

BusinessWeek

BusinessWeek - Personal Business

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February 20, 2006

Putting A Collar On Investment Risk

Options-based strategies can keep stock losses from getting out of line

Excerpts from the article

- "You wouldn't think of not insuring your home," says Thomas J. Schwab, a founder of the investment firm Summit Portfolio Advisors. "But no one thinks about insurance when it comes to their investments." -

- Schwab's collar strategy is at the center of the advisory firm, which opened in September of last year and now has \$7.5 million in assets under management. In fact, it has turned the typical portfolio management process upside down. Instead of choosing stocks first and then perhaps seeking options to protect them, he only chooses stocks on which he can place a low-cost collar that gives him at least twice as much potential gain as loss. -

- The beauty of a collar is that you know, from the outset, the potential losses and gains on a trade. In a runaway bull market, your returns are likely to be somewhat muted because in selling a call, you've given up the right to appreciation beyond a certain price. But on the flip side, you'll have the comfort of knowing you're protected if the stock heads south. "We're a fan of collars for large portfolios, especially retirement accounts," says Kevin Lund, a strategist with Optionetics, a firm that gives options courses. "There is just no reason to incur much risk just for a potential gain." -

- For his clients, Schwab typically collars 8 to 15 large-company stocks, covering each major sector of the economy. He sticks with names that have options with an expiration date one to two years out, since he prefers to be a buy-and-hold investor rather than a trader. Potential collars can be found on his Web site www.ProtectYourStocks.com and include scores of blue-chip companies like Apple Computer, General Electric, and Procter & Gamble. It's the same way he invests much of his own money. -

- Today investing is a family affair, with both his daughter, Liz, and his son, Joe, running the firm with him. "I wish I had been smart enough to use this strategy years ago," says Schwab. Investors can be smarter today. -