


## THETA GROWTH PORTFOLIO

### Portfolio Objective:

To provide income and capital appreciation with less volatility than the stock market.

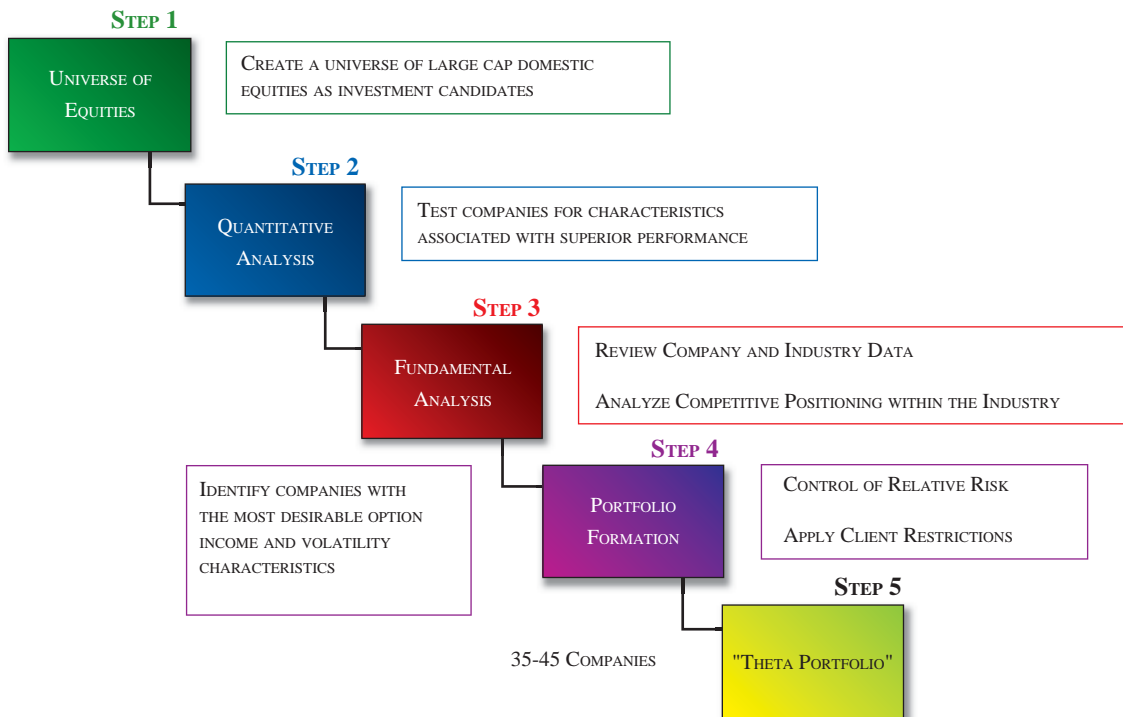
### This Strategy Offers Investors:

- **A conservative equity portfolio:**  
The portfolio is composed of large cap stocks and covered calls.
- **Capital gain potential:**  
The portfolio seeks to achieve price appreciation from the stocks held.
- **Cash flow potential:**  
The portfolio seeks cash flow from the sale of covered calls.
- **Moderation of volatility on equity returns:**  
The strategy is less volatile than the S&P 500.
- **The potential for attractive cash flows:**  
Targeted total annual cash flow .....8 to 10%



*A "Buy-Write" strategy, also called a "covered call", is an investment strategy in which the investor buys a stock or a basket of stocks and writes (or sells) call options that cover the stock position. The strategy can be used to enhance portfolio returns under certain market conditions and to reduce volatility. In down markets, the option premium received cushions the price decline in an equity portfolio. The trade-off is that in strong equity markets, the upside potential of the equity investment is limited.*

# THETA GROWTH INVESTMENT PROCESS



Capstone's "Theta Growth" strategy provides investors with *equity market* participation while enhancing *income potential and reducing risk*. This approach is appropriate for investors looking for capital appreciation, higher yields and reduced risk levels.

- Capstone's investment philosophy is centered on investing in a diversified portfolio of large-cap, high-quality, mostly dividend-paying equities that exhibit competitive advantages. Emphasis is also placed on diversification across various economic sectors to reduce portfolio risk.
- The process starts with a multi-factor quantitative screening process which is applied to the universe to identify stocks likely to outperform the overall equity market. Fundamental analysis is conducted on equities passing the multi-factor screening process, followed by portfolio analysis to ultimately achieve a portfolio of stocks that offers attractive growth, valuation, and diversification characteristics, along with its opportunity to generate option income.
- The options optimization process is a two-step strategy:
  - 1) Each stock is analyzed to determine which option should be written. This determines duration and strike price.
  - 2) Each buy/write is ranked against the entire portfolio to capture the best cash flow opportunities.
- The best case scenario in an out-of-the-money, covered call program is to have each position appreciate to its strike price at expiration and collect 100% of the written option premium and then re-write the option at a higher strike price. The Theta Growth investment process seeks to give the highest probability of achieving the best case scenario.

## “AN INCOME AND GROWTH STRATEGY FOR EQUITY INVESTORS”

The strategy's primary objectives are to generate cash flow together with capital appreciation with less volatility than the broad stock market.

Why 'Theta'?

'Theta' is a measure of the rate of decline in the value of an option due to the passage of time.

