Buy Write Index Returns

Announced in April 2002, the BXM Index was developed by the Cboe in cooperation with Standard & Poor's. To help in the development of the BXM Index, the Cboe commissioned Professor Robert Whaley to compile and analyze relevant data from the time period from June 1988 through December 2001. Data on daily BXM prices now is available from June 30, 1986, to the present time (see below). The BXM is a passive total return index based on (1) buying an S&P 500 stock index portfolio, and (2) "writing" (or selling) the near-term S&P 500 Index (SPXSM) "covered" call option, generally on the third Friday of each month. The SPX call written will have about one month remaining to expiration, with an exercise price just above the prevailing index level (i.e., slightly out of the money). The SPX call is held until expiration and cash settled, at which time a new one-month, near-the-money call is written. Please see the BXM FAQ below for more information about the construction of the index. A "Buy-Write" strategy generally is considered to be an investment strategy in which an investor buys a stock or a basket of stocks, and also writes covered call options that correspond to the stock or basket of stocks. A - 1. Around the year 2000, the Cboe Options Exchange (Cboe) received general interest from institutional and individual customers in having the Exchange create a benchmark index to measure the performance of certain stock and options strategies. The Cboe believes that the introduction of the BXM index could lead to more long-term customer interest in and use of Cboe index options. A - 4. The BXM daily prices are available at www.cboe.com/bxm, and from quote vendors that provide options data. The price level of BXM was 92.21 on June 30, 1986, and was set to 100 on June 1, 1988, the first day that Standard and Poor's began reporting the daily cash dividends for the S&P 500 index portfolio. A - 5. The BXM is a passive total return index based on selling the near-term, near-the-money S&P 500 Index (SPX®) call option against the S&P 500 stock index portfolio each month. The SPX call that is sold (or written) will have approximately one month remaining to expiration, with an exercise price just above the prevailing index level (i.e., slightly out of the money). The premium collected from the sale of the call is added to the portfolio's total value. The SPX call is held until its expiration, at which time a new one-month, near-the-money call is written. The expired option, if exercised, is settled in cash. Click here for more details about the methodology for the BXM Index. Investors attempting to replicate the BXM Index should discuss with their brokers possible timing and liquidity issues. A - 7. Here is a three-part answer to this question: In March 2002 the Cboe began disseminating BXM prices as a general indication of a hypothetical S&P 500 buy-write strategy.The Cboe does not provide specific recommendations for investment funds, but interested investors might explore the possibility of doing some research on the returns and risks of investment funds that engage in covered call writing for at least a portion of their investment portfolios. Reports indicate that there now are investment products designed to track the BXM Index, including a structured product, closed-end fund, exchange-traded note (ETN), and exchange traded fund (ETF). Experienced investors also could ask their brokers about the possibility of directly engaging in an S&P 500 buy-write strategy by investing in stocks and SPX options. As always, investors interested in this and other buy-write strategies should consult with their brokers and legal advisors for applicable advice on relevant issues, including but not limited to considerations regarding margin requirements. For more information about margin requirements, please see Cboe Rule 12.3, Cboe Regulatory Circular RG99-09, and the Cboe web site. In addition, please see Regulatory Circular RG02-46 -- "Time at Which Expiring AM-Settled Index Options are Considered Exercised, Assigned or Purged." A - 8. The added income from the covered calls in a BXM position often has provided a cushion in times of flat to declining markets. On the other hand, in times when the stock market was rising rapidly, SPX buy-write strategies generally underperformed the S&P 500. Please see the charts, tables and publications at this website www.cboe.com/bxm for more specific information on returns and risks. Cboe members and member firms desiring to market the BXM Index and/or the BXM returns to current or potential customers should please note that they are subject to the detailed requirements of Cboe Rule 9.21 - "Communications to Customers." A - 9. A potentially attractive feature to some investors has been the relative steadiness and low volatility of BXM returns; from June 1988 through December 2006, the annualized standard deviation of returns was 13.8% for the S&P 500 and 9.2% for BXM. A - 10. It is expected that buy-write positions generally will have lower returns than