

## Summary:

Can you outperform stock benchmarks such as S&P 500 consistently over long time? Are there alternatives to currently popular diversified, low-cost index funds and mutual funds? I have argued in past, the answer is yes. One strategy is to invest in few highly performing large cap stocks and trading options in them to manage the risks. You are getting option buyers to share risks of stock investment with you. Nominal costs for trading in option make this new strategy viable now. In this short article I share some insights into stock market that enabled me to innovate a new strategy and data on how well my investments following that strategy have performed vs S&P 500, with stocks only or stocks with options. Average return of investments started at different times over last 5 years is twice that of SPY on average, at 27% vs 13%. More impressive is 90% of the investments beat SPY. Even though it is not obvious in the data here, my innovative option strategy generates positive cash flow and protects investments much better during market downturn than diversified funds. Hope to show you that data when markets crash next time.

## Introduction :

Investing in stocks is considered the best approach for long-term investment. S&P 500 has returned about 12% per year and 1+% dividends. That is a good return as most other traditional investment methods return 10% or less. Investing in just S&P 500 is considered risky. Other popular index funds such as QQQ are not much better. So, a common question I get these days is how well my stock investments are doing and what returns have I achieved. if I have a strategy that can beat traditional index funds. One way to answer that is to compare investment returns with SPY or VOO (S&P 500 benchmark). I have done that study and sharing high level results here.

Did you know these facts about stock markets?

- US stock market is about half of world market at about \$60+ Trillion market cap. S&P 500 companies account for 90% of US stock market.
- Top 10 companies market cap is 40% of S&P 500 while top 10% of companies account for 60% of S&P 500 market cap. So, there is significant consolidation of stock market in top US companies.
- S&P performance is market weighted, so top few companies' stocks performance affects S&P 500 benchmark performance significantly.

S&P 500 stocks are invested mostly by big investment management companies. Investing in index funds such as SPY is an established and accepted investment strategy. There are thousands of mutual funds that invest over hundreds of stocks if not thousands.

Five years back, I decided to focus on getting better returns on my lifelong savings invested in stocks, not accept what is recommended and accepted by most. Over my entire engineering career, I looked at alternative ideas, looked at data objectively and evaluated with an open mind to innovate competitive products. So, Initially I started questioning some of these conventional wisdoms.

- you cannot beat S&P 500 benchmark or other index fund returns in long term.
- low risk and income investments like bonds cannot give returns more than 5%
- you need to diversify over hundreds of stocks to manage risks.
- you cannot use past performance to predict future performance.

I also observed following interesting facts early which motivated me to explore alternate strategies and contributed to my innovation.

- 15-20% of companies in S&P 500 significantly beat the benchmark return every year in recent past. Many are well-known large cap companies, and several have trillion \$ market cap now. List of such companies changes slowly over time.
- Large Cap Companies' stock performance is slow to change. Last 3-5 year performance statistics can predict likely performance relative to SPY.
- Options can be used to manage risks as option trading costs are nominal now. It is probably being done by professional funds but may not be visible or benefit investors directly.
- Option premiums are in 10%-20% range for expiration date one year out, and sometimes 10% over 3 months. Option buyers are a bit greedy, so can help reduce your investment risks in a predictable way that can be modeled.

Over years, I have innovated and validated a stocks+options strategy as an alternative to popular diversified, low-cost index investments. Combining stocks and options to optimize returns and risks is more a mathematical problem, so enables AI techniques and computer simulations to be applied. So, I could apply my skills.

#### Validating my investment strategy:

My investments are currently divided into 49 separate items identified by their start dates over last 5 years. Each of these is invested in a specific stock and an option on that stock. Stock position has changed over time, and options are tuned regularly. I have tracked investment performance of each over time. I did not try to time the market when I started a new investment, just invested when I had extra cash to invest. Some of these investments were gains from options during market downturn reinvested (think of as dividends reinvested). Investment performance of these over last 5 years, I believe gives enough data to validate my investment strategy and returns that can be achieved vs S&P 500.

