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'Collar' Touted as Portfolio Protection

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On most mornings, Tom Schwab can be found updating his Web site, www.protectyourstock.com, from an office in his Wailea, Maui, home. The work is part of his money management business and his desire to spread the word about lowering risk when you invest.

Schwab believes he has come up with a method that will appeal to people worried about prolonged and catastrophic market slides that eat into portfolios. He advocates use of "equity collars" to put a limit on losses.

Mornings, he can be found in his office overlooking a backyard pool, watching the financial news channel CNBC while he uses high-speed data feeds and proprietary software to identify what stocks to buy and wrap in a collar. Schwab said collars amount to a form of insurance for stocks.

"I really want people to be aware that there's two ways of owning a stock," said Schwab, 59. "You can own it with a collar, or own it the traditional way. There is an alternative or low-risk way to own big companies."

The approach is starting to net attention for Schwab's investment and money management firm, Summit Portfolio Advisors LLC. It's received more than $6 million to manage since starting in September. Business Week spotlighted Schwab in a February article titled, "Putting a Collar on Investment Risk."

"It has turned the typical portfolio management process upside down," the Business Week said. "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."

Schwab (no relation to brokerage founder Charles Schwab) left a comfortable job managing investment portfolios at the Kahului office of Smith Barney last year to open Summit and the Web site that offers examples and a daily update of stocks with attractive collars.

Schwab's strategy grew out of an experience at Smith Barney earlier this decade, when he watched clients' portfolios decline as the dot-com bubble fizzled and the Sept. 11 terrorist attacks occurred. That prompted him to look for ways to guard against a market collapse.

Last year he formed Summit with his son in Denver and his daughter, who lives in Kula.

"I searched for something that would deal better with event risk," said Schwab, who charges a minimum of $400 a year to manage client portfolios. "Collaring them worked very nicely."

In setting up an equity collar, investors buy a stock and then purchase a "put" option that sets a floor on how much they can lose. They simultaneously sell a "call" option that caps how much they can potentially earn on it, using funds from the call sale to offset the cost of buying the put.

So far, Schwab's record using the approach hasn't yielded stunning gains, in part because any gains or losses are subdued until the options are closer to expiration. In the fourth quarter he had a 1.5 percent return; in the first quarter, 1.2 percent.

David Jacobs, founder of Pathfinder Financial Services in Kailua, said he knows of institutional investors who make use of collars but hadn't seen anyone promoting it for individual investors. He said he prefers other methods to lower risk for his clients, though Schwab's approach is reasonable.

"I wouldn't be telling someone who is using it, 'Get away from that.' " Jacobs said. "It has its own set of pluses and minuses."

Schwab, who worked for Smith Barney for almost 30 years, says his method isn't for everyone and is likely to appeal to certain types of investors: One may be nearing retirement or has a nest egg and is leery of investing in the stock market. Another may be very wealthy and wants to have some money insulated against market meltdowns.

Equity collars are also used by people who have a large amount of stock in a single company and can't sell for tax reasons or other considerations.

METHOD REDUCES RISKS OF VOLATILE STOCKS

Investors who like Google Inc. but don't like the stock's roller coaster prices might drop in to Tom Schwab's www .protectyourstock.com for an idea on how they can own the shares without much worry.

Schwab is a proponent of using equity collars, a practice that makes use of options to limit potential losses and caps possible gains.

For example, on May 9 Google sold for $396.18 a share. Using Schwab's approach, you could have purchased a put option expiring in January 2008 guarding the stock against losses below $380. You also could sell a call limiting potential profits to those up to $480.

Taking into account a net gain on the sale of the call, your maximum potential loss would be limited to $13.48. Your potential gain would be capped at $86.52. You would also owe transaction commissions.

Looked at in another way, the potential reward is more than six times the potential loss.

"In my mind, that's a very low-risk way to play Google, which is a very volatile stock," Schwab said.

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