

Long only, long-term horizon, dividend investing, covered calls writing

Using Options In A Retirement Portfolio

By **William Colsher** Dec. 21, 2015

Summary

I introduce my IRA Plan and current portfolio.

Options activity includes a buy-write, roll outs, new writes on expired positions.

I summarize my December income.

Introduction

The purpose of this series is to document and explain the activities in my IRA both prior to retirement and thereafter.

Background

I intend to retire at age 62, sometime in 2016. I've been fortunate to have a relatively high income for most of my career so Social Security will be a very significant part of my retirement income. Mrs. C is eight years younger than I and will continue to work for 3 or 4 years.

Over the last 4 years we've lowered our basic living expenses to about \$37,000 a year. These costs will drop further when we downsize to a city townhouse, lowering PITI and utilities costs. At that time we'll also eliminate automobile-related expenses, which represent over \$3,800 per year in insurance and fuel costs.

Beginning in August 2015 I began to transfer funds from my 401(k) to my rollover IRA. I had previously spent several months paper trading a dividend + option premium portfolio and when I was satisfied I understood the process began to work with real money.



Those days are documented in [my outside blog](#). Starting this month I'll be publishing a detailed monthly activity summary (like this one) here on SA, providing there's any interest.

At this time my IRA portfolio consists of five positions. That number will grow to about 12 when retirement finally rolls around. My goals are fairly simple:

- Generate about \$15,000 in dividend income annually
- Create additional income from the sale of covered calls
- Seek stability in large cap dividend payers with a weighted average beta of less than 0.5

At this time the IRA portfolio consists of the following equities:

Sector	SYMBOL	Position	Dividend	Annual Income
Utilities	ED	510.2957	\$2.60	\$1,326.77
Pharmaceuticals	MRK	705.3645	\$1.84	\$1,297.87
REIT	HCP	812.7870	\$2.26	\$1,836.90
Telecom	VZ	800.0000	\$2.26	\$1,808.00
Tobacco	MO	600.0000	\$2.26	\$1,356.00
				\$7,625.54

As you can see I'm just over half way to my dividend income goal.

Altria (NYSE:[MO](#)), Consolidated Edison (NYSE:[ED](#)), and HCP (NYSE:[HCP](#)) are all Dividend Champions. They were chosen for their excellent history and strong dividend returns.

Verizon (NYSE:[VZ](#)), though not a Dividend Champion, is a Dividend Contender with an 11-year history of increases according to the CCC list. The company is beginning 5G field tests in 2016 and intends to have parts of its 5G network in commercial operation in 2017. I believe 5G will be an extremely important technology and Verizon will have a 2-to-3-year head start on the rest of the industry, which expects deployment in the 2020 time frame.



Merck & Company (NYSE:[MRK](#)), like Verizon, has a long history of steady dividend payments, but has only started regular increases since December 2011, making the Dividend Contenders list just this year. Their oncology drug Keytruda has proven effective against certain types of metastatic melanoma and was recently (12/18/2015) approved as a first line treatment. In October it was approved for non-small cell lung cancer as well. A Morningstar analyst is predicting it could produce as much as \$9 Billion, roughly 25% of Merck's current sales. That's a good thing, since patents are running out on Zetia and Vytorin, which represent about 22% of current sales. These first five positions were all purchased using the buy-write strategy. When the remainder of my 401(k) account is transferred to the IRA I'll use CSEPs (Cash Secured Equity Puts) to generate current income while waiting for individual equities to come into my "buy zone".

At this time the five positions described above generate a projected \$7,625.54 of dividend income. They have a weighted average beta of 0.36. All dividends will be re-invested at least until Mrs. C retires. Option premiums will be allocated toward a cash reserve of \$74,000 - approximately two year's living expenses.

Activity

December 7, 2015

Using funds transferred from my 401(k) I purchased 600 shares of MO in a buy/write transaction at a net cost basis of \$57.72 per share. This transaction completes the first (approximately half) phase of my conversion from 401(k) to IRA. The remaining funds will be transferred after retirement. It is my intention to maintain about 12 positions in large-cap dividend payers, most selected from ranks of the Dividend Champions.

