HARVEST
EXCHANGE TRADED FUNDS

# The Art Of Covered Call Writing

## A Source of Tax Efficient Income

January 2022

WEALTH PROFESSIONAL CANADA
2021 5-STAR ASSET MANAGER
WP

# The Power of Covered Call Options

**By Michael Kovacs**
President & CEO
Harvest ETFs

## Introduction

Harvest ETFs uses a combination of strategies to produce growth and income in its funds. Harvest starts with a careful selection of the stocks that make up its active ETFs, choosing them through criteria that include, among others, global reach and sector dominance, free cash flow, a history of dividend growth and brand value.

A crucial part of the Harvest model is the use of covered call options to generate extra income. This covered call strategy applied to a suite of strong, global businesses with growing dividend streams creates a uniquely powerful mix for an investor's portfolio. Harvest writes calls on up to 33% of each position on our Equity Income ETFs, generating an attractive tax efficient income while participating in the growth of the companies our ETFs are invested in.

## Part I:
# Call Options Explained

A call option is an agreement between two parties that give the option buyer the right, but not the obligation, to buy a stock at a fixed price within a specified time frame. The buyer pays a fee to the seller for that right. The seller keeps the fee regardless of what happens later.

Here's an easy way to look at it. Suppose you decide to buy a house and agree on a price. You pay the seller a small fee that allows you to lock in that price for the next 30 days while you think about it. In stock option terms, the fee is called a premium.

If the price of the house goes up during those 30 days, you still pay the original price. The fee you paid gave you a 'call' or the right to do that. If the house price drops, you can walk away. You are out the amount of fee, nothing more.

**"Call option" is the right to buy a stock at a specific price for a specific period of time.**

### Here's an example using a stock:

#### Share price rises:

ABC is trading at $100 per share. You buy a call option contract that allows you to buy 1 share of ABC at $100 for the next 30 days. The price for the option contract is $3. If ABC rises to $105 within the 30 days, you would probably exercise the option and buy the stock for $100. Your total cost would be $100, plus $3, or $103 for something worth $105. You can sell ABC for a $2 profit or keep the shares.

#### Share price falls:

Instead of rising, ABC falls to $90 in the 30 days. You would not want to exercise the option to buy it at $100, when you can get it for $90 on the market. So, the option expires worthless. Yes, you lost $3, but not the full $10 decline in the stock. In other words, you did not pay $100 for something that is worth less today.

**Part II:**

# Covered Call Options Explained

A covered call option is similar but approaches the investment decision from the perspective of the seller of the option rather than the buyer.

The seller of the house knows the price can go up or down in the 30 days. So in order to hold that price for the buyer, they want a fee. In exchange for the fee, the seller agrees to accept the agreed upon price should the house value rise. If at the end of the 30 days, the price falls and the house is worth less, the purchaser can walk away. The owner has the house, plus the fee.

