Is it time for options to replace bonds in investment portfolios?

Current mainstream investment strategies still rely on diversified stock funds with bond funds, and not on options. Unfortunately, bond returns are low, typically less than 5%, and unlikely to go up. Bonds also generate income only on a fraction of portfolio. Stock portfolio returns also around 10% over long time, say 5 years or more so overfall annual return is usually less than 10%. So, is there a better investment strategy with reasonable risks than traditional portfolios? Are there new tools that are more effective in improving investment returns and risks ? What about options on stocks ?

Options, derivative of stocks, can be used effectively whether stock markets go up or down. There are many books and articles written, but most focus on options by themselves and even combine multiple options on same stock to support high returns with high risks. Options are also used as an income strategy, but you find less info on that. Options now have very nominal trading fees, which makes strategies feasible now that could not work in past. Can options be used combined with stocks to generate better returns with reduced risks? Answer is yes. Options can be used as 'bond' part of a balanced portfolio to reduce volatility and generate income comparable to premiums on the entire portfolio value during down markets.

In this article, I will refresh on option basics and qualitatively explain how it can be combined with stock investments. First a summary of what options are (Ask ChatGPT to summarize if that helps).

· Options on stocks can be one of the two – 'calls' or 'puts'. Both have an associated expiration date which can be up to 3 years in future and a strike price at which you can buy or sell stock at until expiration date.

· Options are bought or sold in units of 100 called a single contract. So, you typically need more money to invest in options than stock. Options can be sold or bought any time before expiration date in US stock market which makes them very flexible and powerful.

· Options have low trading fees now - $0.65 per contract (very nominal trading fees), which may be in 10s of thousands of dollars. Even with one or more option trades per month, effective trading fees can be <0.1%.

· Call options give you right to buy stock. Its price increases with expiration date (as it is effective over a longer period) and reduces with strike (less likely stock price exceeds strike before the expiration date). Put is complementary to call, it gives you right to sell stock at strike until expiration date.

In this short article we focus on 'calls' more intuitive to understand.

· Call options with strikes around stock price are referred to as at-the-money (ATM) option. ATM Option prices (or premiums) can vary from few percent of stock price to 40+% of stock price depending on expiration date and stock (some stocks are more in demand). For expirations a year out, options premiums are typically in10-20 percent for large cap stocks.

· Option prices consist of two components – intrinsics and extrinsic. Intrinsics is the difference between stock and strike if stock price > strike, 0 otherwise. Extrinsic, the option price less the intrinsics, is referred to as the time value. Extrinsic of an option decay to 0 as expiration date is approached, making option price equal to its intrinsic.

· Extrinsic is maximum for ATM option prices as at those strikes there is most uncertainty of whether stock will be below or above strike as we approach expiration date.

Why would one buy a call option instead of buying underlying stock? It is leveraged investing i.e. you can get significantly higher returns than stocks but with higher risks. An example will help us understand. Microsoft stock today trades around 520. Its option for Sept 18, 2026, expiration, a year out, is about $59 i.e. 11+% of stock price. If you have at least $59*100 = $5900, you can either buy about 11 stocks or 100 options. If stock goes up to 650 before expiration date, you would have made about 25% return on stocks (650-520)/520). However, buying call options would result in much higher return of 120% (650-520)/59). So, you see why investors are attracted to buy call options.

Now let us look at the trade-off of call option from seller perspective. If you are invested in stocks already, and you have 100 stocks or more, you can sell call option on them. In our Microsoft example above, you get $5900 on an investment of $52000. You keep the premium if stock never goes beyond $520 or it is below $520 on expiration date (very likely unless calls get assigned). Even if stock goes up from $520, but stays under $520+$59, you still make more money than investing in stock alone. Note also you get $59 up front and not at end or spread over investment period (which is the case with traditional bonds). There is a very small risk you may have to sell stock at $520 if 'assigned' before expiration date. But if stock is <$520+$59, you can buy back stock and sell call option again. There is only tax impact. In my experience of trading in options over 5 years, assignments never happened near ATM strikes. If stocks stay at same price, selling call option in this example gives you 11+% return on your investment (same as premium rates for ATM strike), so it works as bond with 11+return on your portfolio.