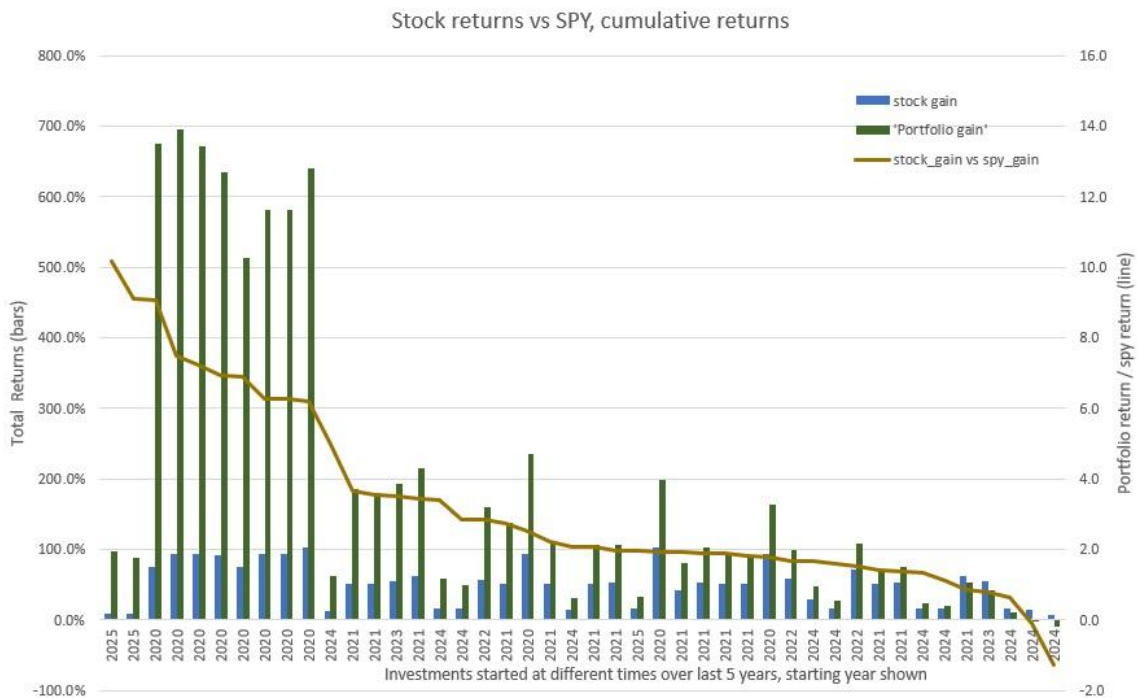
All my investments are invested in just 12 high performing S&P 500 stocks listed below, spread across few sectors. I just picked stocks based on their last 5-year performance and trends, no in-depth business analysis (use my unique box charts of annual return distribution supported in Myfinvar). Stocks have different returns and volatility, list below roughly ordered in increasing returns, volatility & option premiums. Look up these stock performance vs SPY over last 5 years, you begin to understand my point.

MSFT, MS, PWR, HWM, NRG, ORCL, CDNS, NVDA, AVGO, VST, PLTR, TSLA

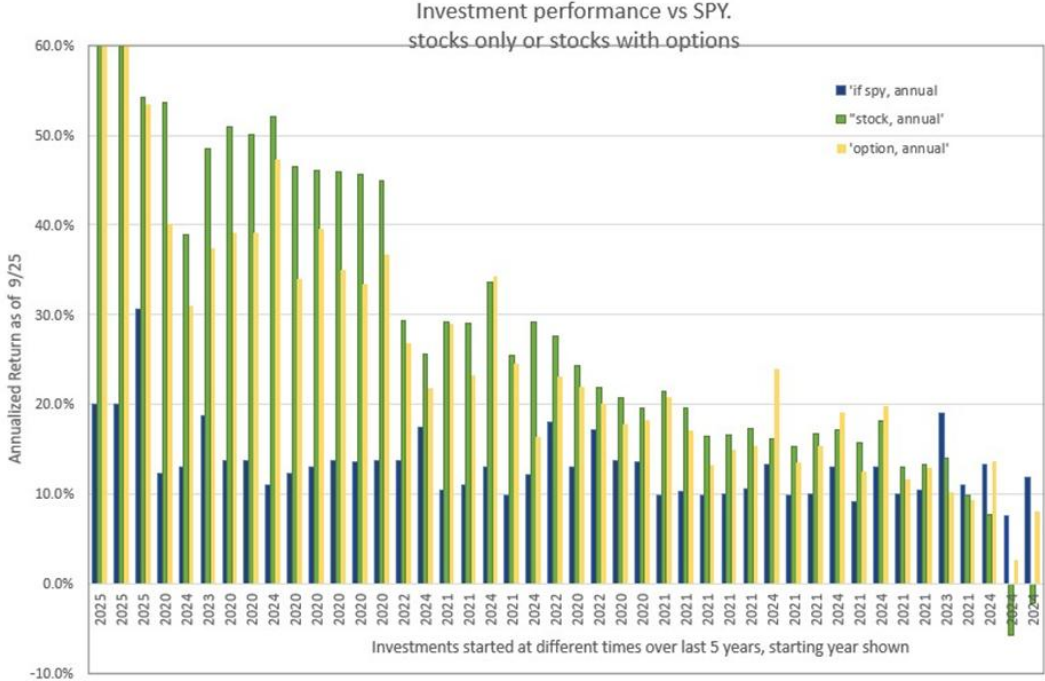
I have found about 10 stocks in multiple sectors are sufficient to have robust returns. I typically change 2-4 of these stock positions every year, and trade options in any of these positions only about once a month. For example, over last year I dropped positions in COST, LLY, MCK, AAPL and added NRG, HWM, ORCL, TSLA. To further reduce volatility of returns and minimize risks, I sell options on these stock positions.