## Here's an example using a stock:

### Scenario A: ABC shares go up.

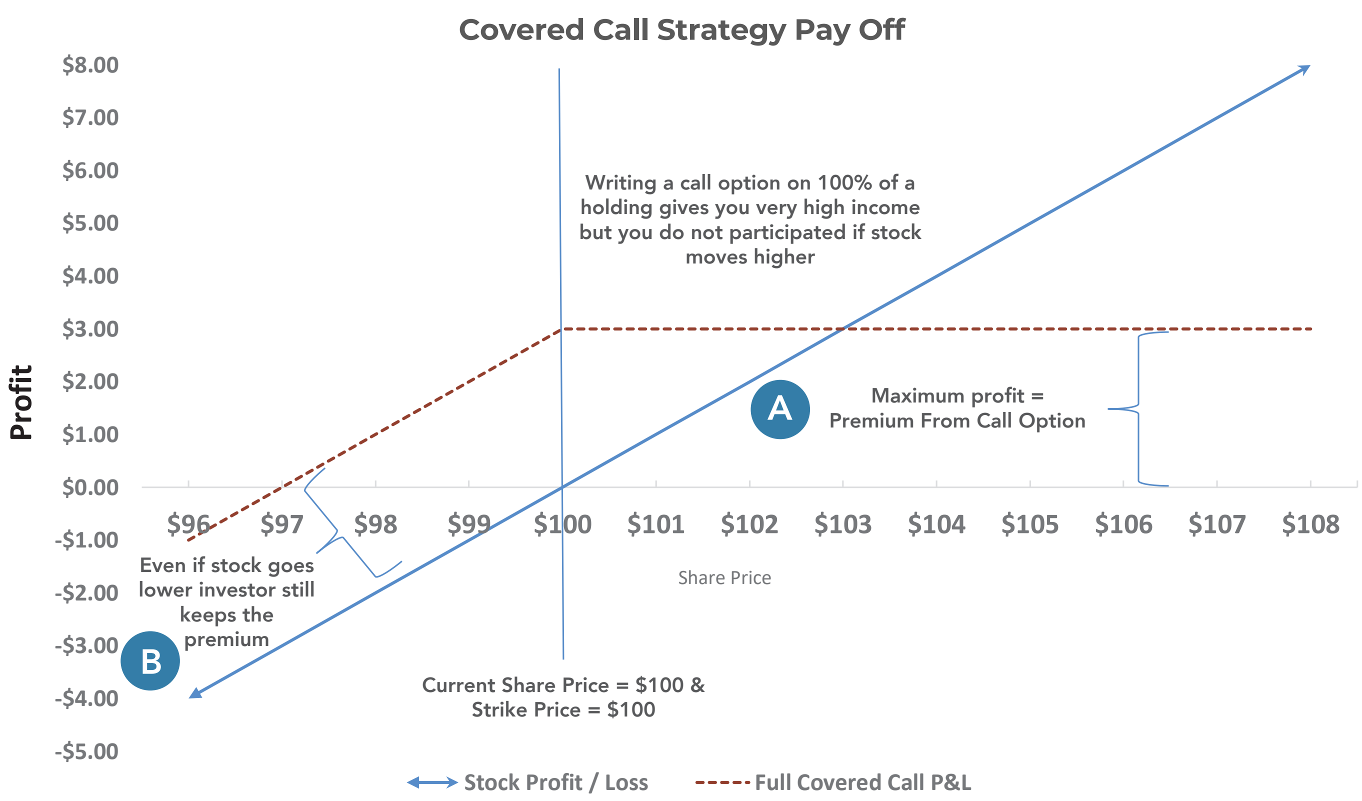
ABC shares go up to $105, owner sells at $100, lost out on price increase but was "covered", keeping the $3 "premium".

### Scenario B: ABC shares stay the same.

ABC shares stay at $100, the calls are not exercised and the portfolio benefits from the $3 "premium".

### Scenario C: ABC shares drop.

ABC shares drop to $95, calls are not exercised, value of portfolio drops, but is cushioned by the $3 "premium", value equivalent to $98.




**Writing a call option on 100% of a holding gives you high income but you do not participate if the stock moves higher.**

**A** Maximum profit = premium from Call Option, but the premium received is certain.

**B** Even if stock goes lower, the investor still keeps the premium.

Example for illustrative purposes only.

