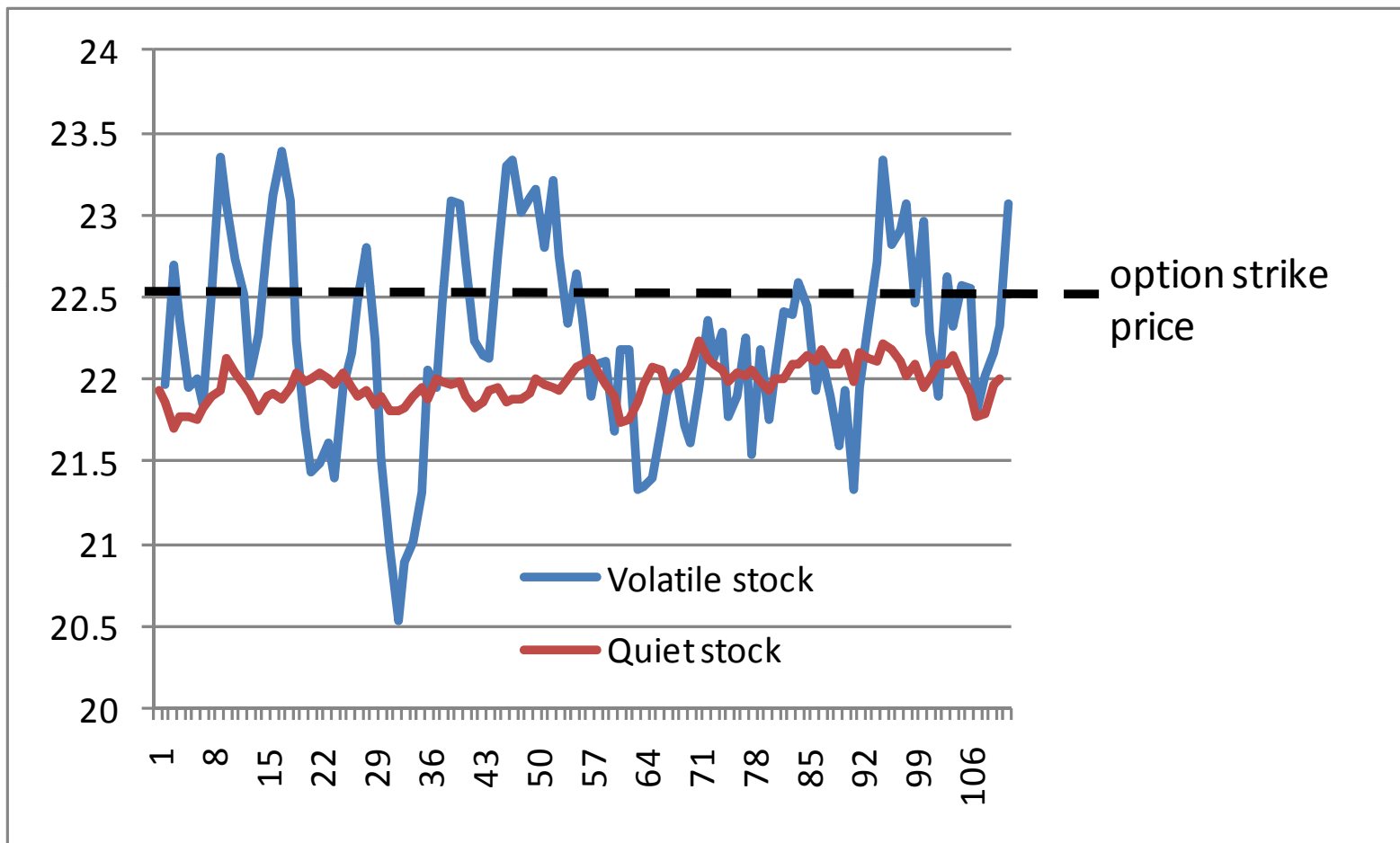
- S&P 500 returned 9.6%/year
- Covered Call Writing Index returned 9.7%/year
- Worst loss in S&P 500 Index was 55%
- Worst loss in Covered Call Writing Index (BXM) was 40%



Covered call writing ETF versus its benchmark, 2007-2011

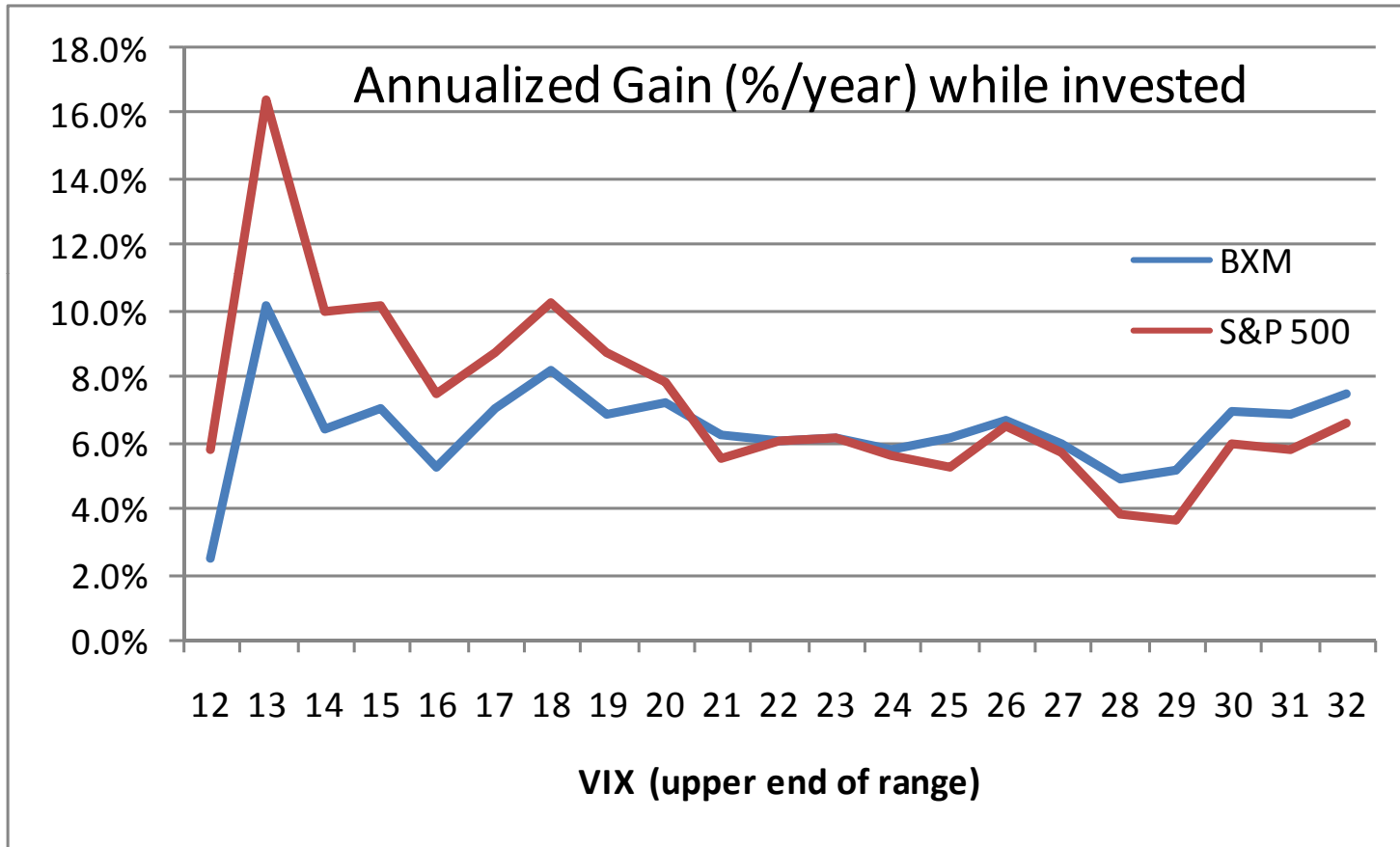


Options on volatile stocks cost more than options on quiet stocks (all else being equal)



