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The case for options

Today's heightened market volatility and the unpredictability it can bring to an investor's portfolio can be a major deterrent for investors. They may be more cautious with investing, more sensitive to financial losses than gains and may value more capabilities to protect savings from significant market downturns rather than fully participating in strong market performance.

Canada Life recognizes that market dynamics and investors' needs have presented some challenges that require new and different ways to protect and maintain steady growth for their hard-earned savings. But what are some ways that we can provide this protection to clients?

Education piece: the case for options

The case for options

Options, which are also referred to under the broader umbrella of 'derivatives,' can often come with the reputation of being considered risky investment vehicles. Although there are circumstances where this reputation is warranted, there are also cases where options can be used as a risk management technique within a portfolio. Understanding how options can reduce volatility and downside risk and provide more consistent returns over time is an important part of successful modern portfolio construction. So, let's start with the basics.

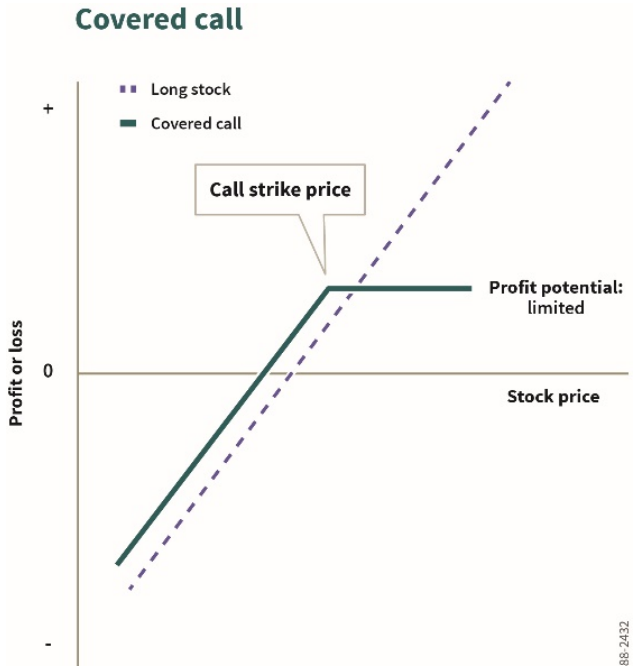
Basic characteristics of options

Underlying security	The investment security (i.e. stocks, currency, indexes, interest rates, etc.) that the option provides the right to either buy or sell at the strike price. For the sake of this piece, we'll focus on stocks.
Strike price	The fixed price at which the option holder can buy or sell the underlying security.
Premium	The amount the option buyer pays to the seller to obtain the right to buy or sell the underlying security.
Call option	An option granting the buyer the right to **buy** the underlying security at a predetermined strike price.
Put option	An option granting the buyer the right to **sell** the underlying security at a predetermined strike price.
Long	Buying or holding an option or investment.
Short	Writing or selling an option or investment.
Exercise	To put into effect the right to buy or sell the underlying security that is specified in the options contract.
Assignment	When the options seller must fulfil the obligation of an options contract by either selling or buying the underlying security at the strike price.

Education piece: the case for options

Using options for risk management

Covered calls
Long stock + short call



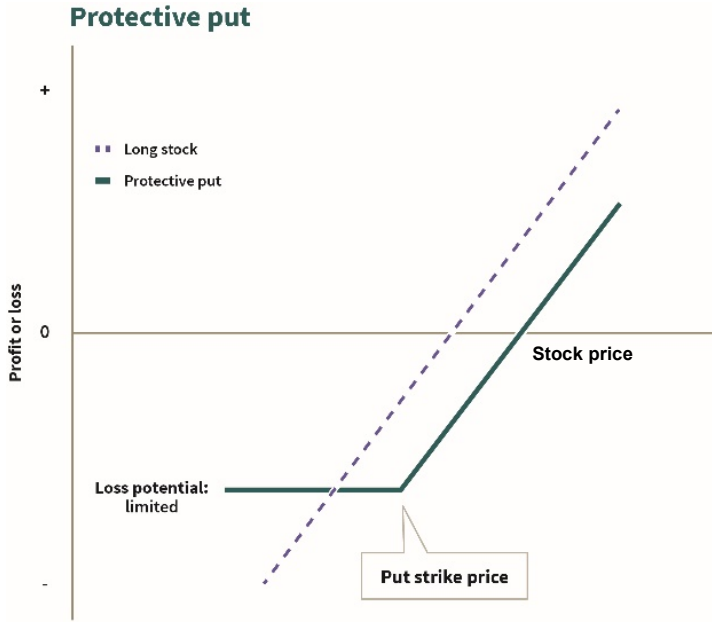
The option writer has sold the right to buy (call) the stock at the strike price to the buyer of the option.