Altria is, of course, a Dividend Champion. Although Altria is trading at the top of its 52-week range, a look at a long-term price chart suggests (as [a recent Seeking Alpha article](#) pointed out) that almost any time has been a good time to buy.

In addition to its strong dividend, Altria also trades with weekly options. Weekly options provide greater flexibility in income generation with tighter strike prices (\$0.50 apart) and more choice in timing. In particular, weeklies make it easier to avoid ex-dividend dates without giving up an entire month's premium.



December 10, 2015

As documented in [my previous article](#), I rolled out my in-the-money MRK position to ensure I would not be hit with an early exercise. This resulted in a net credit of \$764.16. This position doesn't expire until February 19 and Merck's next ex-dividend won't be until early March so I shouldn't have to keep too close an eye on it until then.

December 15, 2015

Consolidated Edison ([ED](#)) paid its quarterly dividend of \$0.65 per share resulting in a payment of \$328.35 that was automatically re-invested in 5.1492 shares. This increased my annual income by \$13.3879 at the current annual dividend of \$2.60. I expect Consolidated Edison to announce an increase when it declares its March 2016 dividend in mid-February 2016. Last year the increase was \$0.08 per year or about 3.17%.

December 18, 2015

Freaky Friday! The last of the four annual "quadruple witching" expirations in which equity options, index options, single equity futures, and index futures all expire on the same day.

This was a horrible day for equities in general. As usual I waited until about 3:30 to start looking at roll outs for HCP and VZ.

(click to enlarge)

HCP Rollout					
HCP 12/18/2015 35.00 C					
HCP 01/15/2016 35.00 C					
Symbol	Action	Quantity	Price	Timing	Time & Date (ET)
HCP 12/18/2015 35.00 C	Buy Calls to Close	8 Contracts	Credit \$0.25 (Applies to both legs)	Day Only	3:25 PM 12/18/2015
	Bought	8	\$1.52	Settles 12/21/2015	3:25 PM 12/18/2015
HCP 01/15/2016 35.00 C	Sell Calls to Open	8 Contracts			3:25 PM 12/18/2015
	Sold	8	\$1.83	Settles 12/21/2015	3:25 PM 12/18/2015

At 3:25 my rollout of the HCP 35 calls filled for a net gain of \$226.62. This was surprisingly early, but when rolling out I look for the ask price on my short calls to be about 3 or 4 cents above their intrinsic value. My experience has been that's about the best a retail investor like me will ever see.



(click to enlarge)

VZ Rollout					
VZ 12/18/2015 45.50 C					Get a Quote
VZ 12/31/2015 45.50 C					
Symbol	Action	Quantity	Price	Timing	Time & Date (ET)
VZ 12/18/2015 45.50 C	Buy Calls to Close	8 Contracts	Credit \$0.40 (Applies to both legs)	Day Only	3:36 PM 12/18/2015
	Bought	8	\$0.35	Settles 12/21/2015	3:40 PM 12/18/2015
VZ 12/31/2015 45.50 C	Sell Calls to Open	8 Contracts			3:36 PM 12/18/2015
	Sold	8	\$0.75	Settles 12/21/2015	3:40 PM 12/18/2015

Then at 3:40 my VZ roll out filled for a net gain of \$298.32. Same deal here - the ask was getting into my range so I placed the order and got filled a few minutes later.

I rolled the VZ calls to December 31 rather than January 15 because the January 15 has only the standard "monthly" strikes.

So after commissions and fees I made \$524.94 - not that bad for about 20 minutes of watching quotes update.

