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Insure Your Stock Market Investments

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Just as you always insure your property, do you wish you could protect your stocks against unforeseen disaster? Well you often can, and depending on the stock, your insurance costs might be minimal or sometimes even zero. It's called an "equity collar."

An equity collar places boundaries (or a collar) around a stock. While a stock is wrapped in the collar, any loss or gain is limited by the minimum and maximum price range of the collar, no matter how much the stock actually falls or rises.

For example, on March 3rd when Eastman Kodak was trading at about $28 per share, a collar was available which protected Kodak stock below $25 for about two years; the collar also limited the potential upside to $35. In the best case scenario, the investor could make a 26.4% return (14.0% annualized) versus the worst case, where the investor could lose 8.7% (4.6% annualized), a reward to risk ratio of 3:1 (assuming current dividend rate and excluding commission expense).

*Also on March 3rd, attractive collars were available on many other popular stocks including st1:City>Rochester area companies Bausch & Lomb, Constellation Brands and Paychex. On any given day, hundreds of widely traded stocks are available with attractive collars. One source to view a daily posting of collar opportunities is at **www.ProtectYourStock.com** posted under Collar List.*

When weighing the purchase of a particular stock, it might be worthwhile to see if collars are available for that stock, and if so, compare the benefits of owning the stock on a stand alone basis versus wrapped in a collar. Also, investors may wish to build a portfolio from the ground up, screening for stocks with attractive collars as one criterion for consideration. When stocks are purchased and wrapped with collars on the same day, the holdings are protected from day one.

The equity collar is a defensive strategy, but it also enables investors to be more aggressive. For investors with substantial amounts in money market funds, the collar may enable a greater asset allocation to stocks because the collar allows investors to be in the stock market without taking the full risk of the market.

Tax sheltered accounts (pension plans, IRA, IRA rollovers, etc.) are ideal places to use collars because many tax issues for this type of account are moot. If you are planning to use collars in a taxable account, be sure to check with your tax advisor and make sure your brokerage firm provides good reports to assist you in your tax preparation. As a general rule, you should always review any potential transaction with your tax, legal and investment advisors.

Diversification has been the primary way to reduce risk in the stock market, but 9/11 made investors aware that a single event can collapse even the most diversified portfolio. If a catastrophic event should occur, the portion of assets that are protected with equity collars should retain the bulk of their value and provide a source of liquidity. Just as you always insure your house, consider doing the same for your stocks.

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