

BMWM CONFERENCE MYRTLE BEACH, SC OCTOBER 2011

INCOME GROWTH

Fixed Income, Commons stocks , Covered Calls,
PUTs , the BMW Method.

A RETIRED PERSONS PERSPECTIVE

Pop Quiz..

How many years does it take for a dividend growth stock paying a 3.7% current yield increasing its dividend by 9% per year to exceed the income of a fixed income investment at 7% yield?

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Pure Answer: 8 Years.

Reinvested answer: 10 Years. I'll explain later.

Covered Call answer: 13 Years.

Retired Investment Goals

- Increase income every year by 4%.
- Live off the income from the portfolio without having to sell anything.

PRIORITIES:

1. Income
2. Income Growth
3. Conservative Investments (BMW type stocks)
4. Capital appreciation

Investments Used

- Common stocks
- Preferred stocks
- MLP
- Covered Calls
- PUTs

Wait a second JoKingMe, You're using PUTs, but your #3 priority is to be conservative!!!

Are PUTs a conservative investment?

Let's consider:

1. I'm using leverage (other stock assets provide the margin for selling naked PUTs and PUT spreads).
2. I'm earning cash dividend on my leveraged investment plus cash received on PUTs plus Covered Call income.

The BMWWM suggests that the answer is YES?

WFC 16 year BMW Chart

Can sell PUTs at/below -2 RMS line.



Looks like a good time to sell PUT

On 8/24/11 sold WFC Jan2013 \$15/\$12.50 PUT spread for net \$.52.



PUT position start rules

1. Stock below 200 and 50 day moving averages.
2. 200 DMA and 50 DMA trending down.
3. Nice if stock is still below 10 DMA.
4. Verify the BMWM chart trends.
5. Check your valuation.
6. Check 15 Point Rule Score.
7. Check opinion of stock subscription service.
8. You must be willing to own the stock.
9. Try to initiate position on down days.

What PUT to sell?

- 10% discount to the current stock price.
- DELTA under 20 (-.2).
- Duration: Try to keep your expirations balanced, but 6-18 months are OK. The longer the better as this gives the BMWM more time to work in your favor.
- Position size: Exposure of $<1\%$ of total portfolio for naked PUTs or Spreads. Start most with $\frac{1}{2}$ position, willing to 'double up' at better price.

PUT return expected.

Mostly, you get what the market gives you that conforms to the 'What PUT to sell' guidelines.

Spreads: 15-25% on exposure amount. Bottom of the spread is 15-20% below the short PUT strike.

Naked PUT: 4-8% on full exposure of stock going to zero.

I'm more focused on spreads than naked PUTs.

Real Money Experiment

I have 20% of my taxable assets in an account that allows PUTs, covered calls, spread trades, etc.

Goal for next 12 months is 9% cash return from this portfolio from:

1. Dividends
2. Covered Call premiums
3. Naked PUT and PUT spread premiums

I'll have to be more aggressive with covered calls than I will be in my primary account.

Most recent PUT Spread started

SY Y – Sysco Corp.

Date 10/19/2011

Expiration 5/19/2012

\$22/\$17 spread for a net of \$.48 (\$.69/\$.21).

17.1% CAGR on \$5.00 of exposure.

** end of diversion into PUTs **

Retirement Portfolio Construction

40% Preferred Stocks

9% High yielding stocks (MLP, NLY, PWE)

40% BMW type dividend paying/growing stocks.

10% Commodity stocks.

1% Cash (remember, I'm using the cash generated for living expenses).

The PLAN

- Use excess cash generated by options sales to add to high income positions or BMWW bargains.
- Use aggressive CC's and conservative PUTs for non-BMWW stocks (energy/commodities).
- Allow BMWW dividend growth stocks to provide most of the annual income growth of the portfolio.
- Stay disciplined with CC's on BMWW stocks.
- **Convert any BMWW stock called away into preferreds.**

Convert any BMW stock called away into preferreds. **WHY?**

- The POP QUIZ second answer of 10 years for a solid dividend grower to catch up to a preferred provides the answer.

The extra years come from investing the excess current income (7% versus 3.7%) in additional preferred stocks at 7% to increase the annual income of the fixed income portfolio.

Boosting the 10 Years to 13 Years.

Let say I buy 100 ABT for \$5325 and sell a Jan2013 \$60 covered call for \$183.

I'll invest the \$183 in a preferred.

Assuming in Jan2013 ABT gets called at \$60. I can invest the \$6000 at 7%.

It will take ABT 13 years of 9% dividend increases to generate the income of \$6183 invested at 7% while re-investing the excess of ABT's dividends in more preferreds.

Other Variables to consider

Selling options for multiple years before being called away increases the disparity of Dividend Growth versus Fixed Income.

Dividend Growth is much more likely to slow than to accelerate in the future. Even a small amount of dividend growth degradation increases years for dividend growth to overtake re-invested fixed income.

First Year Retirement Performance...

- 2011 is the first year with this plan in mind and being used. 2012 will be the first full year of retirement.
- Annual taxable account income increased 5.6% since Jan 1, 2011 to 10/19/2011.
- Everything looks to be on target for a successful first year.

Concluding Random Thoughts

- I don't expect to maximize my results with this strategy.
- I won't minimize them either.
- Portfolio is significantly less volatile than the market in general.
- I'm comfortable with the level of risk to long term income growth and financial security.