

What is PowerShare's Buy/Write Portfolio (PBP)?

Why Do iSectors[®] Liquid Alternatives and Endowment Portfolios Own PBP as a Liquid Hedge Fund?

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Let's look at what PBP is and what it does. First, PBP is an exchange-traded fund. The investment seeks performance results that correspond to the price and yield performance of the CBOE S&P 500 Buy/Write index. The fund normally invests at least 80% of total assets in common stocks of the 500 companies included in the S&P 500 index and writes (sells) call options on them. It writes one-month call options on the S&P 500 index in order to generate income on its portfolio holdings each calendar month.

1. Call options are usually overpriced. Those who sell them tend to make more money than those who buy. PBP sells them.
2. The strategy "has generated superior risk-adjusted returns over the last 20 years... generating a return comparable to that of the S&P 500 at approximately two-thirds of the risk."
3. Over the last decade ending March 31, 2010, buy-and-hold investors in the total U.S. stock market have lost about 6% of their money. Investors pursuing a buy/write strategy would be up about 27%.
4. From April, 1990 through March 31, 2010, the Buy/Write index has made total returns of about 475% -- slightly ahead of the broad U.S. equity market. In other words, the Buy/Write index beat the stock market, with a lot less volatility.

Why it may be particularly good to hold PBP in this economy

First, PBP may be particularly attractive because many blue chip stocks are cheap. Here are some examples:

Johnson & Johnson (J&J) is trading at 12 times earnings right now. These shares have only traded this inexpensively a couple times in history.

- J&J was at 11.9 times earnings in March, 1980. **The stock doubled in less than three years.**
- June, 1984, it traded at 10.9 times earnings. **The stock nearly tripled over the next three years.**
- April, 1994, it had at a P/E of 13.8. **The stock tripled in three years.**

While Johnson & Johnson is cheap, Pfizer is even cheaper...notice its statistics versus its high in 1999.

	1999 High	Today
Price-to-earnings ratio	70x	7x
Price-to-book ratio	20x	3x
Price-to-sales ratio	13x	2x

Merck is like Pfizer...selling for 7 times earnings.

Pharmaceutical giant Abbott is similar to Pfizer and Merck. It's selling at 2 times book value and 3 times sales.

Big banks, for various reasons, and big oil are also selling below intrinsic value.

Big Banks Are Cheap*

8.3 Bank of America

8.0 JPMorgan Chase

9.7 Wells Fargo

9.0 Citigroup

(*forward P/E ratios)

Big Oil Is Cheap*

8.9 Exxon

7.4 Chevron

7.3 ConocoPhillips

Even big tech stocks like Microsoft have relatively low P/Es, despite large amounts of cash; it trades at 11.45 times next year's earnings. Microsoft, sold at \$58 in December, 1999, now sells for less than half that at around \$26 dollars per share.

I think this gives you the idea -- basically, many large blue chip stocks are quite cheap. The overall average P/E of the S&P 500 is about 14.5.

The second reason PBP might be particularly attractive now is that volatility is high. Typically, market volatility is measured by the VIX. The VIX measures the cost of options (or the "option premiums"). When the market is perceived by investors to be risky, the price of (or premium on) options is high. When the VIX is above 25, the price of options is above intrinsic value. Right now, the VIX is high, so buying options is expensive.

However, by owning PBP, we are selling options. That means we are the ones that get to keep those big overvalued premiums. To us, those premiums are income.

Therefore, as you may have already figured out, a strategy like PBP, that buys the stocks in the S&P 500 index (big blue chip stocks) and then earns an income selling options (at high premiums) against them, can thrive in this environment.

When PBP purchases undervalued blue chip stocks, the downside risk of holding them is reduced and the possible upside gain of owning them increases. At the same time, high volatility (measured by the VIX) indicates that PBP can sell richly priced options against those undervalued stocks, which will provide unusually high monthly income.

Therefore, although PBP has historically been a good strategy in general, it may be even better in the near future, due to undervalued large blue chip stocks and high market volatility.

DISCLOSURE: Investors have frequently requested more information about iSectors holdings, which is why particular holdings have been included in various iSectors allocation models. This brief article is intended to explain the buy/write strategy. The contents of this presentation are for informational purposes only. This is not a recommendation, offer or solicitation to buy and/or sell securities. No one should change or buy investments without first consulting with their professional registered investment advisor.

Vern Sumnicht has 25 years experience as a successful financial planner and has been recognized for four consecutive years by "Worth Magazine" as one of the Nation's Top Wealth Advisors. Vern and his team, with more than 100 years of collective post-graduate education, certifications and experience, developed iSectors® diversified ETF allocation portfolios. For more information about iSectors® ETF allocation portfolios, visit www.iSectors.com, email Vern at vern@isectors.com, or call 1-800-iSectors.

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