After a miserable day like Friday, here's something I love to see in my transaction history:

Date	Action	Details **	Symbol	Description ¹ (Full Short)	Quantity
12/21/2015 as of 12/18/2015	Expired		MO 12/18/2015 58.50 C	CALL ALTRIA GROUP INC \$58.5 EXP 12/18/15	6
12/21/2015 as of 12/18/2015	Expired		ED 12/18/2015 65.00 C	CALL CONSOLIDATED EDISON\$65 EXP 12/18/15	5



December 21, 2015

Call writing day! First up - Consolidated Edison:

Build		Vega	Theta	Gamma	Delta	IV	Bid	Ask	Strike
ED Jan 15, 2016 (25 days to expiration)									
Select		0.000	0.000	0.000	0.000	0.000	8.10	9.00	55.00
Select		0.034	-0.015	0.035	0.879	33.013	6.20	6.60	57.50
Select		0.045	-0.016	0.063	0.813	24.938	3.80	4.20	60.00
Select		0.064	-0.022	0.106	0.627	20.953	1.90	2.10	62.50
Select		0.061	-0.019	0.117	0.329	18.099	0.60	0.70	65.00
Select		0.029	-0.009	0.059	0.095	16.887	0.10	0.15	67.50

Selecting a strike for ED is almost always easy. There are only monthly options with strikes \$2.50 apart. Like most utilities, ED is pretty stable with a five-year beta of -0.04. The lowest front month out of the money call often has a delta around 0.30 - .35. Delta is a measure of how much the option price will move for each \$1.00 the underlying changes. Covered call writers tend to delta as an estimate of the odds that the call will be exercised. In this case Schwab showed a delta of .329; about a 1 chance in 3 this position will be assigned January 15.

When setting my limit price I often use what's probably the simplest possible technique: split the bid/ask difference. I placed my order at \$0.60 (the table above is from later in the day after I decided to write this explanation.) and was filled almost immediately. That gave me a net income of \$287.16. Many traders like to see a monthly return on a covered call in the 1% to 1.5% range. This trade comes in at 0.89% on my cost basis- a little low, but that something that comes with the low volatility of companies like this.



ED goes ex-dividend on the 22nd, but this position is well out of the money so there's no danger of an early exercise.

And Altria...

Build		Vega	Theta	Gamma	Delta	IV	Bid	Ask	Strike
MO Jan 15, 2016 (25 days to expiration)									
Select		0.058	-0.014	0.154	0.624	15.994	1.35	1.40	56.50
Select		0.061	-0.015	0.162	0.544	15.905	1.05	1.12	57.00
Select		0.061	-0.016	0.163	0.463	15.887	0.82	0.86	57.50
Select		0.058	-0.016	0.157	0.383	15.862	0.62	0.65	58.00
Select		0.054	-0.015	0.145	0.308	15.865	0.45	0.49	58.50
Select		0.048	-0.013	0.128	0.242	15.876	0.32	0.36	59.00

Altria was a little volatile Monday morning but the January \$58 strike looked attractive. So I placed my order at the ask price this time, believing that it would only take a move of a few cents to bring the bid up. Sure enough my order filled about 10 minutes later, netting \$376.39. That one came in at 1.08% on my cost basis so that's a win in my book.

Income For December

Date	Activity	Amount		
10-Dec	MRK Rollout	\$764.16		
15-Dec	Bank Interest	\$0.03		
15-Dec	ED Dividend	\$328.35		
18-Dec	HCP Rollout	\$226.62		
18-Dec	VZ Rollout	\$298.32		
21-Dec	Sell Calls MO	\$376.39		
21-Dec	Sell Calls ED	\$287.16		
	Income For December	\$2,281.03	1.65%	21.74%
	Options Only	\$1,952.65	1.41%	18.37%



As you can see, December income was darn good. The IRA represents approximately half of my retirement finds (51.09% right now) so results like December's look very promising in terms of the income from the full rollover.

It's possible that my VZ calls will need to be rolled out on the 31st; their delta is .540 just now. If that's the case, I'll update the December income to reflect that.

Upcoming Events:

- Verizon's next ex-dividend date is January 6.
- Merck will pay its regular quarterly dividend January 8.
- Altria will pay its regular quarterly dividend January 11.
- Verizon will announce 4th qtr. earnings January 21.
- Altria will announce 4th qtr. earnings at the end of January.

Conclusion

I'm very happy with this month's results. Extrapolated to the eventual full positions (remember this is about half of my total) suggests we could see income at about 185% of of our basic living expenses as things are currently structured.

