

A MOTLEY FOOL PRO SPECIAL REPORT

# 2 PRE-ELECTION PLAYS TO MAXIMIZE YOUR INCOME IN 2012

By Jeff Fischer, Advisor, *Motley Fool Pro*



*The Motley Fool PRO High-Yield Handbook:*

# 2 Pre-Election Plays to Maximize Your Income in 2012

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Dear Prudent Investor,

There are plenty of reasons *not* to invest your hard-earned money in the stock market right now...

Among them... worries about the future of Europe, concerns about the health of the U.S. and global economies, and uncertainty about how the upcoming presidential election will impact investors.

But let's face it... there are *always* plenty of reasons not to invest...

Yet history and numerous studies have shown time and time again that those who sit on the sidelines (or worse, those who try to time the market) end up far behind those who have the brains — and the guts — to stick with it.

Of course, as any successful professional investor or veteran hedge fund manager will tell you that if you want to maximize your gains and minimize your risk in uncertain times like these, *you must have a well-thought-out strategy in place — and you must be willing to use any and all investment tools available to you.*

That's why I wanted to share some of the “deeper” strategies and tools my team and I are using at *Motley Fool PRO* to help our members protect — and grow — their wealth no matter what happens with Europe, the economy, or the election.

I'm confident that what we've laid out on the following pages will help you do exactly that. But please read on and judge for yourself.

If you have any questions about these strategies or our *Motley Fool PRO* service, feel free to send them to [AskThePros@fool.com](mailto:AskThePros@fool.com) — and we'll do our very best to address them over the course of the next few weeks.

I sincerely hope you'll enjoy — and profit from — what we've put together for you today.

To making money in any market,



Jeff Fischer,  
Advisor  
*Motley Fool Pro*

**P.S.** *Motley Fool PRO* is currently closed to new members, but we will be re-opening the service for a brief period beginning July 17 — and this is most likely the final time we'll be accepting new members in 2012. So please be on the lookout for details on how you can be one of the select few who will get to sample *Motley Fool PRO* without risk or obligation.

## Introduction: Let's Talk Income

**N**ews Flash: Stocks have been flat for 13 years! Since 1999, the S&P 500 index is unchanged. It traded around 1,300 in 1999. It trades there right now.

That's 13 years — a sobering 17% of the average American man's lifespan! — where the index that holds the 500 strongest, most popular companies in the world went absolutely nowhere.

And the problem is, there are good reasons to believe the coming years won't be much better. With government austerity programs bringing Europe's economy to its knees, and with the U.S. facing the same budgetary music soon, too, it's hard to see where strong, sustainable growth is going to come from.

Especially when you remember that, worldwide, Baby Boomers are reaching an age where they save, rather than spend. This huge demographic of people is going to spend less and less in the future — and they're easily a big enough group to affect economies, just as they have all their lives.

In short, as we head into what may be another “lost decade” for stocks, you do not want to be relying on a rising stock market to reach your long-term financial goals. You've already seen how the market doesn't always cooperate. You need something better... you need something more. Something that works again and again, and is simple yet powerful. We've used the safe strategies we're about to share with you since 2000, and they've made all the difference — the difference between a highly profitable decade rather than a lost one. Most of us can't afford another lost decade, so read on.

### STARTING YOUR OWN INCOME STREAMS

How many times have you bought a stock only to see it decline? If you're like most people, it's most times. It's just how it works out. When you buy a stock, it's likely to trade lower at some point after you bought it. That comes with investing. But it doesn't have to be this way. Instead of buying a stock and watching it drop, why not wait to buy it when it declines and get paid while you wait?

That's exactly what selling (or writing) simple “put” options allows you to do. A quick primer: When you sell a put option, you're agreeing to buy a stock if it declines to a stated price (the strike price) by your option's expiration date. For that agreement, you are paid on day one. You collect income called a “premium,” because you're basically selling someone else insurance. The put buyer knows that if the stock falls, they can sell the stock to you at the set price. So, they're paying you for that assurance. The great news is you can write puts again and again for repeated income on strong stocks. Let's take a real-world example.

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## Income Play #1: Intel

Microprocessor giant **Intel** (Nasdaq: INTC) has been an active and profitable position in *Motley Fool PRO* since we launched in 2008. Wall Street has had the company all wrong, expecting no growth, expecting it to be crushed by mobile devices. But Intel dominates the highly profitable business server chip market, and is selling PCs like crazy in the new largest PC markets in the world: China and Brazil.

Meanwhile, Intel avoided the mobile chip market (smartphones) because the margins were too low. Now that Intel can produce smartphone chips in volume and at margins that companies demands, Intel is entering the mobile space. And

it's not too late! You know how often you get a new mobile phone: every few years, if you're typical. The product cycles are very short. This means Intel can always get its chips into new phones as they're designed, and enter the market quickly.

We've been right so far. Intel has grown earnings by strong double digits even as Wall Street expected flat results. And we've made money on Intel. Now the stock is up quite a bit, though, so we only recommend buying it cheaper. That means: Write put options for income until you get a cheaper price. You can do this again and again, so you don't even mind if your price comes along or not!