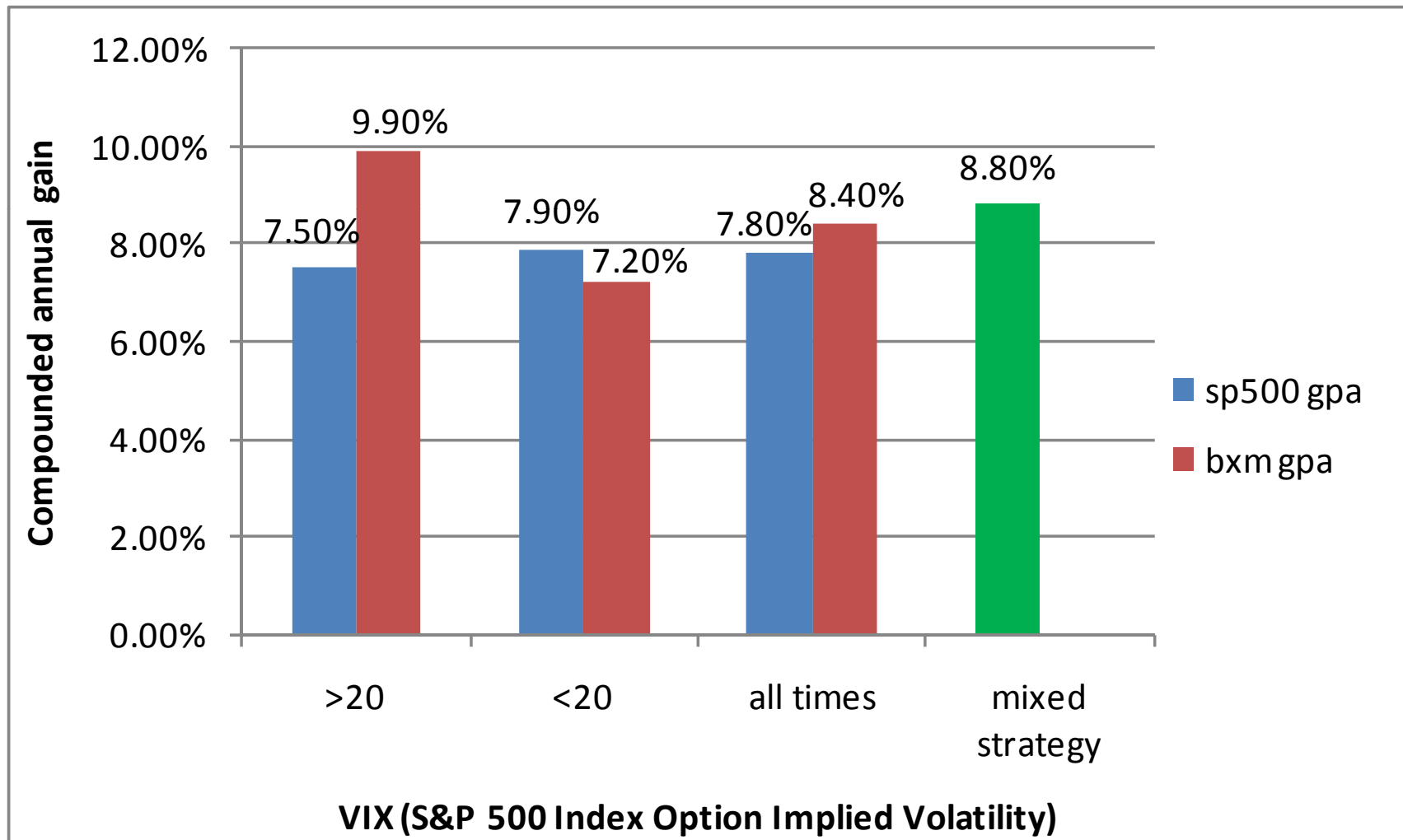
Hypothetical volatile stock and quiet stock both start at \$22, option strike price is \$22.50. The volatile stock is more likely to finish above the option strike price.

VIX and market performance



Total return data, 1990-2010. Source: www.cboe.com/micro/vix/historical.aspx.
Add gpa data for vix < 20, vix > 20 for spx and bxm

Investment returns 1990-2010 at different levels of option implied volatility



High yield bonds

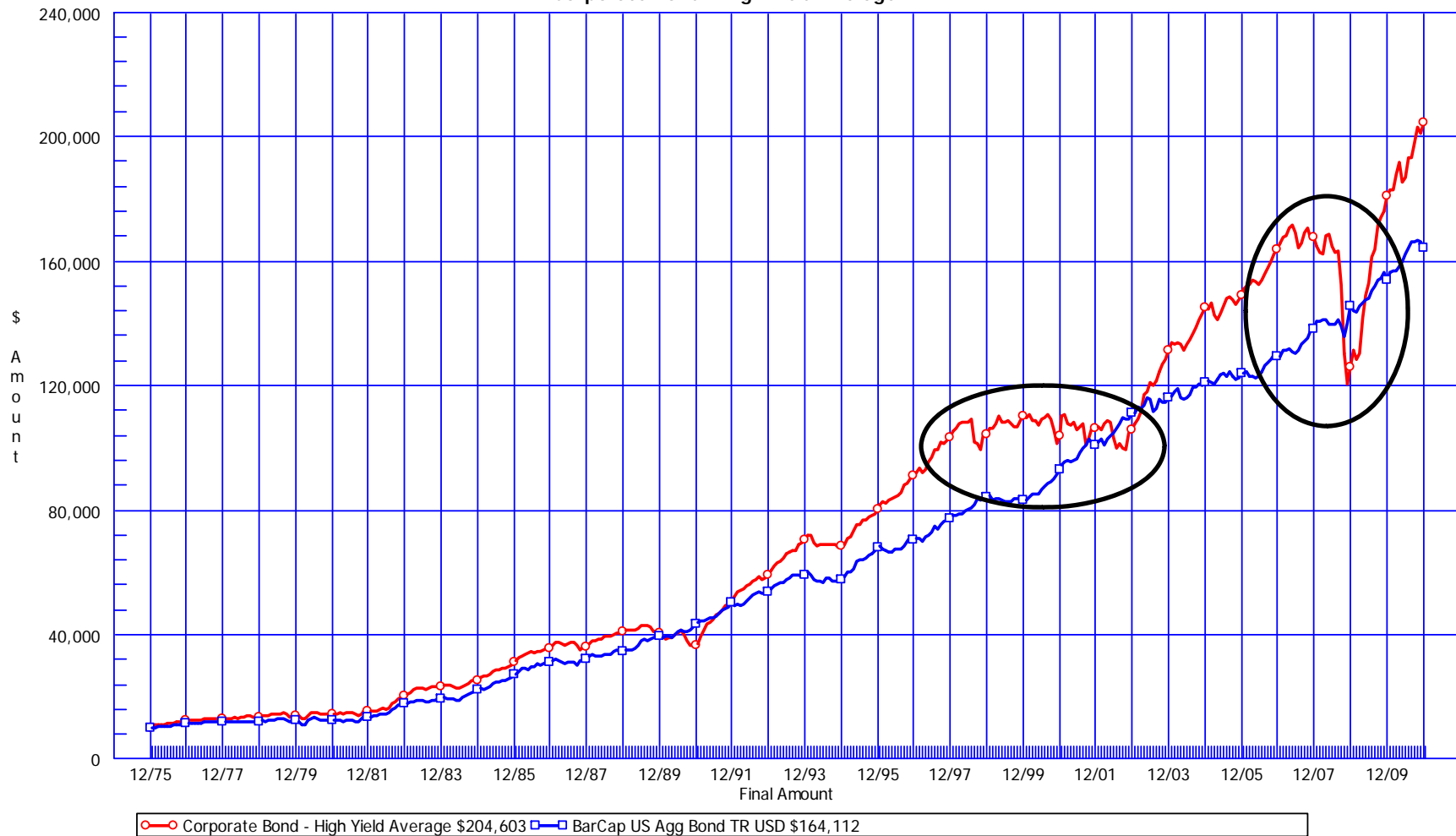
- Higher risk borrowers
- Higher interest rates
- Average default risk 5%/year
- About 1/6 of US corporate bond market
- Credit rating BB / Ba or lower
- Expensive to trade individual bonds

Comparison of investment-grade and high yield (junk) bonds

Feature	Investment-grade	High yield
Risk of loss	Usually low	Potentially high
Level of interest income	Low	High
Predictability of returns	High	Low
Best way to invest	Individual bonds or mutual funds	Mutual funds mandatory
Level of ongoing oversight required of you	Low	High

