INVESTOR'S BUSINESS DAILY

# Exchange-Traded Funds

## Advisers Urge Caution When Trading Options

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Two new funds tracking the CBOE BuyWrite Index have moved to the head of the class.

The idea behind the S&P 500 Covered Call Fund (BEP) seems straight forward. It invests in stocks mirroring the S&P 500. It also sells call options on the benchmark. That means investors get a return whether the stocks go up or down.

A sister fund, the Enhanced S&P Covered Call Fund, (BEO) uses swap contracts along with covered calls. In the past week and month, both funds have been moving up IBD's list of top performing ETFs.

But some advisers are cautioning investors. For one, the funds have a short track record. And money managers aren't so sure either fund's passive strategy is the best way to implement options trading in a fund format.

The funds are set up similar to closed-end funds. That means they can sell at a discount or premium to their net asset value.

### Trades At Discount

Right now, the Enhanced S&P Covered Call Fund is trading at a 5.57% discount. The other fund is selling at a 5.05% discount. Those numbers represent the difference between each fund's market price and NAV. "Just like most closed-end funds, they sold at a premium when introduced last March," said Roger Nusbaum, an adviser at Your Source Financial.

At least 20 closed-end funds are also trading at attractive discounts, he says. Those are actively managed, which is a key reason he's not investing in the new passively managed funds.

Investors interested in a covered-call fund should realize they are limiting their upside potential, says Jon White, chief investment officer at Beacon Hill Financial. "Your gains are essentially capped because you've sold the right for someone else to buy your holdings at a certain price," he said. "If the market keeps going up, you won't be able to participate as fully."

### Limits Downside

If the market drops, you can limit losses.

For example, if you sell an option at $1 and the fund has dropped $5 in price, you'll lose $4 instead of $5.

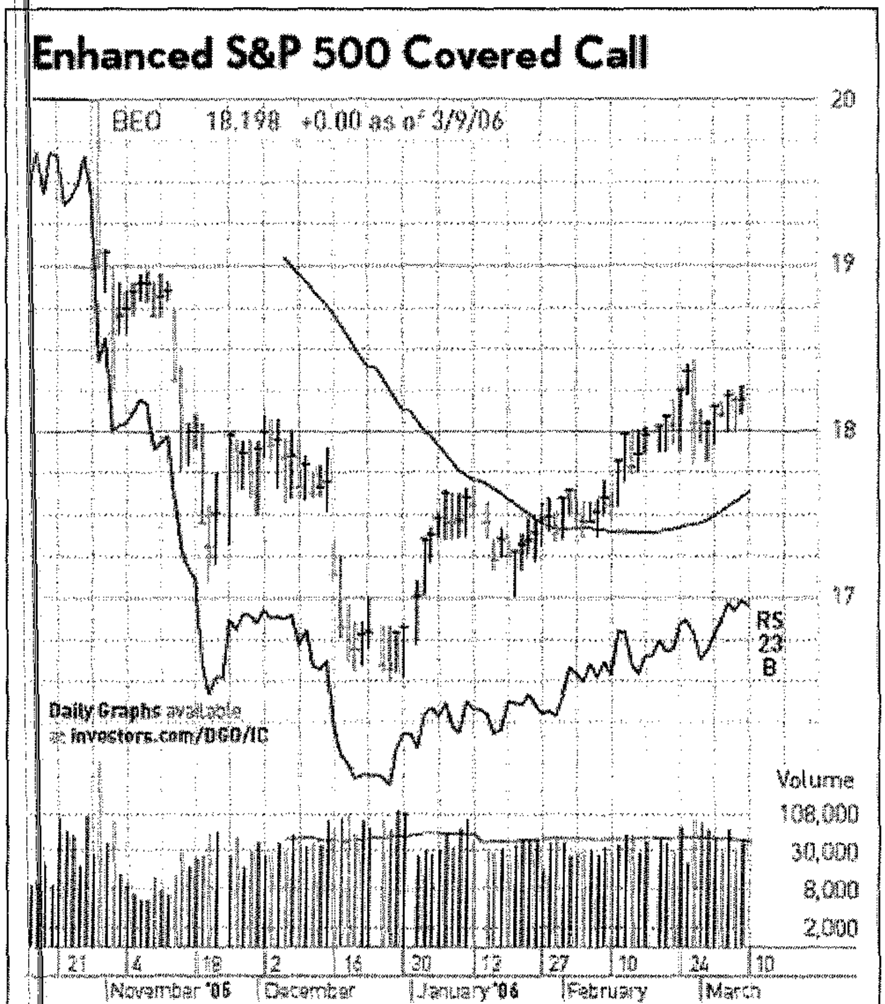
A covered-call fund has one sure bet going for it. Namely, your investment will gain increased yield no matter which way the market goes.

"These types of funds are usually sold as income-generating vehicles," said White. "They're most popular with very conservative fund investors."

He prefers to buy options himself, picking and choosing specific names as well as times to use the tactic with funds.

Cary Carbonaro, president at Family Financial Research, agrees. She also questions whether buying an index-based ETF that automatically sells options every month is a wise idea.

"Instead of buying a passively managed covered-call fund, why not just put a stop-loss order when you make an ETF purchase?" said Carbonaro. "That doesn't cost anything and it won't limit your upside."

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