## Trade Essentials

- **Intel** (Nasdaq: INTC): \$27 (June 21)
- **October 2012 \$25 puts:** Bidding \$0.85 per share
- **Yield on potential share purchase (\$0.85/\$25):** 3.4% in four months (more than 10% annualized)
- **Trade:** “Sell to open” one October \$25 put for every 100 shares of Intel you’re willing to buy
- **Potential outcome #1:** Intel ends the October expiration still trading above \$25. You keep the \$0.85 per share you were paid, earning quick income even though the stock did nothing — or even if fell to \$25.01, or 7% lower.
- **Potential outcome #2:** Intel ends the April expiration below \$25. You still keep the \$0.85 you were paid, and your \$25 puts are turned into shares, so your net start price is an attractive \$24.15 (10.5% lower than the current stock price).

So even if Intel shares decline a steep 7% by October, you still earn all of your income and have no obligation. Now imagine doing this again and again on an array of stocks you trust, setting up expirations for every month, basically writing yourself checks month after month as stocks just bounce around. That’s how reliable and steady writing puts on strong companies is, even over the past 12 volatile (but ultimately flat!) years for stocks. And that’s why *PRO* is offering members at least a dozen such income trades a year.

## The Next Step...

Now imagine that you *did* get to buy Intel stock at \$24.15 through your puts. You’ve locked in a 3.6% dividend yield for as long as you own the shares. But your income checks don’t stop there. They’ve just started. Because now that you own shares, you can turn right around and write covered calls, which are just as simple as writing puts. Writing covered calls is an income strategy so reliable that it’s a favorite not just of retirees, but also of hedge funds. When you write (or “sell to open”) a covered call, you are promising to sell a stock you own if it appreciates to your set strike price by your option’s expiration. Whether the stock rises or not, you keep the income that the covered call pays you.

So, imagine it’s October 2012 and you now own Intel stock, bought at your discounted price thanks to the puts you wrote. You could wait for the stock to appreciate a bit and then write covered calls, or start earning income right away. In October,

assuming Intel is around \$25, you should be able to write \$27 covered calls that expire in three months and get paid about \$1.20 per contract. That would be another 4.9% yield on your purchase price, this time earned in just three months. Let’s walk through this presumed trade.

- **Intel** (Nasdaq: INTC): \$25ish come October 2012
- **January 2013 \$27 calls:** Bidding \$1.20 per share
- **Yield on your purchase (\$1.20/\$24.15):** 4.9% in just over three months (around 20% annualized)
- **Estimated Trade:** “Sell to open” one January 2013 \$25 call for every 100 shares of Intel you already own
- **Potential outcome #1:** Intel ends the January expiration period below \$27, so you collect all of the call income, and still keep your stock. You can write covered calls again for more income. Meanwhile, you’re getting the stock’s dividend, too.
- **Potential outcome #2:** Intel ends the January expiration period above \$27, so you let your shares be “called away,” or sold at that price. You still keep the \$1.20 you were paid, so your net sell price is \$28.20. You’ve made 16.7% on your \$24.15 purchase in about eight months.

And now that you’ve sold your Intel stock, you can turn around and write new put options, to potentially get new shares again lower — or just keep getting paid.

You can see how these excellent combined income strategies can be used again and again on strong but generally range-bound stocks (although if the stocks go up, you also make money). With 500 of America’s best companies on average going nowhere since 1999, writing puts and covered calls have been fantastic ways to make money on them again and again as they bounce around a range.

Sell to open puts to earn income and potentially buy shares on dips.

And then sell to open covered calls on the shares you do purchase to earn income while waiting to sell on a rebound.

And repeat that again and again.

These are such reliable and lucrative strategies across a wide array of stocks that they will change how you invest, give you much more flexibility, *produce regular streams of income*, and still let you enjoy upside in these positions and the rest of your portfolio. Best of all, you’ll no longer mind flat or range-bound stocks. You’ll welcome them!

## Income Play #2: American Express

Now for something just a little bit different...

When you become a member of *Motley Fool PRO*, you receive free access to our sister service, *Motley Fool Options*, for the life of your *PRO* membership. *Motley Fool Options* is famous for teaching newcomers how to use options and for issuing profitable recommendations. Last summer in that service, we recommended buying stock and writing options on one of Warren Buffett's largest holdings, **American Express** (NYSE: AXP). Recently, shares are up 16% for members, but our option strategy has increased our total return to a much larger 30.6% — in just 10 months. At the same time, our option strategy *decreased* our downside risk.

We like American Express' options so much that we recently added a recommendation to *PRO*'s real-money portfolio, too. The options on Amex pay so well that, if you buy shares, our safe option-income strategy could **pay for your whole stock position** over a small handful of years and still let you own the stock (cost-free) for appreciation.

*That's* attractive, *PRO*-style investing. Let me explain.

Too many investors ignore dividends (Amex pays a small one; Intel, much bigger), let alone simple option strategies to generate income. Perhaps these people think these strategies can't add up to real money. But let me assure you: They can make all the difference. It's well known by now that dividends account for nearly 40% of the S&P 500's total return since 1926. What isn't so well known is how much *extra, regular, and steady income* you can create for yourself, again and again, by adding more basic option trades to your portfolio — as I'm about to demonstrate with American Express.