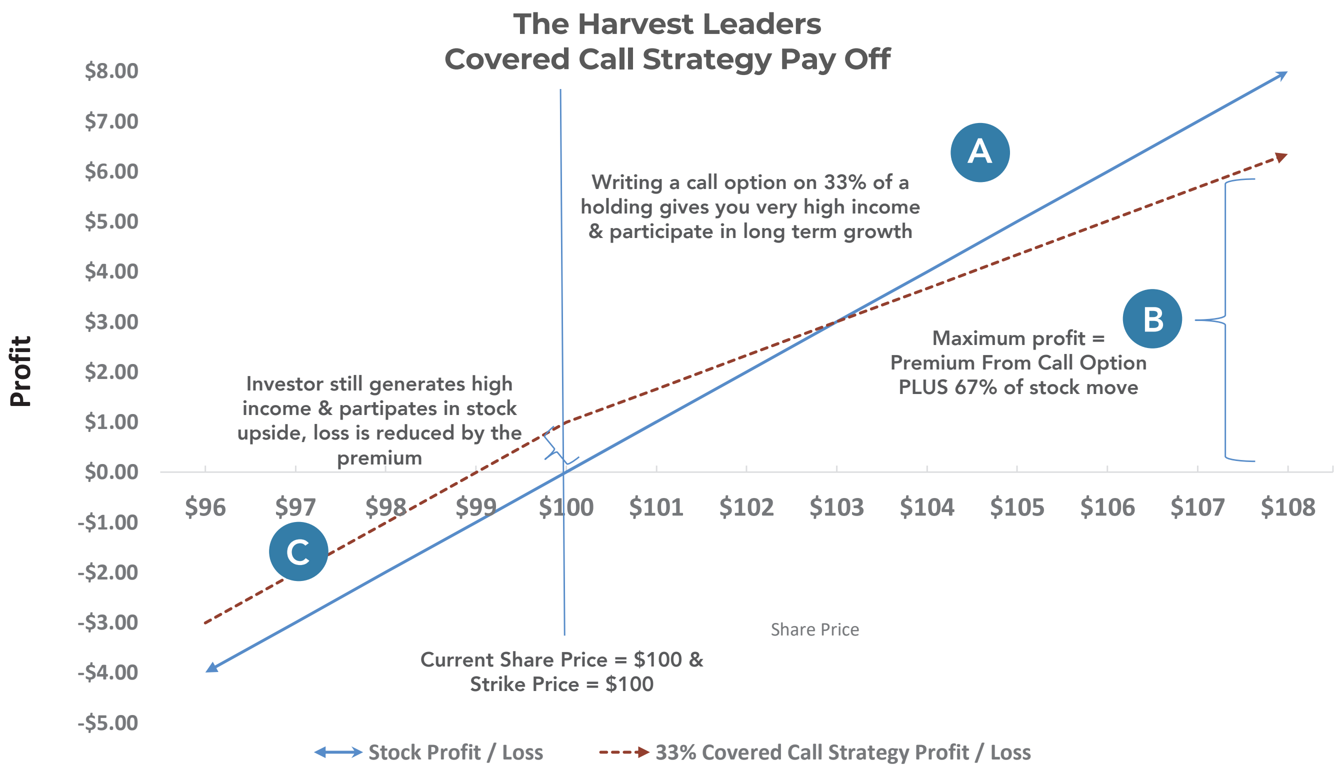
# The art of the Covered Call Strategy

There are a number of moving parts when writing covered calls. At Harvest, we integrate them into our long-term view of investing.

All Harvest Income ETFs are equity income ETFs, which means they are invested in stocks or the shares of businesses we believe have great long-term dynamics and are leaders in their fields. A key feature of the Harvest Leaders strategy is that all our equity income ETFs will only write covered calls to a maximum of 33% on any position. This means that we are able to earn additional income by writing on a portion of the position and will always have a minimum of 67% exposure to the underlying securities.

# The Harvest Leaders Covered Call Strategy Pay Off

The chart highlights how the Harvest Leaders ETF's can generate high income but still participate in the long-term growth of the companies we invest in.




## Writing a call option on 33% of a holding gives you very high income as you participate in long term growth.

**A** Writing a call option on 33% of a holding gives you very high income as you participate in long term growth.

**B** Maximum profit = Premium from call option PLUS 67% of stock move.

**C** Investor still generates high income and participates in stock upside, loss is reduced by the premium.

Example for illustrative purposes only.

In practice, not all premiums are the same. They depend on factors like how much time there is to expiry, how close the strike price is to the stock price, or the expectations of the stock's volatility. The last point is key. When a stock is expected to be more volatile, the premiums are higher.

The Harvest option strategy draws on years of experience to assess these variables and applies a proven proprietary process to generate tax advantaged income for investors. As an example, if one of the Harvest Leaders ETF's has 20 Stocks, we will write call options selectively each month and at different levels. The Harvest investment team reviews all the activity around the stock when making their decision.

## These include:

- Has a particular stock sold off or rallied recently?
- Are there earnings or business announcements in the near term?
- What is the premium on the options?
- Why are the premiums higher/lower than other companies or during other times in the past?

This is all part of the monthly process around decisions to write options on each ETF. For Harvest's ETFs the covered call writing process is a tax efficient means to generate additional income for unit holders. This is because the income generated by writing covered calls is considered capital gains which is a preferred method of receiving income.

Our objective at Harvest is to provide long-term capital growth through business ownership and attractive tax efficient steady income by collecting dividends and writing covered calls every month.

# Harvest Equity Income ETFs

## Covered Call Option Strategies

| ETF Name | TSX Symbol | Investment Thesis |
|---|---|---|
| Harvest Healthcare Leaders Income ETF ** | HHL | Equity Income / Global Healthcare Leaders |
| Harvest Brand Leaders Plus Income ETF ** | HBF | Equity Income / Global Brand Leaders |
| Harvest Tech Achievers Growth & Income ETF ** | HTA | Equity Income / Global Technology |
| Harvest Equal Weight Global Utilities Income ETF | HUTL | Equity Income / Global Utilities Leaders |
| Harvest Global REIT Leaders Income ETF | HGR | Equity Income / Global REIT Leaders |
| Harvest Energy Leaders Plus Income ETF * | HPF | Equity Income / Global Energy Leaders |
| Harvest US Bank Leaders Income ETF * | HUBL | Equity Income / US Bank Leaders |

* USD available. ** USD and Unhedged available.

## About Harvest

Founded in 2009, Harvest Portfolios Group Inc. is a Canadian Investment Fund Manager. At Harvest, our guiding principles are premised on building wealth for our clients through ownership of strong businesses that have the potential to grow & generate income over the long term.