

UK equity enhanced income

Geoff Kirk, Co-fund manager: Premier Optimum Income Fund

The Premier Optimum Income Fund takes the proven Premier UK Income Fund portfolio, managed by Chris White, and adds a covered call option strategy to bring the overall dividend yield up to a much higher target of 7% p.a. Using a bespoke option strategy, co-fund manager Geoff Kirk sells options on certain shares in the fund's UK equity portfolio, receiving an option premium in exchange for giving up some of the potential future growth. The fund continues to receive the dividends on all the shares it holds. The annual dividend income from the UK equity portfolio, currently expected to be about 4 to 4.5%, is added to the option premium income, currently expected to be 2 to 2.5%, to reach the 7% per annum target.

There are only four possible outcomes of the covered call option strategy: if the share price remains the same, the option is not exercised and the fund receives the option premium. If the share price rises, but not as much as the option strike price, the fund receives the option premium and the growth in the shares. If the share price rises higher than the strike price, the option is exercised and the fund receives all of the growth up to the strike price of the option, plus the option premium. If the share price falls, the value of the fund's holding falls, but this is mitigated by the value of the option premium.

Typically, around 30 of the 60 or so shares held will have options sold over them. This is expected to be in the range of 50-70% of the net asset value of the fund most of the time. Geoff Kirk, who manages the options strategy, trades over the counter options, so all the options used are bespoke. The fund managers decide how much option premium they want to take from each name and a competitive auction process ensures the highest possible strike price for that option. Active management of the options strategy is a key part of the fund and the investment team don't overwrite every stock in the portfolio. Indeed, it is likely that most of the time a significant portion of the portfolio will not be overwritten. Stocks with the most exciting growth potential, which are often also smaller and less liquid, generally fall into this category.

The key risk control is to only sell options on shares held. This ensures that any liability that comes due under the options can be met by gains that the fund has already made through ownership of the underlying stock. There is no counter-party exposure and no need to post collateral.

In terms of the impact on the portfolio, the option strategy introduces a simple trade-off. Some of the uncertain potential future growth is exchanged for the certainty of the up-front cash premium. For three month options, the individual share upside is likely to be capped at around 110% on average. For one month options, individual share upside is likely to be capped at around 107% on average. The volatility of returns in this fund is expected to be lower than for the Premier Income Fund.

The fund's total return is expected to be better or worse than the equivalent pure UK equity portfolio depending on the market environment. When share prices are rising strongly, the strategy is likely to underperform an equity-only portfolio. During periods of gently rising share prices or when there is no clear direction, it has the potential to outperform an equity-only portfolio. The fund managers also expect the fund to typically outperform the pure UK equity portfolio in weaker markets.



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Please note that the target yield is not guaranteed.

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For your protection, telephone calls are recorded and monitored for quality assurance purposes. A free, English language copy of the fund's Prospectus, Key Investor Information Documents and Supplementary Information Documents are available on the Premier website. All data sourced to Premier Asset Management unless otherwise stated.

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