Myfinvar app from myfingita, llc can quickly summarize ATM option premiums as percentage of stock price for different expiration dates for stocks in the portfolio. An example is as shown in the cover chart for this article for the initial portfolio example at

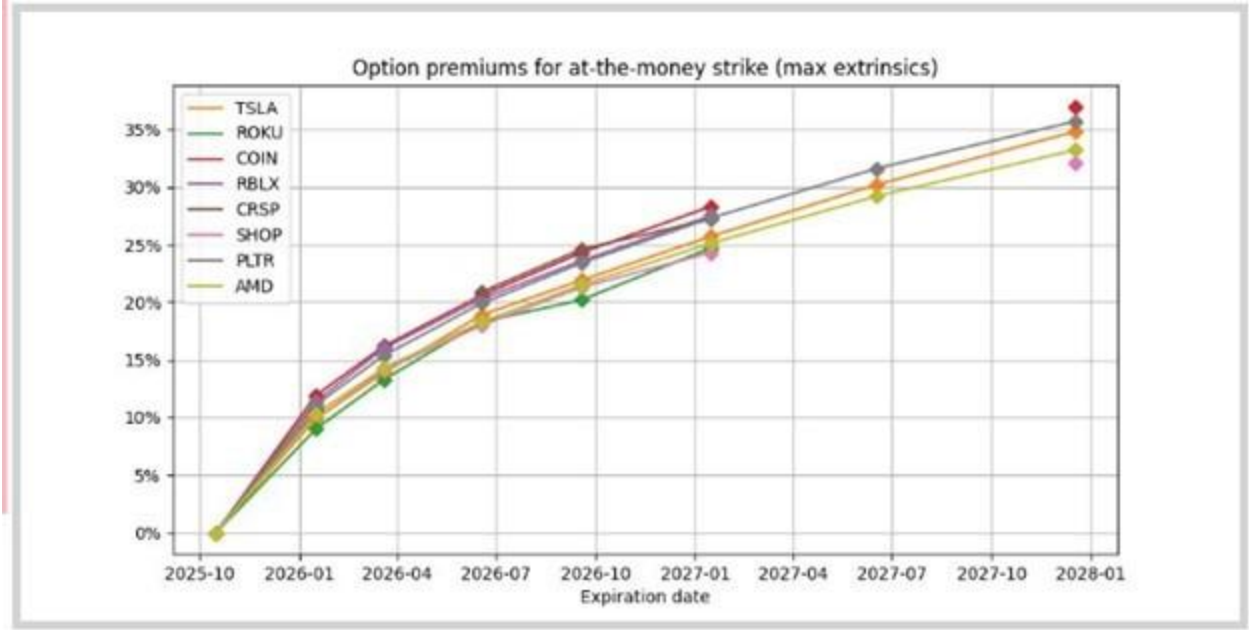
start. For sept 2026 expiration date, premiums vary from 10% to 20%, much higher than bond rates. You can look up for other stocks.

The example above is a well-known call option strategy and referred to as single covered call as you are selling a single call option in a stock position you own. The limitation of this simple for seller (stock investor) is your option premium cannot cover loss partially if stock prices reduce by more than premium. Is there a way we can make it work even if stock prices change more than option premium rates? Can the portfolio work as if invested in stocks+bonds where 'bond' part returns are the same as option premium rates? Ideally, you want to keep stock returns when they go up as if you never sold options but cover all losses by option premiums when stocks go down. By covering losses, you effectively make portfolio behave like cash, the best you can do in a down market. You will also avoid losing sleep when markets are very volatile.

Over years, I have focused on, developed and tuned such an optimized stocks+options strategy, where losses are minimized or eliminated when stock goes down while keeping most of the stock gains when it goes up. You also can get annual returns equivalent to option premiums if stock prices change little. You are invested in stocks as usual, but options help reduce volatility while keeping most of the stock returns. I have been investing in that strategy for 5+years now. Strategy also has been modeled and back tested, giving more confidence. Impact of options on stock return only depends on few reliable fundamental option metrics. Strategy is more robust and better returns than diversification which is common today. Unfortunately, I cannot go into the specifics of the strategy in this article.

There are already some innovative funds that try to convert volatile stock returns into steady income. One example is XYLD, that aims to give steady income of about 1%per month by investing in S&P 500 and options on them. Unfortunately, such an income strategy seems to come with a steep cost when you compare XYLD with S&P 500benchmarks such as SPY.

There are also already investment funds that do reduce diversification to increase returns, one such fund is ARKK (Google gave ARKK as an example for investments giving high returns). Fund only invests in 42 stocks, and top 10 holdings account for 50% of portfolio (somewhat like S&P 500 funds like SPY). Even though one year return is very high >80%, 5-year return is low. Returns seem to vary significantly year over year. The option premium chart below is for the top holdings in ARKK generated by Myfinvar app. You see one common thing; they all have high option premiums. Premiums for sept 2026 is in 20%-25% range, compared to 15%-20% for moderate stocks in cover chart. Higher volatility stocks typically have higher option premiums, but they can also give very high returns.



Option premiums for top holdings in ARKK fund, generated by myinvar app (myfingita.com/app/myfinvar/options)

To conclude, there are signs of innovative investment funds coming up with less diversification and/or combining stocks with options. Myfingita has innovated one such strategy - developed, validated and tuned. That has performed very well for my investments over last 5 years in both up and down markets. Will these new investment strategies replace traditional portfolios of highly diversified stocks and bonds which is the norm today? Only time will tell. There are many other benefits that options data bring into investment strategies, will explain in future articles.