Continue on to see how to begin your own reliable *PRO*-based income strategy on the stock today.

## Buy and “Strangle” American Express for Steady Income

American Express has 98.7 million credit cards in use, up 7% from last year — half in the United States, the rest spread around the world. Customers swiped their Amex cards to the tune of \$211 billion in commerce last quarter alone (an average of \$3,770 per card member). This makes Amex's customer base the most lucrative per capita of any credit card company.

Management grows revenue by spurring customers to spend more on their Amex, and then captures high-margin transaction fees with every swipe of a card. Finance charges and card fees also pad revenue. American Express operates what it calls a “closed-loop network,” letting it capture more of the value chain across its huge industry. The company issues and manages its card base, originates loans to users, manages its network with merchants, and runs the network. This means Amex is able to closely watch customer spending and drive results where needed. Serving the more affluent, American Express maintains one of the best loan portfolios in the banking world, with charge-off rates running below 3%. But because Wall Street lumps the company in with all of the other bank stocks, American Express options pay lucratively. That's where we step in.

### Trade Essentials

- **American Express** (NYSE: AXP): \$56 (June 21)
- **Stock strategy:** Buy half of a full allocation in the stock, at least 100 shares
- **Option strategy (write a covered strangle on your new shares):**
  - “Sell to open” October 2012 \$52.50 puts to potentially double your allocation to the stock; so, sell one put for every 100 shares you just bought
  - “Sell to open” October 2012 \$57.50 calls, selling one call for every 100 shares you already own
- **Option yield:** 8.4% in four months, or more than 25% annualized. The puts and calls you sell pay you \$4.70 per share combined — that's a full 8.4% of your \$56 stock purchase price.
- **Potential outcome No. 1:** If the stock is still between \$52.50 and \$57.50 by the October expiration, both options expire unused, you've earned 8.4%, and you can sell a new strangle to earn strong income again.
- **Potential outcome No. 2:** If the stock is between \$47.80 and \$62.20, you can “buy to close” your options for a partial profit, or some income, still keep your shares, and sell to open another strangle for still more income. This is because the options paid you \$4.70 per share, providing you a very wide range, well beyond your

strike prices, in which to profit. (The math:  $\$52.50$  strike -  $\$4.70 = \$47.80$  breakeven on the downside.  $\$57.50$  strike +  $\$4.70 = \$62.20$  upside before gains are capped.)

- **Potential outcome No. 3:** If American Express' stock declines sharply, your puts obligate you to buy your second half of shares unless you roll them to a later month or close them entirely. But if you accept more shares, you still keep the  $\$4.70$  you were paid, so your second batch of shares would be bought at a cheap  $\$47.80$ , net, lowering your cost basis. The stock needs to fall 14.6% to hit that price. You then own more Amex at a great value and can consider writing covered calls on at least half your shares to keep earning income while waiting for appreciation.
- **Potential outcome No. 4:** If the stock is above  $\$62.20$ , you have a large profit. You could let your shares be called away or sold and then look to write puts to get started again at a lower buy price; or, you could keep your stock by rolling your strangle to higher strike prices and a later month for another income payment and more upside potential. The choice is yours.

## How You Can Follow Our Strategy

So, if you're ready to do more than our first Intel recommendation, here's a summary of how you can get started with American Express right now, too:

### ACTION:

Buy half of a full allocation in the stock, in round lots of 100 shares. So, if you'd be comfortable holding 6% of your portfolio in American Express, as we are, then invest 3% of your funds to start, in round lots of 100 shares.

**Recent share price:**  $\$56.00$

### NEXT ACTIONS:

With one trade, sell to open a "strangle" option strategy on the stock (most brokers let you use a strangle order for one commission):

- Sell to open October 2012  $\$52.50$  puts, one for every 100 shares you just bought
- Sell to open October 2012  $\$57.50$  calls, one for every 100 shares you just bought

By doing these two simple trades (buying stock and then selling to open these two options in one other trade), you'll buy shares around  $\$56$  (recently) and get paid about  $\$4.70$  in option income, giving you a break-even cost of  $\$51.30$ .

That 8.4% option income (or yield) on your share purchase price is earned between now and Oct. 20, 2012, as long as the stock ends between your two strike prices on expiration

day — a wide range it has frequented this year.

In less than four months these options expire. So, you can see that if you do this strategy two or three times a year, you could pay for a full fourth of your stock position each year with option income and manage the position to maintain stock upside, too. We of course offer this valuable real-time guidance to *PRO* members.

## Years of Results

As powerful as these strategies seem when we write about them, they're much more powerful when put into practice. For years, investors like us have been making real and steady income month after month with these sensible strategies on stocks that are loved by investors far and wide. It just takes a little guidance to learn how to do this, and that little bit can change your financial life forever. Don't let another day, let alone year, go by. You already follow the market. Now it's time to generate your own returns from it, even when the market goes nowhere.