Performance of high yield and investment grade bonds

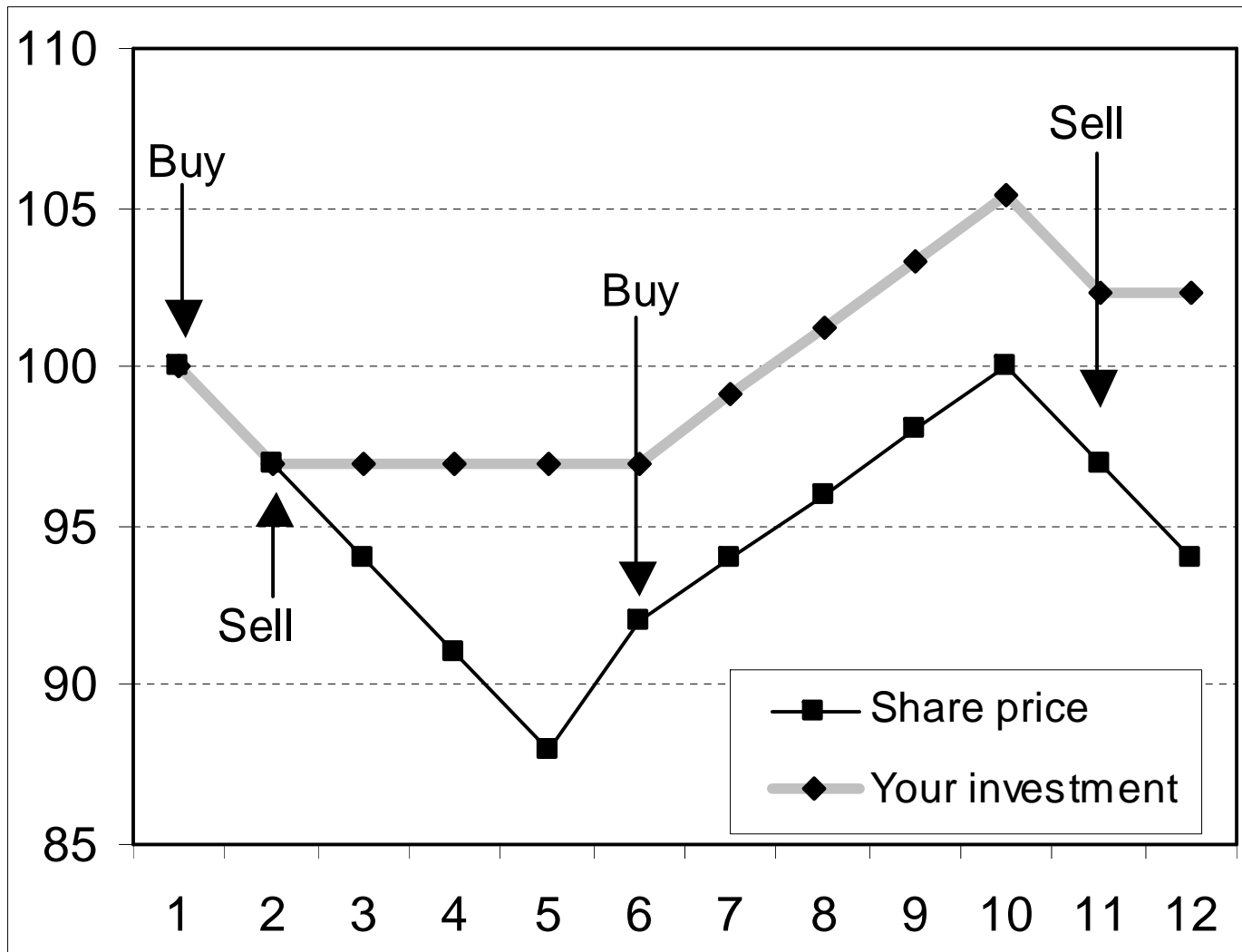
Monthly Growth of \$10,000
Corporate Bond - High Yield Average



Sell and buy stops for high yield bond funds

- Evaluate the value of your investment on the last trading day of each month.
- Move to cash whenever the value of your fund falls by 3% (including dividends) from the last high point.
- Re-enter whenever the value of your fund rises by 3% off of its last low point.
- Overall results: higher returns at half the risk (historically—future not guaranteed)
- Just 2-3 one-way transactions per year, on average. Invested more than 70% of the time.

