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How To Insure Your Stocks - Use An Equity Collar

By Daily Record Staff

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by Thomas J. Schwab*

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.

As an example of an interesting collar, on Nov. 14 when Google was trading at about \$393 per share, a collar was available which protected Google stock below \$390 for over two years; the collar also limited the potential upside to \$490.

In the best case scenario, the investor could make about \$96 per share versus the worst case, where the investor could lose about \$4 per share, a reward to risk ratio of about 30:1. And, with Google trading at about \$393, the cost of protection below \$390 for more than two years was 10 cents per share. (Commission expenses are not included in this example.)

As in the above example, a collar is generally most attractive when potential gains under the collar substantially exceed potential losses, and the cost of the collar is minimal. On any given day, hundreds of well known stocks including area companies Bausch & Lomb, Constellation Brands, Eastman Kodak Co. and Paychex may have attractive equity collars. One source to view a recent list of collar opportunities is at www.ProtectYourStock.com 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 criteria 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, such as considering a current investment in Google. 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.

Thomas J. Schwab is chief investment officer for Summit Portfolio Advisors, LLC. He can be reached at tschwab@summitportfolioadvisors.com.

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