This provides the seller with additional income via the premium they receive from the buyer, enhancing their returns if the price of the stock remains below the strike price.

If the price of the stock increases above the strike price, the buyer of the call option can exercise the call and the seller would have to sell the stock to the buyer at the strike price.

With a short covered call, the seller owns the stock and would simply need to sell to the buyer at the strike price if the option is exercised. The downside potential is more the opportunity cost of foregone gains as the stock is already held by the seller and after selling, they would miss out on any continued upside. **This type of call strategy provides income generation with minimal risk.**

Protective puts
Long stock + long put



The buyer has the right to sell a stock at the strike price. If prices fall below the strike price, the buyer can exercise the put option and sell the stock at the higher strike price, providing a limited downside.

The upside potential is the difference between the strike price and the actual price of the stock (less the premium spent).

The downside potential is the premium spent, which can also be thought of as premium spent on an insurance policy providing **downside protection from a stock's potential price decline**.

Education piece: the case for options

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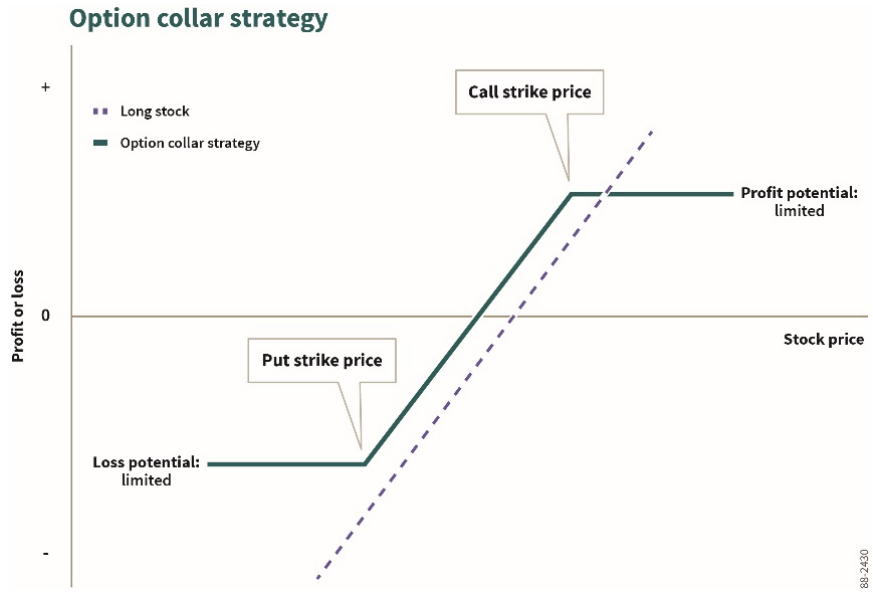
Combining the two: equity option collar strategy
Long stock + short call + long put



This illustrates the combination of buying a put option and selling a call option against a long stock position.

Ideally, the premium from the sale of the call finances the premium for the purchase of the put entirely, adding downside protection without paying any premium.

This type of strategy is used for risk reduction, creating a **protected corridor of returns**, giving up some of the upside in order to protect against the downside for more consistent returns over time.

How to access this sophisticated risk management strategy

The equity option collar strategy is a sophisticated risk management tool you can use within your clients' portfolios to help protect against sequencing risk and provide more consistent returns over time. However, due to the complex nature of options and their requirement for active management, you and your clients won't be able to find this sophisticated strategy in just any fund. For funds to offer this strategy, options need to be listed as an approved investment type within their regulatory documents and the portfolio management team behind the fund is required to have specific licensing, designations and expertise. With increased sophistication compared to traditional funds, funds offering option strategies are gaining popularity but come fewer and farther between when compared to their traditional counterparts.

With the introduction of the new **Canada Life Risk Managed Portfolios**, you can now help your clients accomplish their goals with funds that are specifically designed to help them protect their hard-earned savings by **limiting the impacts of volatility while still allowing them to participate in the markets**. To drive towards specific income, risk and return outcomes, this suite of portfolios uses sophisticated portfolio construction techniques including enhanced risk management and growth strategies (such as option collar strategies) that meet clients' objectives. Through these portfolios, you can now provide your clients with these sophisticated risk management strategies, giving your them the best of both worlds by allowing them to participate in the markets to better achieve their goals, while providing built-in risk management strategies when they need it most.

The option collar and cash covered put strategies within Canada Life Risk-Managed Portfolios are managed by **Irish Life Investment Managers (ILIM)**, via the Canada Life Risk Reduction Pool. ILIM is a highly experienced team, with award winning expertise with proven processes and track record. ILIM has been working with sophisticated, institutional clients globally to build investment solutions and is entrusted with more than $23 billion CAD in multi-asset strategies. This team's key focus is risk management when designing investment solutions, so you and your clients can both feel confident about accessing opportunities for growth while mitigating risk.