'Theta' can also be referred to as the time decay on the value of an option.

'Theta' is part of the group of measures known as the 'Greeks' which are used in options pricing.

Why 'Growth'?

Growth refers to the capital appreciation objective of the portfolio and the fact that we are selling calls “out of the money” to allow for price growth.

- Capstone's Theta Growth strategy is designed for investors who want equity market participation with enhanced income potential. This approach is appropriate for investors looking for higher income, capital appreciation and reduced risk levels.
- The portfolio is composed of high quality, large-cap stocks, many of which are recognizable “household” companies.
- Income is generated from cash dividends and the sale of covered calls.
- The strategy offers investors:
  - A conservative equity portfolio
  - Price appreciation potential
  - The potential for attractive cash flows
  - Moderation of volatility on equity returns

## WHO SHOULD CONSIDER USING THETA GROWTH?

- Investors looking to generate cash flow.
- Investors looking to reduce risk and volatility in their equity portfolios.
- Investors who are willing to limit upside in exchange for downside protection.
- Investors who are neutral to moderately bullish regarding longer-term equity market returns.

A recent survey on investors attitudes showed that\*:

- Increased cash flow has become a key investor focus.
- Investors "have become more risk-averse",
- 46% of investors cite market volatility/losses as their main concern in making stock market investments,
- 49% of investors are less willing to take more risk to achieve higher gains than they were 1 year ago,
- Long-term equity expectations have ratcheted down from the high "teens" to single digits.

Theta Growth is the solution!

\* Securities Industry Association on Investors Attitudes.

## RELEVANT TERMS

**ATM:** At-the-money: An option is at-the-money if the strike price, the price the option holder must pay to exercise the option, is the same as the current price of the underlying security on which the option is written. An at-the-money option has no intrinsic value, only time value.

**Buy/Write:** The term buy-write is used to describe an investment strategy in which the investor buys stocks and writes call options against the stock position. The writing of the call option provides extra income for an investor who is willing to forego some upside potential.

**BXM:** The CBOE S&P 500 Buy Write Index (BXM) is a hypothetical benchmark index designed to track the performance of a hypothetical buy-write strategy on the S&P 500 Index. The BXM Index was developed by the CBOE in cooperation with Standard & Poor's. The BXM is a passive total return index based on (1) buying an S&P 500 stock index portfolio, and (2) "writing" (or selling) the near-term S&P 500 Index "covered" call option. The SPX call written will have about one month remaining to expiration, with an exercise price just above the prevailing index level (i.e., slightly out of the money). The SPX call is held until expiration and cash settled, at which time a new one-month, near-the-money call is written. The BXM records run from July 1988 to the present.

**Call option:** Buyer has the right to Buy shares at a fixed price.

**Deferred volatility:** The implied volatility of a long-duration option, typically the first LEAP expiration month.

**Delta:** Measure of the relationship between an option price and the underlying futures contract or stock price. As options near expiration, "in the money" contracts approach a delta of 1.

**Expiration:** Date on which a contract (option contract) or agreement ceases to be effective. It's the last day on which an option can be exercised. If it is not, traders say it expired worthless.

**Implied volatility:** The volatility of a stock implied by the value of the stock's option derivative.

**Intrinsic Value and Time Value:** The intrinsic value (or "monetary value") of an option is the value of exercising it now. Thus if the current (spot) price of the underlying security is above the agreed (strike) price, a call has positive intrinsic value (and is called "in the money"), while a put has zero intrinsic value.

**ITM:** In-the-money: An in-the-money option has positive intrinsic value as well as time value. A call option is in-the-money when the strike price is below the current trading price. A put option is in-the-money when the strike price is above the current trading price. Another characteristic of In-the-money options is that when the current price is much higher than the strike price, for a call option, this option behaves like the underlying security because the probability of exercise is very high.

**Option Duration:** The length of time until the date of expiration of the option. Capstone typically has an option duration of 4-6 months as an average in the portfolio. We seek to stagger the life of the options so that they are not all expiring in the same month. This contributes to more constant cash flow and less possibility that a majority of the portfolio could be called away leaving too much cash not invested.

**Option Premium:** Amount per share paid by an option buyer to an option seller for the right to buy (call) or sell (put) the underlying security at a particular price within a specified period. A premium of \$5 per share means an option buyer would pay \$500 for an option on 100 shares to the option seller. Capstone is a seller of options and the premiums contribute to the cash flow in the account.

**OTM:** Out-of-the-money: An out-of-the-money option has no intrinsic value. A call option is out-of-the-money when the strike price is above the current trading price of the underlying security. A put option is out-of-the-money when the strike price is below the current trading price of the underlying security.

**Prompt Volatility:** The implied volatility of a short-duration option, typically, the current expiration month.

**Put Option:** Buyer has the right to sell shares at a fixed price.

**Stock Option:** A contract giving its owner the right to buy or sell a fixed number of shares at a fixed price at a fixed time in the future.

**Strike Price / Exercise Price:** Price at which a stock or commodity underlying a call or put option can be purchased or sold over a specified period.

**Theta:** The change in the option price caused by a change in the time value (time decay).

**VIX:** The ticker symbol for the Chicago Board Options Exchange Volatility Index, a popular measure of the implied volatility of S&P 500 index options. Referred to by some as the fear index, it represents one measure of the market's expectation of volatility over the next 30 day period.