ARGENTUM
Asset Management Inc.

CASE STUDY 1: INCOME GENERATION USING OPTIONS

Income Generation

Income generation can be achieved by selling puts or calls on the underlying instrument. The team has extensive experience selling options on precious metals bullion, equities and futures.

When you sell a call or a put, you receive premium from the sale. You then have an obligation to sell or buy the underlying instrument at a predetermined price if the put or call option becomes in-the-money (ITM) for the buyer.

However the intention of this strategy is to NOT get exercised, ie not having to buy or sell the underlying instrument and to keep the premium generated from the initial sale with the buyer.

To accomplish this, the option strike price and expiration dates have to be carefully selected based on the underlying volatility of the instrument.

To generate a consistent income stream the team would be required to sell puts or calls with various expiration dates at strikes sufficiently out-of-the-money (OTM) to reduce the risk of being exercised by the buyer of the option. The strategy dictates that once the option is sold (by us) the option price will eventually expire "worthless" for the buyer.

The risk of this strategy is that the underlying instrument prices move against the seller (us) and the option becomes ITM for the buyer. In this case we can choose to deliver the underlying instrument (in the case of a call) or purchase the underlying (in the case of a put) at the pre-determined strike price or we can settle financially at a loss.

This strategy is especially useful for precious metals where there is no income stream from holding this asset in the portfolio. Since this strategy's objective is income generation, the team will select options on a <u>conservative basis</u> i.e. option strikes that are sufficiently OTM.

Whilst these strategies involve risk Argentum Asset Management's team understands, monitors and manages the risk on a real time basis.

Our return objective is to generate annual income of at least 200 basis points of a portfolio value with a utilization rate of 20-30%. (Utilization rate represents the percentage of portfolio value that options are written on). We feel this return is conservative since it is based on a very low utilization rate. Returns are heavily dependent on market volatility of the underlying investment, the strike price selected, expiration period and on the utilization rate (20-30% of portfolio exposed).

The options implemented should be short-dated (approx. 3-6 month duration) and diversified across strike price and expiration to reduce risk.

Once the option is sold the Argentum team would monitor the underlying security daily. Generally the passage of time will benefit the option seller since time decay will gradually decrease the value of the put option.

When sufficient time has passed, or when the market moves in our favor, the team can either buy back the option contract to lock in gains or let it expire worthless (for the buyer).

The best time to deploy this strategy is when the underlying instrument has had a large percentage drop, which increases the volatility and hence the value of the options. This also allows for a lower strike price and hence less risk of being exercised by the buyer.

Options on precious metal bullion is usually traded over-the-counter (OTC) and has to be negotiated directly with precious metal brokers. Whereas options on equities and futures are listed options and usually offer good liquidity making it easy to exit an option position.

This income generation strategy should be able to generate sufficient revenue to cover most of the cost of this investment strategy.

A call option is an option contract in which the holder (buyer) has the right (but not the obligation) to buy a specified quantity of a security at a specified price (strike price) within a fixed period of time (until its expiration).

A put option is an option contract giving the owner the right, but not the obligation, to sell a specified amount of an underlying security at a specified price within a specified time. This is the opposite of a call option, which gives the holder the right to buy shares.