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Custom Option Overlays by Aptus Capital

Strategies and Opportunities to Protect and Diversify Concentrated Positions

Concentrated positions can drive significant wealth creation but also carry substantial risks. Whether stemming from a large inheritance, long term growth, stock-based compensation, or the sale of a business, concentrated positions present unique financial planning challenges due to their idiosyncratic risk and inherent volatility. A large allocation to a single position or a few holdings magnifies potential losses, as price fluctuations can have a major impact on overall wealth and financial stability. Additionally, underperforming concentrated positions can drag overall portfolio performance.

This guide is divided into two sections:

1. **Hedging via an Option Overlays**: Strategies to manage and mitigate risks associated with concentrated positions.

2. **Diversifying Through the Use of an Option Overlays:** Techniques to gradually transition concentrated positions into a more diversified allocation.

Effectively managing a concentrated equity position involves a range of complex challenges. Significant tax liabilities or other constraints often limit the ability to exit these holdings, necessitating alternative options to mitigate risks.

Hedging Concentrated Positions via an Overlay

A portfolio overlay is an option-based investment solution designed to sit on top of and complement a fully invested portfolio. Custom option overlays strategies, such as protective puts, collars, covered calls (for income enhancement), and tax-sensitive diversification approaches, can help mitigate the impact of concentrated position risk within an investor's overall allocation. These techniques are designed to manage risk, reduce volatility, define outcomes over specific time frames, or enhance returns through additional income generation.

For investors with concentrated positions, hedging strategies provide a way to retain those positions while reducing associated risks. By incorporating downside protection, such as put options, investors can specify downside objectives and customize the structure of an options overlay strategy to align with their financial goals. Here are a few sample ways an investor can reduce the risk of a concentrated position with an overlay.

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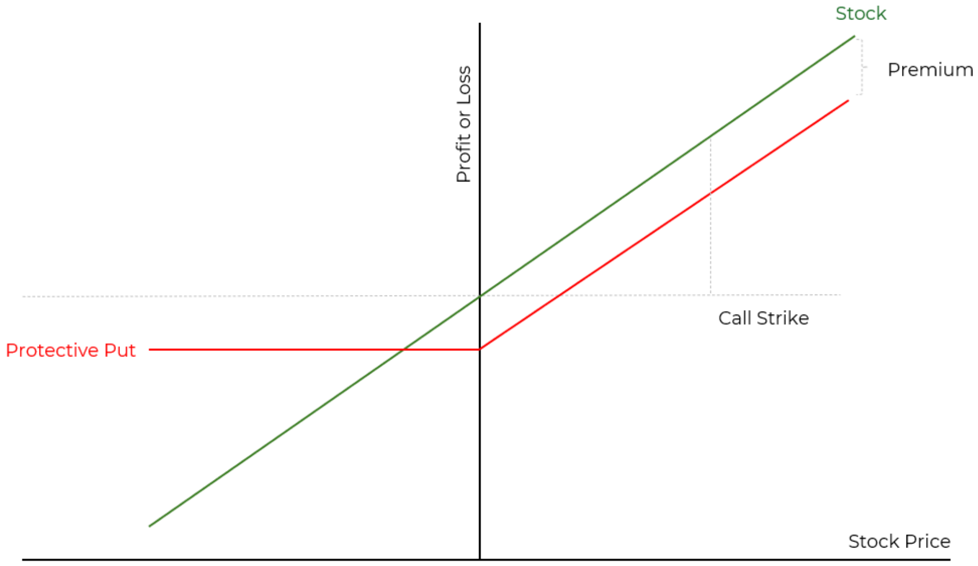
Protective Puts

A put option gives the holder the right to sell the underlying asset at a predetermined price on a specified maturity date, providing downside protection against declines below the strike price, as well as cushion the decline along the way. Protective puts balance downside risk with upside potential, offset by the cost of the premium paid for the protection. Typically structured with 3 to 12 month maturities and renewed either at maturity or repositioned before expiration, these strategies are best managed professionally to adjust, monetize, and maintain optimal positions to limit the cost of hedging and to reduce foregone upside.



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Income Enhancement with Covered Calls

Options can be an effective tool for enhancing income from concentrated positions by supplementing the dividends typically provided by stock or index-based exposures. A common strategy, covered calls, involves selling call options on an underlying asset to generate upfront premium income. This obligates the investor to sell the asset at a predetermined strike price if the stock price rises above that level, capping potential upside and possibly triggering capital gains taxes.