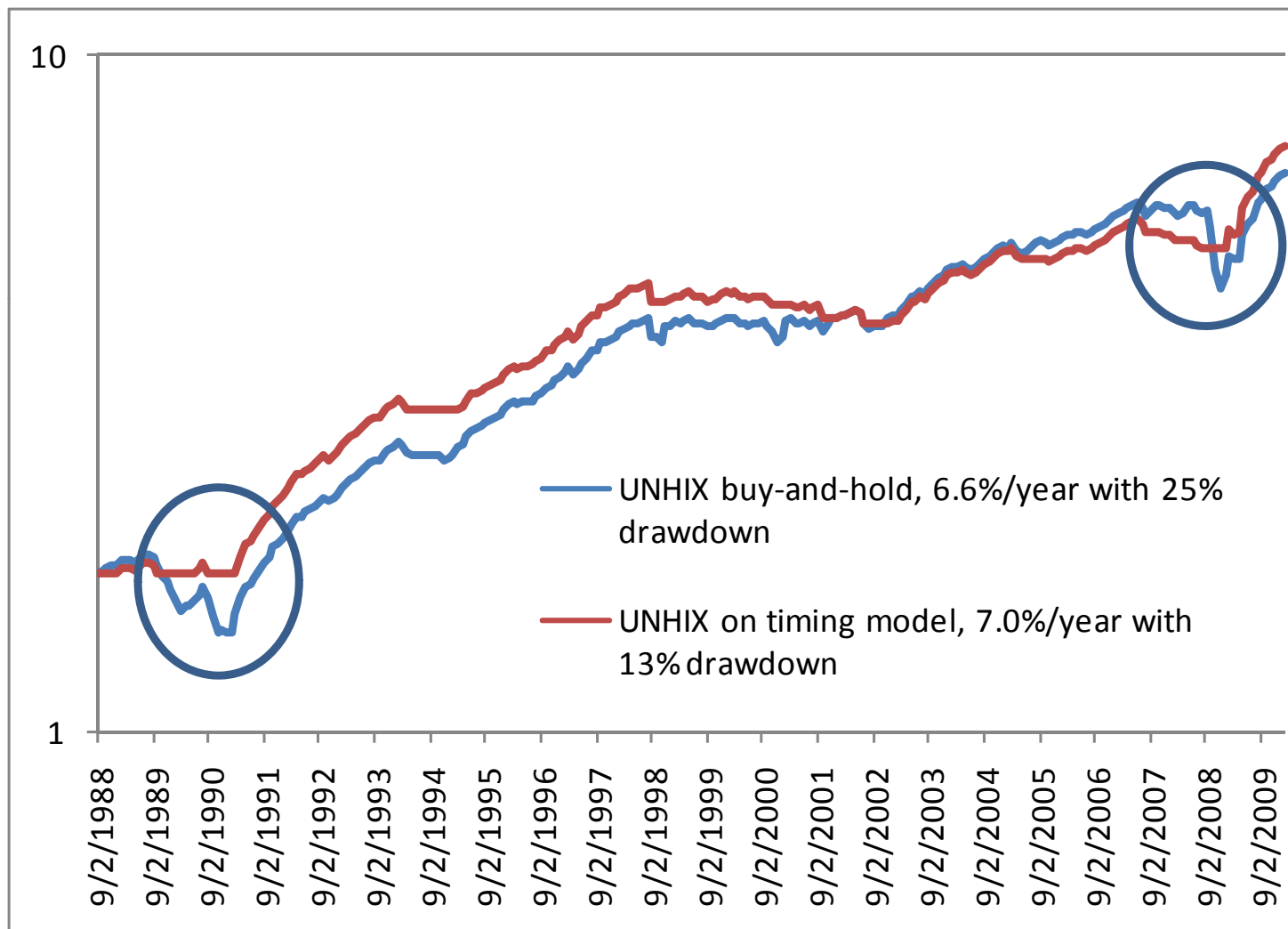
Buy and sell stops



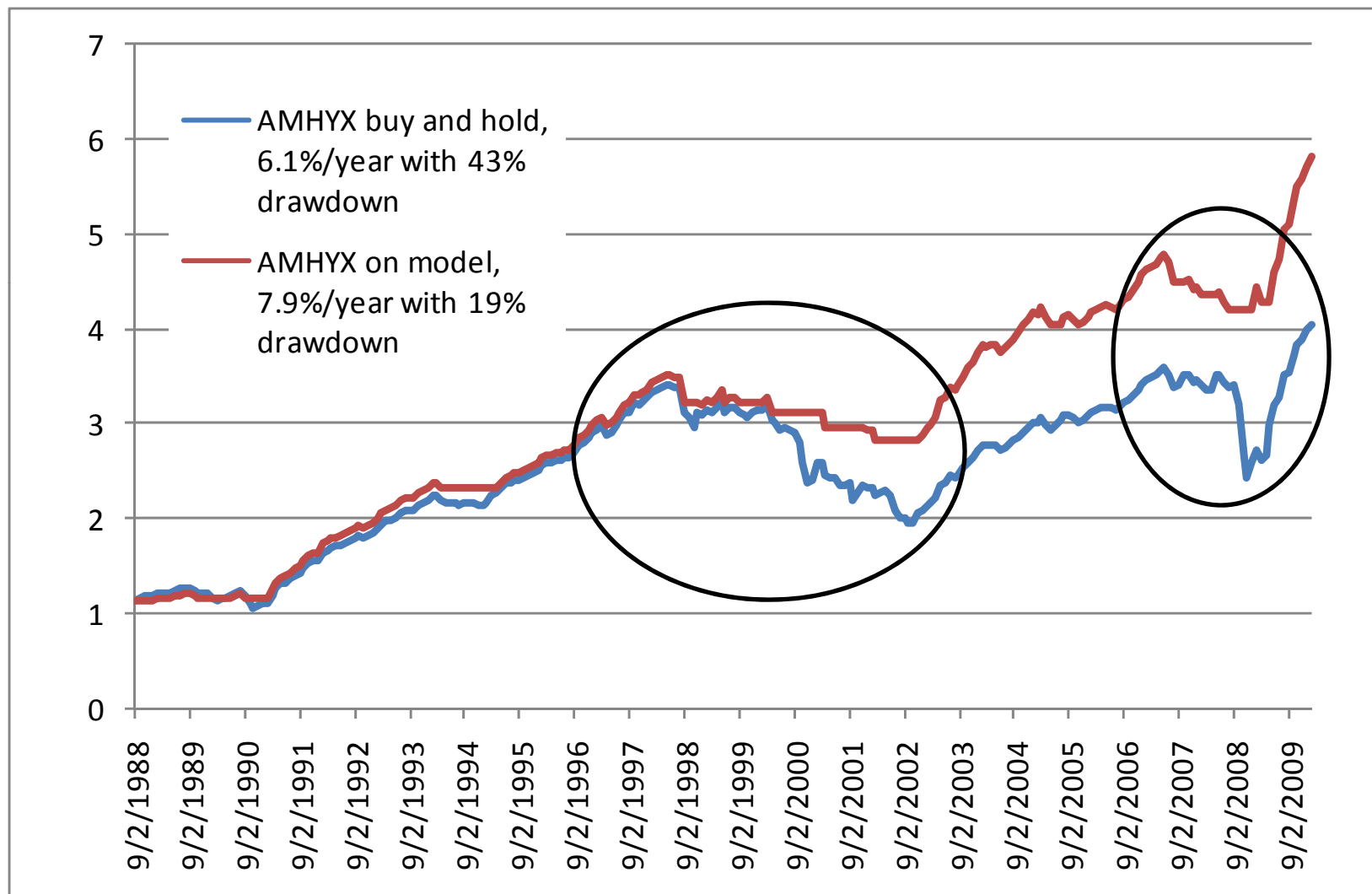
Numerical
example of
high yield
bond fund
trading,
2008-2010

	UNHIX	Position	Comment
1/31/2008	5.864	Cash	
2/29/2008	5.814	Cash	Low point
3/31/2008	5.841	Cash	
4/30/2008	6.015	Buy	Buy 3% above low point
5/31/2008	6.033	In fund	High point
6/30/2008	5.928	In fund	
7/31/2008	5.85	Sell to cash	Sell 3% below high point, close out trade at a loss
8/31/2008	5.886	Cash	
9/30/2008	5.627	Cash	
10/31/2008	4.815	Cash	
11/30/2008	4.545	Cash	Low point
12/31/2008	4.737	Buy	Buy 3% above low point
1/31/2009	5.04	In fund	
2/28/2009	4.993	In fund	
● ● ● ● ● ● ●			
1/31/2010	6.72	Still in fund	High point
2/28/2010	6.69	Still in fund	1/2% below high point

High yield results, 1988-2010--UNHIX



High yield results, 1988-2010--AMHYX



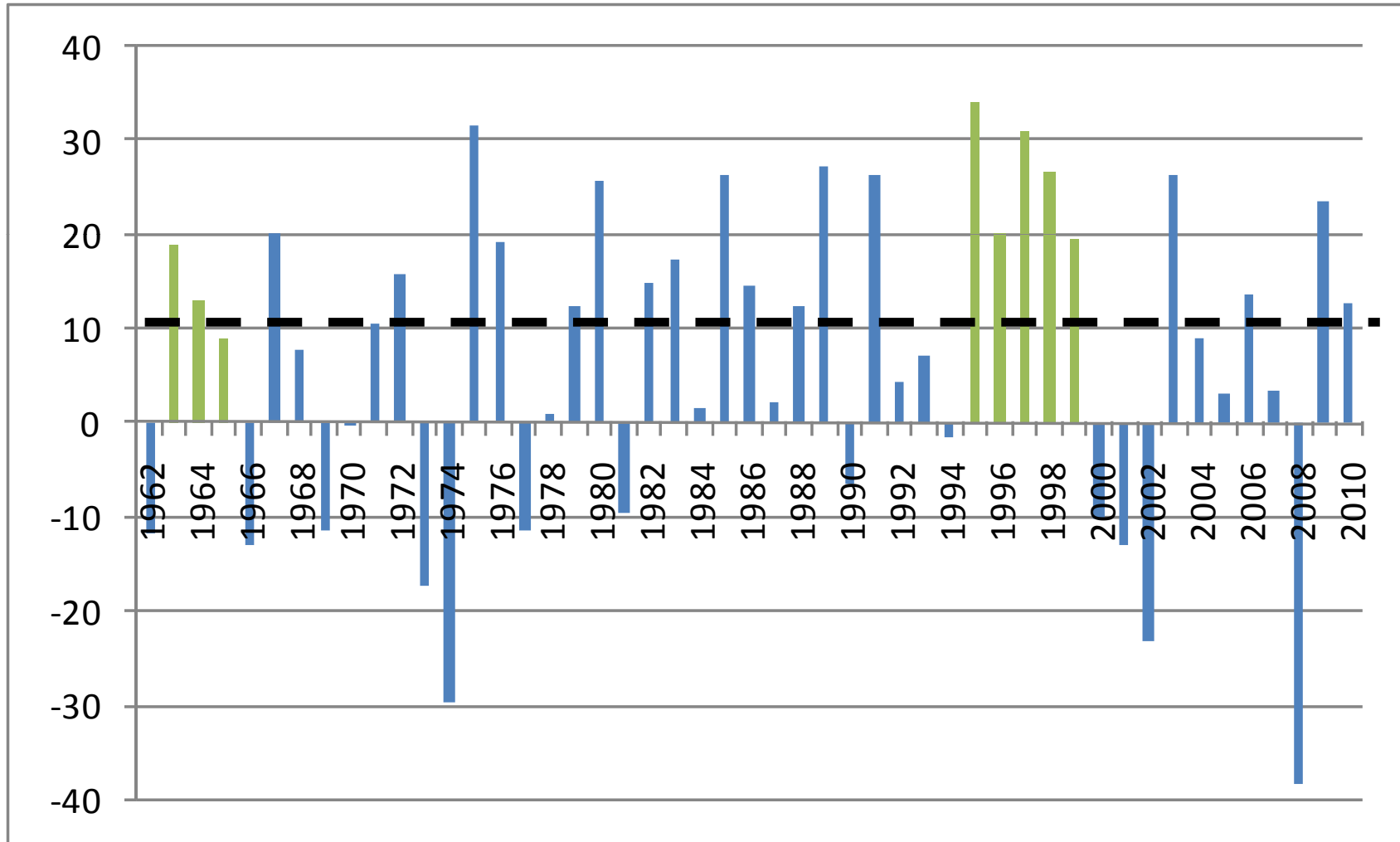
Refinements to high yield bond fund trading—make them even safer

