The Options Industry Council
Client Strategy Article: Writing Options on ETFs
By: Libby Dubick

Main Management uses ETFs, and ETF options exclusively in managing client assets. "We believe option writing on broad based ETFs makes good sense because broader based index ETFs typically exhibit lower volatility than individual securities,"' said the firms's marketing director." In addition, single stocks tend to be more susceptible to headline risk (e.g. significant earnings shortfall, FDA rejecting a drug) that typically affect indexes far less dramatically. As a result, although the option premiums on indexes tend to be lower, there will generally be less dramatic moves that would wholly negate the call premium 'protection'".

"Options are a great tool to help shield the investor from volatility. We use a buy/write options strategy—using as our benchmark the CBOE Buy Write Index." says Hafeez Esmail of Main Management. The San Francisco-based investment advisor has more than $300 million in assets invested in ETF managed solutions.

The company pursues a strategy similar to the CBOE Buy Write Index with two distinct differences. First, while the CBOE index writes systematic monthly options at the money, Main has the discretion to write options that are in-, at- or out-of-the-money, depending on the firm's forward view of the market.

Second, Main will write options on multiple broader market indexes including global equities and fixed income, not just the S&P 500, as the CBOE does. If the firm makes the correct decisions about the underlying asset allocation it can have a positive impact performance.

"Writing out-of-the-money options has enabled greater participation in rising markets and allocations to the correct broader market indexes has enhanced the total return of the strategy," said Hafeez. "Correctly shifting allocations to fixed income have helped to cushion the downside as we saw in 2008. Our approach has out-performed the CBOE Buy Write Index with less volatility."[1]

Main Management was founded with the philosophy of using only ETFs. "In 2000 there were 32 ETFS offered, in 2002—when we were founded—there were about 100, and today there are almost 1,000 ETFs," Hafeez said. "This is a quickly expanding landscape. In the next few years there will be perhaps a couple of thousand. With ETFs you are buying a basket of securities rather than individual securities so you are automatically managing security risk, plus, ETFs offer liquidity and transparency."

"We offer our clients a low overall cost structure," he notes. "It is hard for mutual funds to outperform when the funds' expense ratio and trading costs total somewhere between 200 and 300 basis points (bps). At Main Management our advisory fees are 65 bps, embedded ETF fees average 25 bps and trading costs are 1-2 bps so the client is all in at under 100 bps. While there

[1] http://www.mainmgt.com/documents/Buy-Writeonepager03-31-10.pdf

are no guarantees in the market," Hafeez said, "we believe using ETFs to build investment portfolios is simply a more efficient model."