Results :

Charts below show my investment performance vs. what if I had invested in SPY. Returns are shown for just stock investments or stocks with options. Investments are sorted from highest annual returns to lowest in the chart and bars are labeled by their start year. Some key observations from this performance comparison -



1. Cumulative returns from my stock investments vs SPY have been impressive. Most total returns have been twice SPY or more, several have hit 10 times SPY performance. Highest returns have exceeded 600% within 5 years, while the best case for SPY has been around 100%. You can just look up the performance of the stocks listed earlier to confirm it is possible. My overall portfolio has more than tripled in less than 5 years.



2. Since investments were of different durations, you can convert the cumulative return to equivalent annual returns and compare them with SPY. Investing in SPY would have given relatively stable returns, most in 10%-15% range, and average is about 13% (blue bars). Returns from my investments in have been more volatile (no surprise there), in 10% and 50% (green bars), and average is about 27% per year (without first two outliers invested for less than a year). My investment return average is about twice that of SPY. Note also 90% of my investments have outperformed SPY which validates strategy works. My expectation is remaining 10% will do so soon, at least with options.

3. Impact of options: My option strategy as of now has reduced the average annual return slightly, from 27% (average of green bars) to about 23% (average of orange bars). Options improve returns when markets go down as can be seen with investments on right. However, when stock returns are high, you may also have to lose some returns to liquidate investments if you cannot wait for options to expire. What makes it practical now is the nominal costs of trading in options. You need reasonable investment amount in 200K or more as options are traded in units of 100 stocks. Option strike and expiration dates can be tuned to adjust stock risk and returns.

4. Even though almost all investments have positive returns now, that was not the case in past. For example, in late 2022 1/3 of my investments had negative returns and so was if I had invested in SPY. Options helped my investments do well by minimizing losses and generating positive cash flow that was reinvested when stocks were down. Options help me manage my investments well for several other reasons including tax but won't be able to get into all that in this short article.

Investment performance over 5 years shows index funds such as SPY are over diversified to minimize risk and give up significant investment returns. Investing in small number of high performing stocks and using options to manage risk and optimize returns works much better. Investment strategy can be simplified to not diversify into bonds, international funds, gold, real estate, commodities, ... . The only risk is US \$ currency.

Motivated to help others invest in stocks better:

Myfingita.com website was launched 2+ years back to provide some of the apps I developed for myself. Myfinvar App helps with stock and option investing. You can find high performing stocks and study performance of portfolios quickly as I do. I have also given some sample stock portfolios, and you can compare their performance with traditional portfolios of stocks and bonds. You can also check option premiums and relative spread of activity. UX is not very professional and state-of-the-art right now, but good enough to try. I have explained in other articles why I felt the need for my app to complement similar info available on popular brokerage and investment sites.

I have plans to improve UX and support Myfinvar as an android or iPhone app. My innovative option strategy details, including option trading algorithms, are not yet disclosed but exploring options to disseminate to limited number of users.

I am looking into potential business strategies to enable others to benefit from my option strategy and innovation. One way is to let others emulate my portfolio and convince them that it works well. If you have ideas or proposals, DM me and I can follow up with you.