- More frequent evaluation
- Use of stock market indicators to guide bond trading decisions
- Need to take note of mutual fund trading restrictions
- Selection of different high yield bond funds

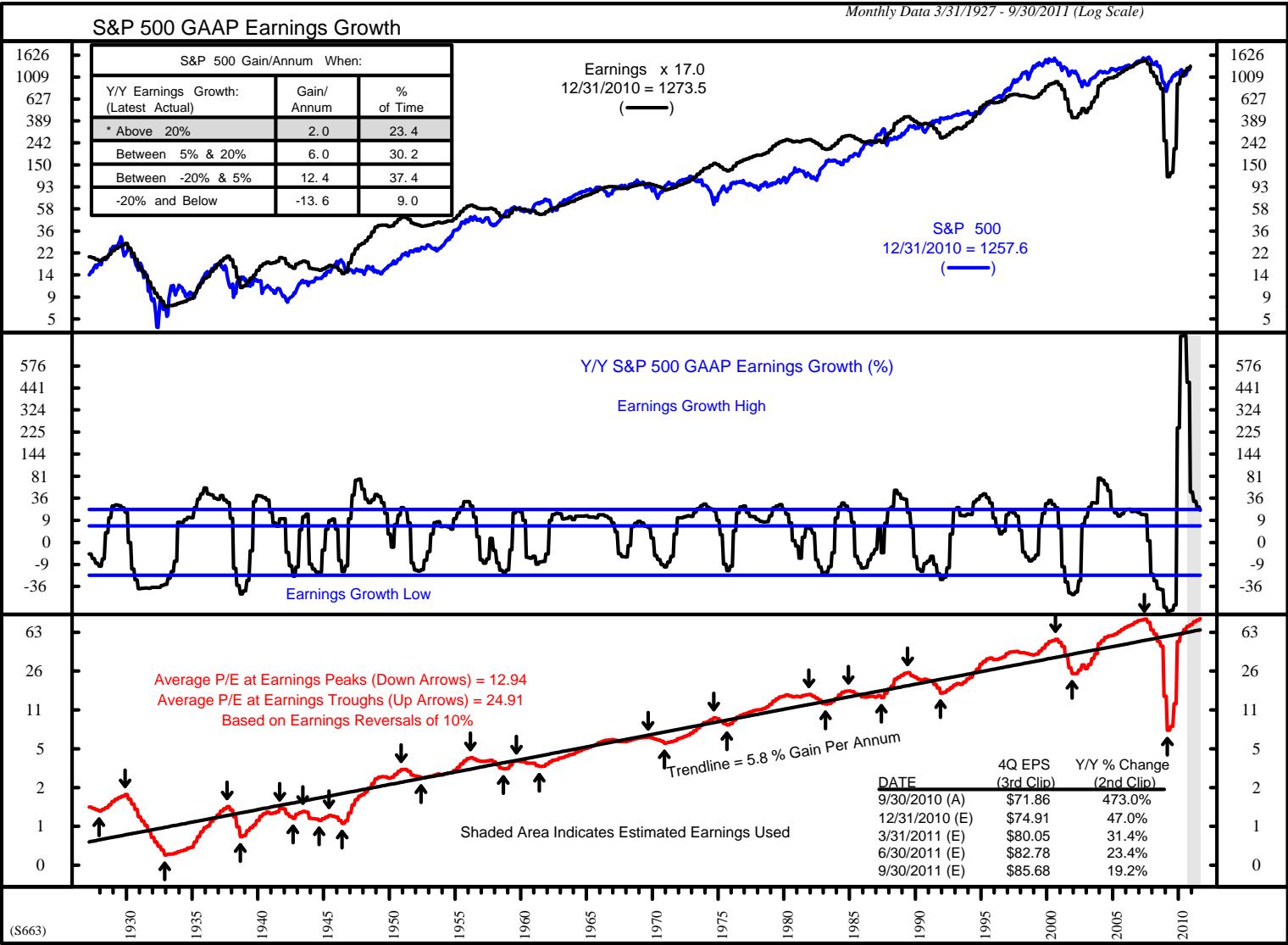
Stock market outlook

- Election-cycle seasonality and Federal Reserve policy—both favorable for stocks until at least April-June.
 - Pre-election year has not been negative since 1939.
 - But we did have the crash of 1987
- History suggests that 2011 will not be highly profitable.

S&P 500 Index Annual Gains/Losses, 1962-2010



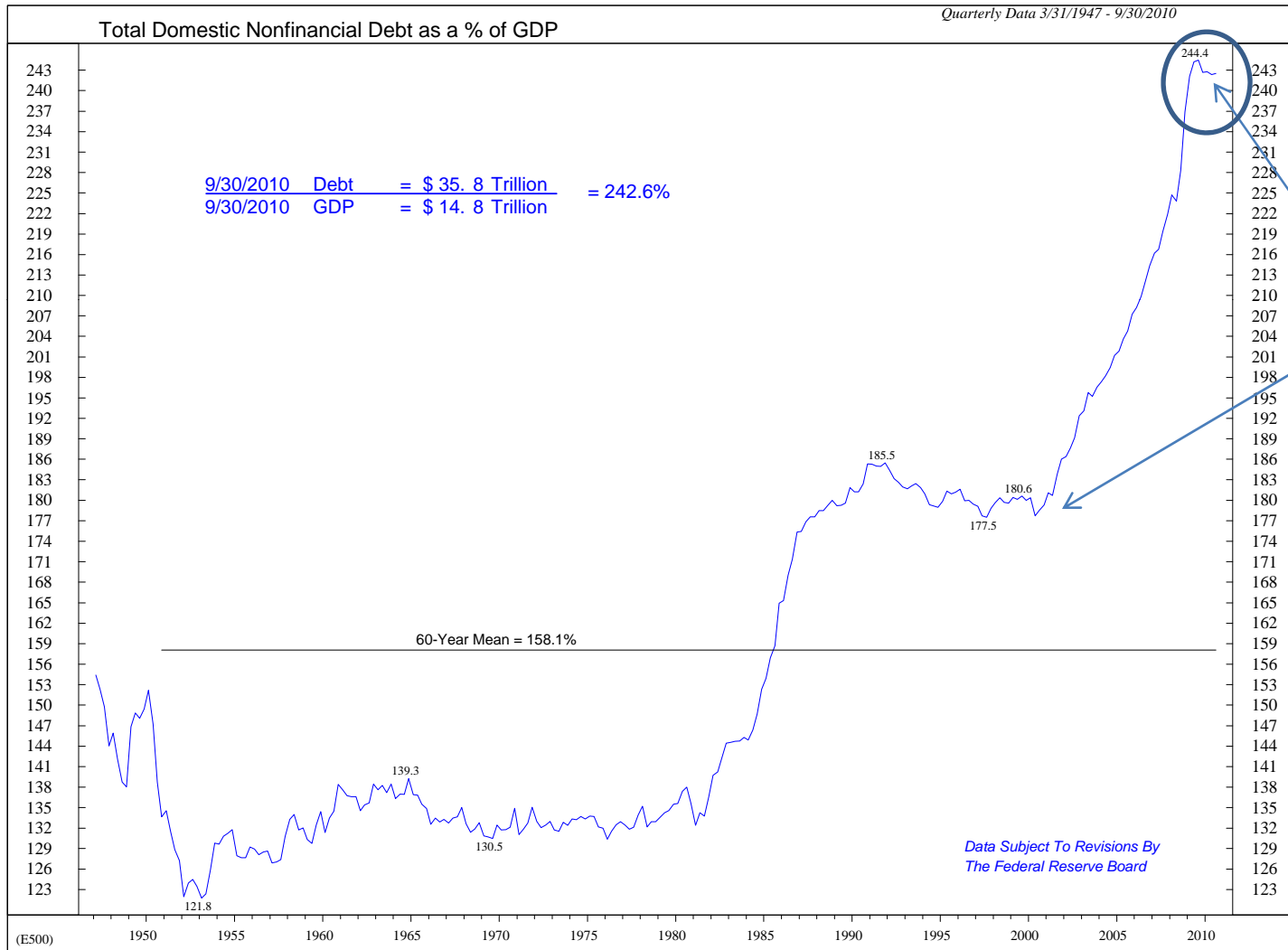
Long-term stock market prospects are average (based on valuation)