stocks in times of rising stock markets. A covered call writer does not participate in upside stock gains beyond the strike price plus the premium received. In addressing issues regarding writing covered calls using index options, Cboe Regulatory Circular RG99-09 provides in part that: "As a reminder, it is important to understand that due to the cash settlement feature of SPX® options and the "timing risk" involved, there is an inherent limitation on the ability of writers of SPX® options to cover the risk exposure by holding positions in SPDRS®." Commissions, taxes, market impact costs and other transaction costs will reduce returns so that an investor might find it difficult to match BXM returns. Options involve risk and are not suitable for all investors. A - 11. Like many passive indexes, the BXM Index does not take into account significant factors such as transaction costs and taxes and, because of factors such as these, many or most investors should be expected to underperform passive indexes. The BXM Index is designed to represent general trends for a hypothetical buy-write strategy. Prior to 2003, the BXM methodology used an assumption that the SPX options were sold at the bid price (rather than the mid-point of the bid-ask). Transaction costs for a buy-write strategy such as the BXM could be significantly higher than transaction costs for a passive strategy of buying-and-holding stocks. A - 14. No, there is no early exercise for SPX options. Unlike equity and certain other index options, SPX call options have "European-style" exercise, that is, SPX options generally may be exercised only on the last business day before expiration. A - 16. In addition to SPX options, the Cboe offers (1) cash-settled options based on a number of stock indexes, including the Cboe Volatility Index (VIX), S&P 100 (XEO and OEX), Dow Jones Industrial Average (DJX), Nasdaq-100 (NDX and MNX), Russell 2000 (RUT), and several sectors; and (2) options on exchange-traded funds based on the Nasdaq-100 (QQQ) Dow (DIA), and S&P 100 (OEF). These different indexes have different settlement procedures and early exercise considerations, which should be understood prior to trading in them. Click on any of the product links in this answer for more information on index options. The **CBOE S&P DJIA BuyWrite Index** (ticker symbol BXD) is a benchmark index designed to show the hypothetical performance of a portfolio that engages in a *buy-write* strategy on the Dow Jones Industrial Average (DJIA). The term buy-write is used because the investor **'buys'** stocks and **'writes'** call options against the stock position. The writing of the call option provides extra income for an investor who is willing to forgo some upside potential. The BXD Index is designed to show the hypothetical performance of a strategy in which an investor buys a portfolio of the 30 stocks in the DJIA, and also sells (or writes) covered call options on the DJIA Index. Investors have used exchange-listed options to engage in buy-write strategies since the 1970s, but prior to 2002 there was no major benchmark for buy-write strategies. In 2000 and 2001, options portfolio managers requested that the Chicago Board Options Exchange develop benchmark indexes for buy-write strategies. The CBOE S&P 500 BuyWrite Index (BXM) was introduced in 2002, and the CBOE DJIA BuyWrite Index (BXD) was introduced in 2005. The S&P/ASX Buy-Write Index combines the underlying accumulation index (S&P/ASX 200) with an ASX call option selected from the series closest to the money with the nearest expiry. In Australia, index option series expire each quarter, so at the time of selection, each option used in the index will have 3 months to expiry. Once an option series has been selected, it is held to maturity. A new series is selected at the expiry of the current one based on the criteria: ASX index options are European style options with cash settlement at expiry. An adjustment to the S&P/ASX Buy Write Index is made each expiry to reflect the funds (if any) that need to be paid to settle the option contract. At the same time, a new option series is written with the proceeds from the option premium being reinvested in the index plus option portfolio in accordance with the formula provided by Whaley*. This differs from the Chicago Board Options Exchange (CBOE) methodology where index options expire monthly and options with one month to expiry are selected. Otherwise the methodology used in the calculation of the back history mirrors the methodology set out by Whaley* and used by CBOE.

A full copy of the original methodology is available at www.cboe.com/bxm The S&P/ASX Buy-Write Index (XBW) replicates the performance of a well known option trading strategy where the investor holds a long position in a security and then writes (or sells) call options against the long position. The short call position earns option premium for the investor however the short call also limits the potential profit from the long security position.

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