



Registered Investment Advisor

## STEIN WHITTINGTON DENIEL INVESTMENT ADVISORS

# Wealth Manager

Jan 08

## COVERED CALLS SHINE ONCE MORE!

We used the title above in our January 2006 Newsletter when our Covered Call Strategy significantly outperformed the major market indices in 2005, a year in which the market indices went up, down and finally settled with a ho-hum performance. Well, we pulled an even bigger feat in 2007! In 2007, our "Equity Income" accounts (most conservative: all ETFs, all covered) achieved a 12.07% return for the year; "Equity Growth and Income" accounts (moderate: ETFs and common stocks, some uncovered), achieved a 12.99% return. Growth accounts returned 16.26%. These returns are net of all fees. At the same time, the DOW was up 6.43%, the S&P500, 3.53% and the Nasdaq, 9.81%. The Russell 2000 Index was negative 1.57%.

In late 2001, as we struggled with a severe bear market, Stein Whittington Deniel embarked on a course to implement a better strategy for all markets, a strategy known as "Covered Call Writing". This strategy is well suited for the risk adverse investor. The great majority of our clients are not after "home runs" but prefer a steady portfolio that is somewhat protected during market downturns. Yet, Stein Whittington Deniel will manage each individual portfolio in the style that matches client wishes. The main objection to Covered Call Writing lies in the fact sometimes a security is sold at the option "strike price" which is below the market price on the third Friday of a month. The argument goes we "leave money on the table" when writing Covered Calls.

We have disproved this argument once again as we outperformed the equity indices in 2007 by a wide margin in most cases. For example,

suppose a client purchases 1000 shares of the Nasdaq ETF for the sum of \$49.70 per share (\$49,700) on November 19, 2007, and writes a Covered Call Contract expiring December 21, 2007, with a \$50 strike price, while receiving a Covered Call premium of \$0.75 per share (\$750). Assume the Nasdaq goes up to \$51.85 per share on December 21st. The 1000 shares of Nasdaq in this example must be sold for \$50 per share strike price. The client has obtained a 1.51% return for an approximate 28 day period; thus, the client is very happy. The "buy and hold" investor has on paper earned a higher percentage return, however, if the

Nasdaq drops below \$50 a share a short time later — a likely scenario — the "buy and hold" investor may have no return at all unless he sold at the 'right' time.

In summary, the advantages of Covered Call Writing include: (1) a disciplined sale strategy, taking profits periodically; (2) a predictable and reliable stream of income which mitigates losses in a declining market and provides an excellent source of

cash for monthly distributions from an account; (3) reduced volatility, a form of risk, thereby constituting a more conservative strategy than any other for owning equities; and (4) a Covered Call strategy necessitates the review and repositioning of the portfolios monthly.

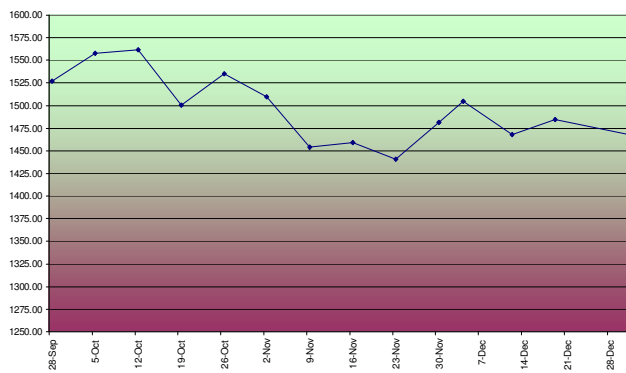
Our firm is rather unique in offering this Covered Call strategy for individual clients. The strategy requires a lot of work and is generally reserved for very large accounts at the major firms. Most advisors place their clients in Mutual Funds, where managers unknown to the client invest moneys in bulk.

Important Point. Overall return is measured by both cash premiums earned as well as performance of the underlying securities in the account. Thus, production of cash alone does not constitute overall performance.

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## THE QUARTER IN REVIEW

SP 500 INDEX  
 Oct 1 - Dec 31, 2007



As a severe housing slump, sub-prime loan chaos, and disappointment in the FOMC intensified, the fourth quarter of 2007 reversed a strong third quarter leading most indices for the year to mediocre/poor, returns. Many pundits were even predicting a recession for the United States. During the past quarter, the Chinese and European markets also suffered considerably, led mostly by grim reports from banks and other financial institutions. During the quarter, the DJIA was down 4.5%, the NASDAQ Composite down, 1.8%, and the S&P500 down, 3.86%. High volatility continued. Indeed, for the entire year 2007, the Russell 2000, a broad index of small cap companies was negative 1.57%, while the DOW was up for the year, 6.43%, S&P500, up 3.53% and the Nasdaq, by far the best performer, was up 9.81%.

Traditionally conservative institutions such as Merrill Lynch, Wachovia, and Bank of America had very large losses in mortgage backed securities; this spooked the markets and many smaller brokerage houses and banks followed suit. However, the real culprit to many people lay in potential or real inflation which was on everyone's radar screen as crude oil spot prices flirted with \$100 a barrel, gold traded at about \$800 an ounce, and grain prices were doubling from the end of 2006. Higher grain prices constitute a very serious topic as it become clear that increasing demand for fuel usage is causing inflation in grain competing with human and livestock needs. The weak dollar aggravates this trend as imported goods become more expensive. In short, an environment of fear pervades the markets as 2007 closes. The country's budget and balance of payments remain out of control, while the trade balance has improved.

Geopolitical events continue to aggravate the eco-

nomie environment. These include the murder of Benazir Bhutto and political instability in Pakistan, frustration in the Middle East as Russia continues to arm Iran and Iran refuses to give any assurances about its nuclear ambitions and no bright spot appears in the Palestinian Israeli situation following the failed attempt to mediate the dispute at Annapolis.

On the positive side, the world economy remains strong, and the War in Iraq is going better for the United States. Moreover, employment in the United States remains strong and, by historical standards, interest rates remain low. As the crisis in the financial sector unfolds, it is likely that events will prove less desperate than they now appear in the current negative environment.

On the bright side, our Covered Call clients continue to experience a "windfall", meaning considerably higher premiums from Covered Call Writing than normal due to the increased volatility. As explained on the front page, our firm's conservative Covered Call strategy has served our clients very well in this difficult market environment.

**Seminars:** Currently, we have one breakfast seminar scheduled: Mira Monte Resort, Wednesday, February 13, 2008, 8:30 to 10:30 am. Please call if you would like to attend.

**Schwab Alliance:** If you haven't done it yet, please remember to call the Schwab Alliance Team (800) 515-2157, #3 and request enrollment in electronic delivery. They assist clients on the phone; and walk you through the enrollment process while you are online. Please ask to enroll in e-Confirms, electronic delivery of annual reports and 10K's and e-Statements. This will entitle you to receive reduced commissions on equity trades and avoid the clutter in your mail box. Schwab continues to improve its website offerings, including viewing statements and 1099 tax reports as soon as they become available.

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