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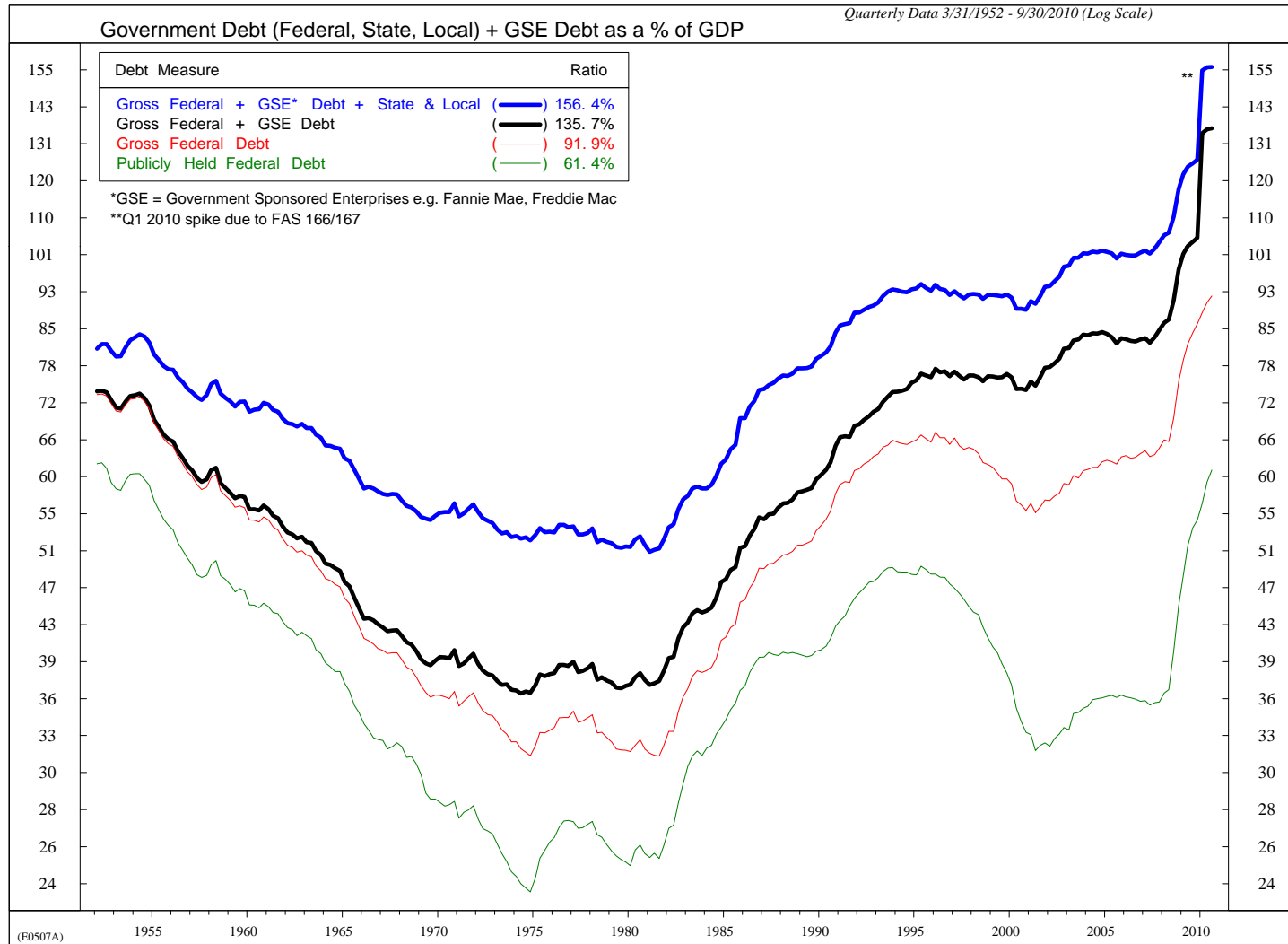
Bond market outlook

Debt explosions: 1982-1991, 2000-2009

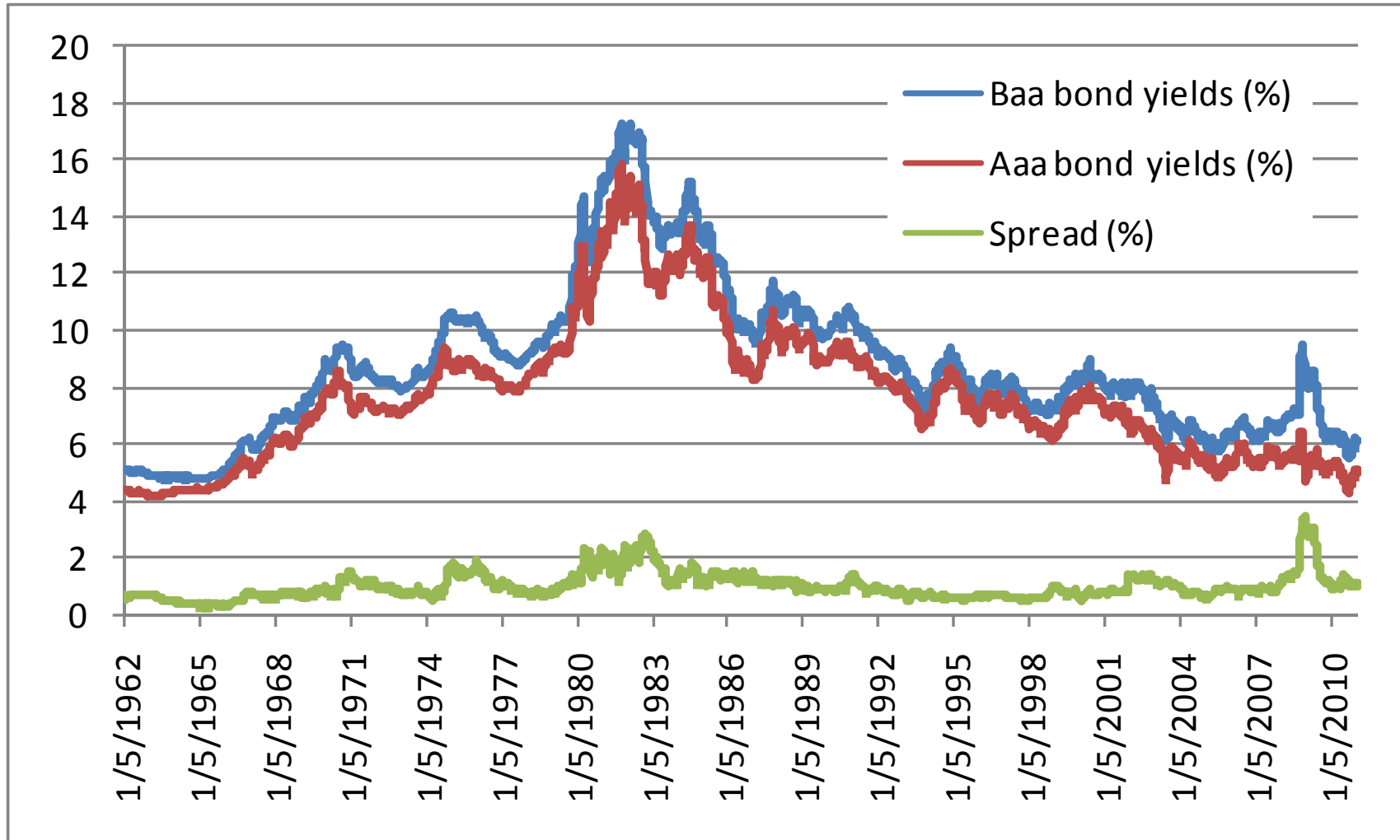


We would have to repay more than a quarter of all outstanding debt to get back to where we were ten years ago.