While covered calls offer some downside protection up to the premium received and are particularly effective in flat or low-volatility markets, they come at the expense of gains beyond the strike price and should not be viewed as protection against significant

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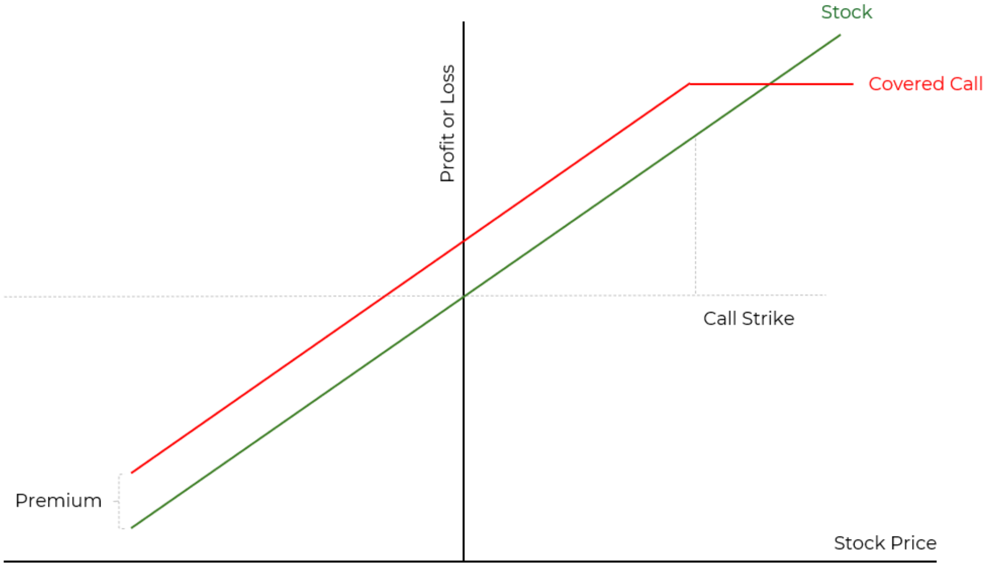
downside risk. By thoughtfully incorporating covered calls, investors can increase income and potentially boost total returns while managing the trade-offs inherent in this approach.



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Collars (Costless, Low Cost, Net Credit) by Combining Covered Calls and Protective Puts

Collaring a stock or index position involves purchasing puts for downside protection at a predetermined threshold and selling covered calls to help offset the cost of the puts. The premium received from the covered call provides upfront income, which can partially or fully cover the cost of the protective put (the downside hedge).

However, this strategy caps the stock's upside at the short call's strike price, limiting potential gains. Professional management is critical, as a rise in the stock's price above the call's strike price at expiration may result in the stock being "called away," potentially triggering capital gains taxes. Typically structured with maturities of 3 to 12 months, collars are renewed at maturity or adjusted before expiration based on the underlying asset's performance and market conditions, offering a balanced approach to mitigating downside risk while avoiding the full cost of hedging solely with puts.

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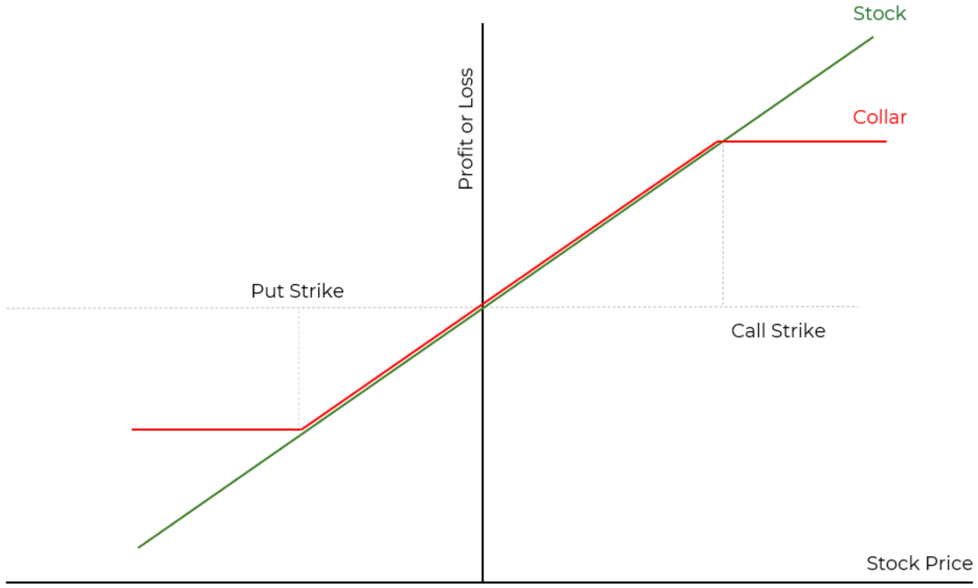

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Diversification Strategies

Investors with concentrated positions can employ a variety of options-based strategies to achieve greater diversification and manage risk.