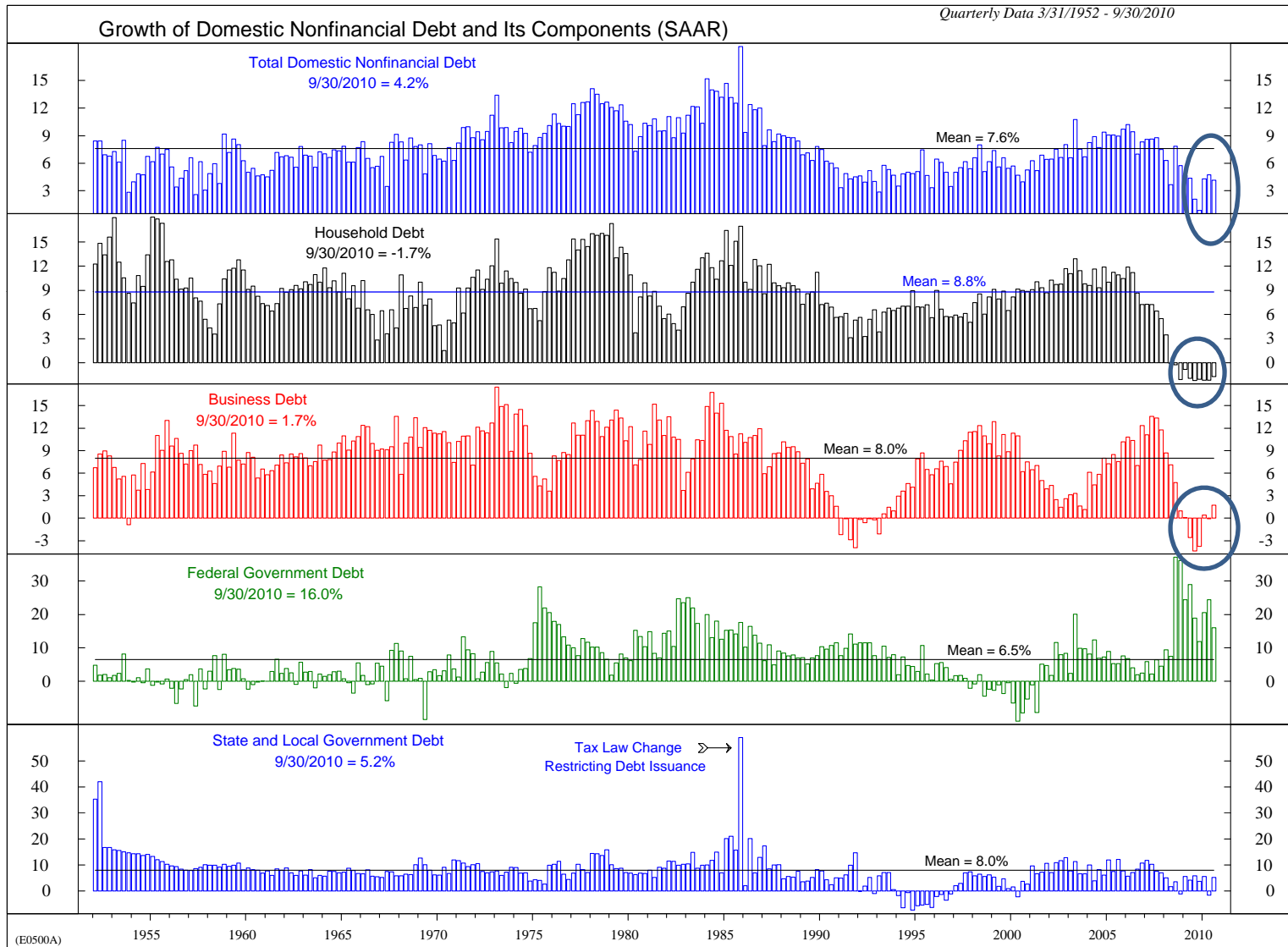
Total government debt at new highs relative to the size of the economy



Interest rates at 45-year lows



Why interest rates remain low



Overall borrowing is below-average

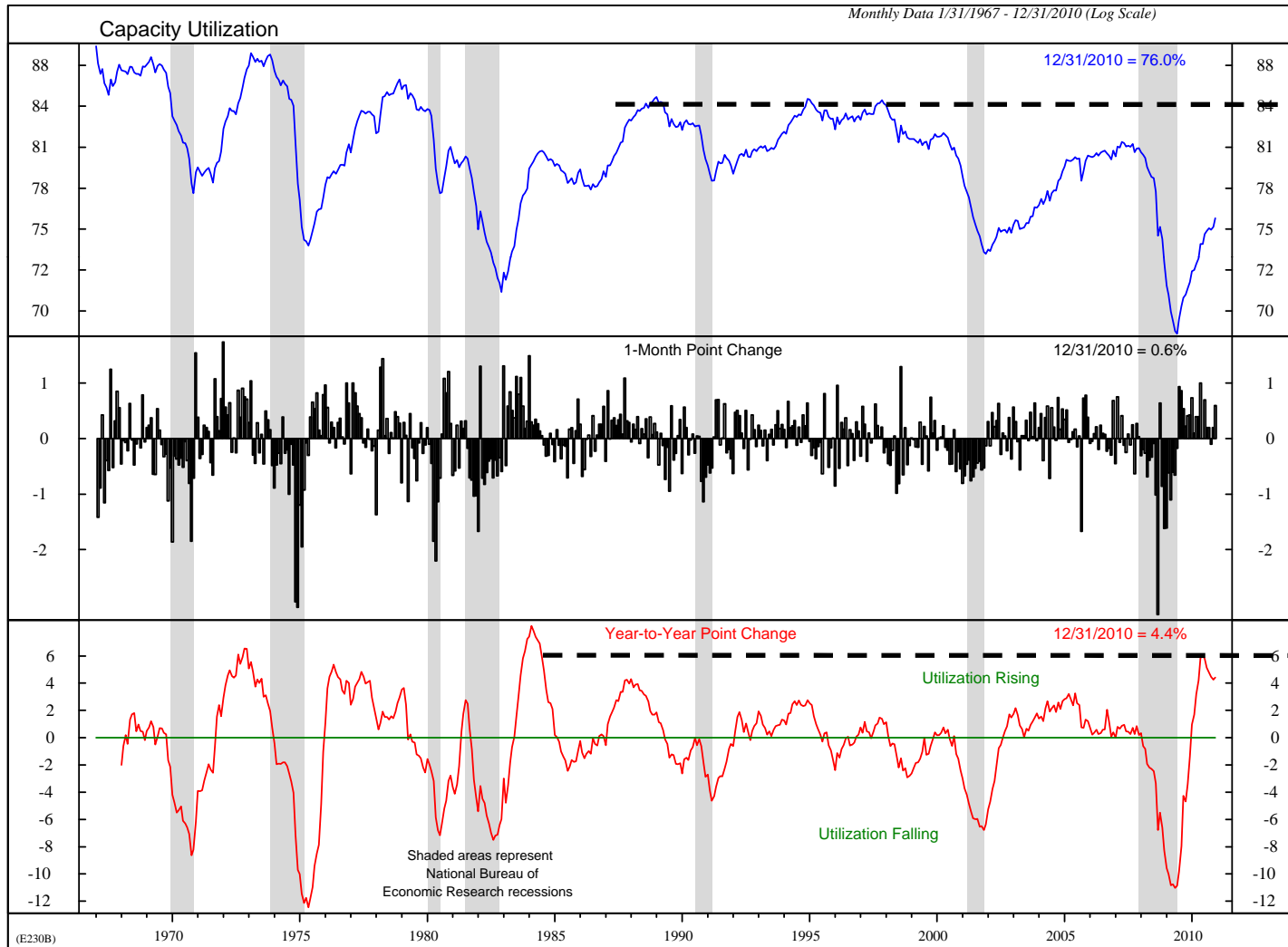
Households are paying down debt

Businesses are barely borrowing.

Federal government borrowing briskly.

State/local borrowing at slightly below average rate.

Economic recovery



Approximately 5%-7% slack in the economy. (Matches slack of about 4% in labor force.)

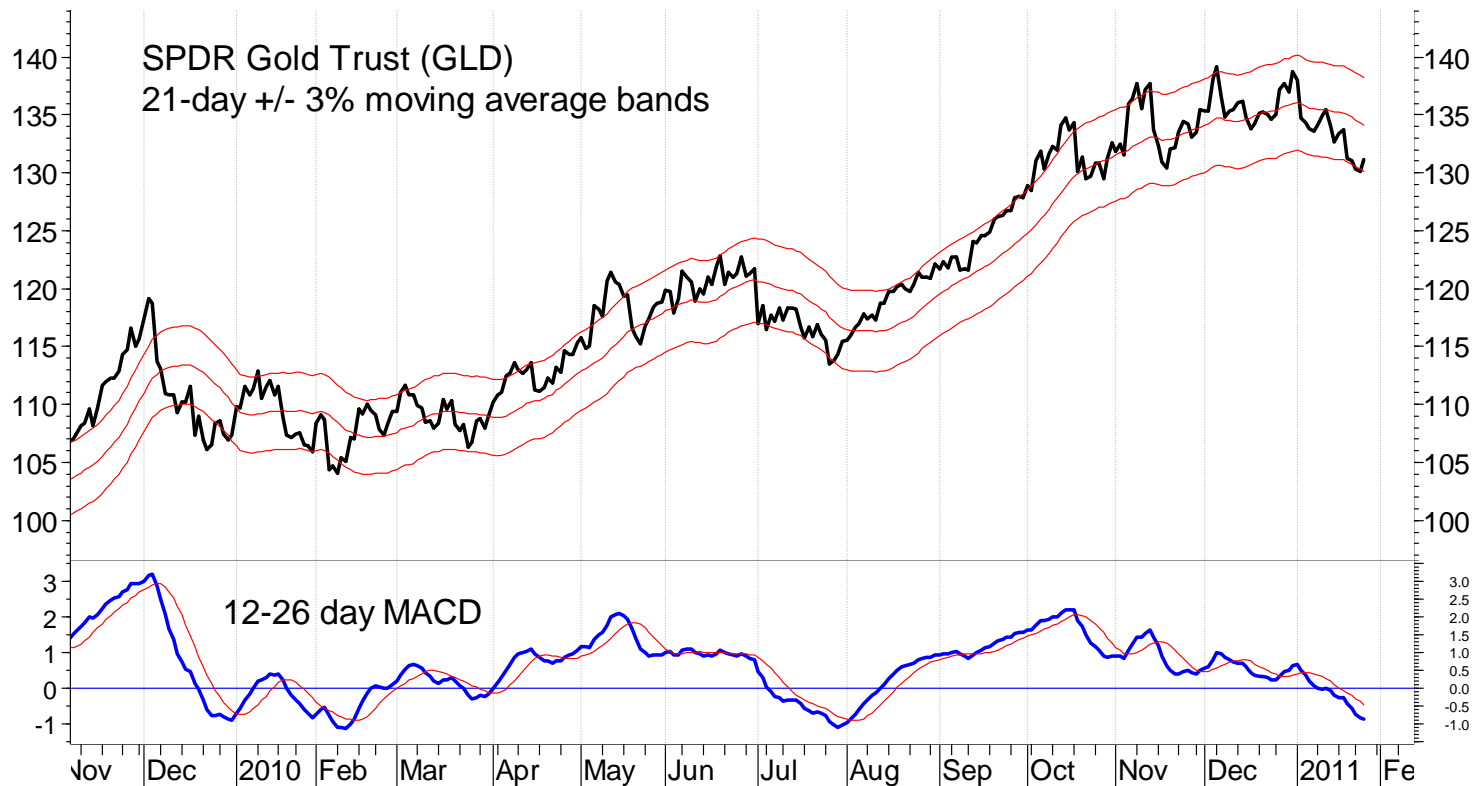
Biggest rebound since the early 1980s.

The economy will do well in 2011

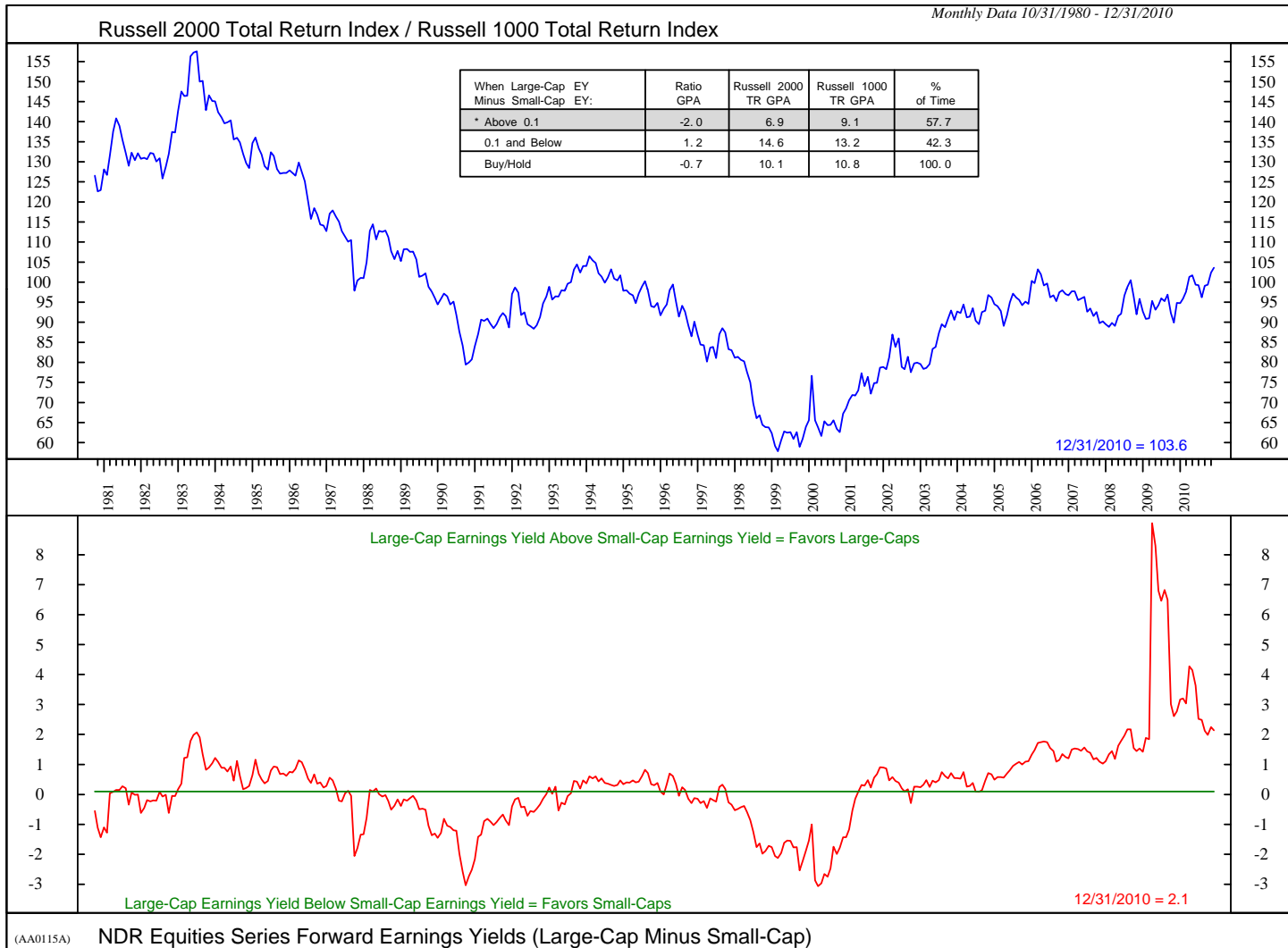
- Most commentators believe that the economy will grow well (approx. 3.5% above inflation) in 2011 as a result of the December tax cuts.
- Favorable for high yield bonds
- Poses risks for investment-grade bonds.
- Moderately positive for stocks.
- Favored U.S. sectors:
 - Energy (XLE)
 - Industrials (XLI)
 - Basic materials (XLB)
 - REITs (IYR)

Longer term outlook (2012 and beyond)

- Higher inflation and higher interest rates
- However, I don't like gold



Valuations favor large-caps



Investment implications

- High yield bond mutual funds are best for 2011
- Investment-grade bonds will be problematic
- Stocks are due for a correction but should be decent performers in the years ahead.
- The strategies here should help you moderate stock market volatility.

HIGHER RETURNS



USING BONDS, STOCKS, AND OPTIONS
TO GENERATE LIFETIME INCOME

MARVIN APPEL

Some of the material in this presentation originated in “Higher Returns from Safe Investments” (Prentice-Hall, 2010), available on Amazon.com or BarnesandNoble.com

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