Covered Call Transition

Using covered calls, investors can generate income from their concentrated positions while gradually transitioning toward a diversified allocation. The short call acts as a limit sell order, providing premium income while facilitating a structured and tax-efficient monetization plan. These transitions can be customized to manage capital gains within specific calendar years and implemented over extended time horizons, making them suitable for clients seeking current income and a more deliberate diversification process.

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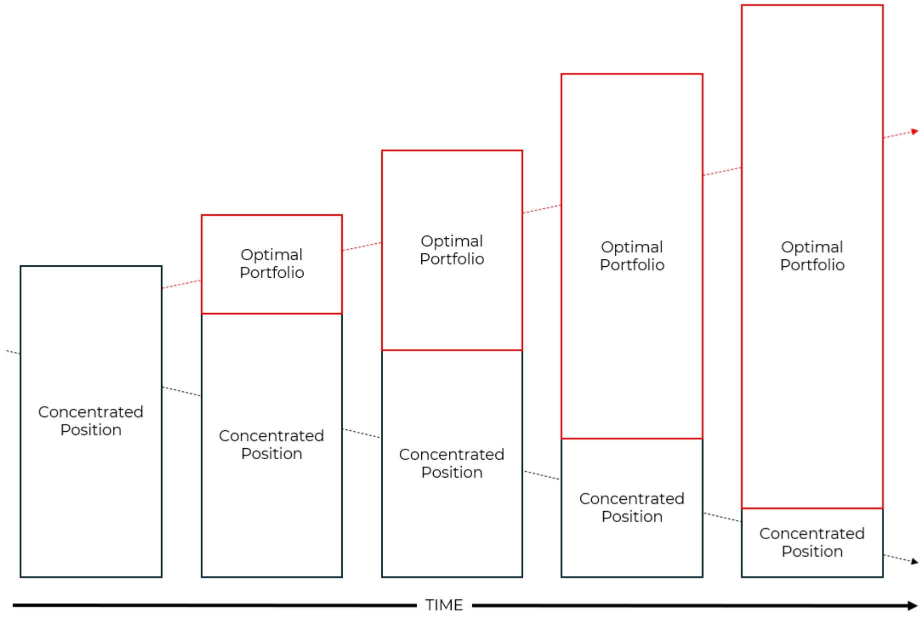

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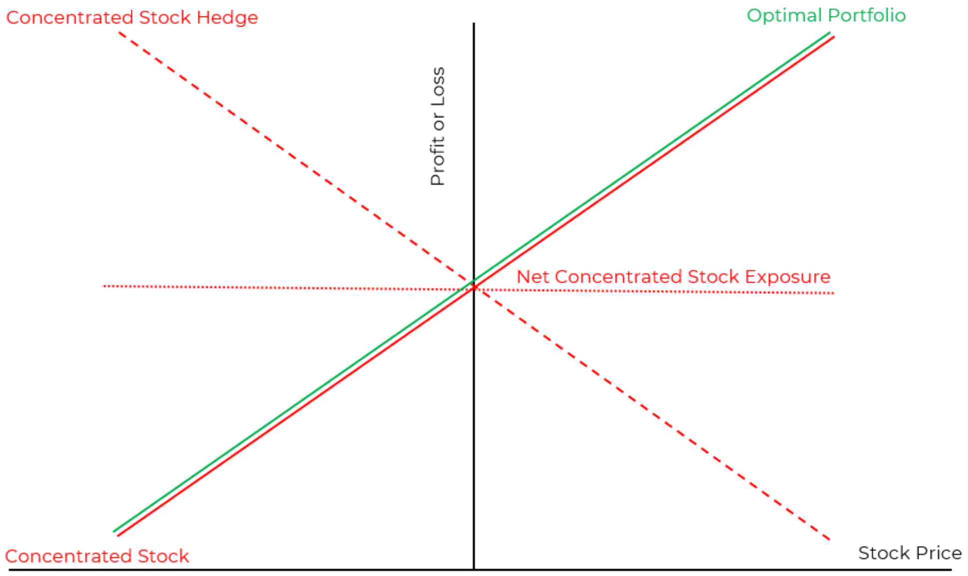
Concentrated Position Exchange

An equity collar can enable investors to replace the risk of a concentrated position with that of a diversified index without triggering immediate tax consequences. This strategy uses a combination of options to hedge the concentrated position's risk and create synthetic exposure to a diversified index, offering market diversification without the need to sell the underlying asset.



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Customized Solutions for Your Situation

At Aptus, we believe options and active options management are powerful tools for investors with large or concentrated positions. Many traditional options strategies lack the necessary customization and active management to adapt to changing market conditions or incorporate nuanced views of underlying holdings.

Aptus addresses these shortcomings with a hands-on approach that combines active management, fundamental and technical insights, and flexibility to align strategies with each client's unique objectives. Our process goes beyond simple, rules-based "set it and forget it" systems to deliver tailored solutions designed to meet the evolving needs of our clients.

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