Covered Calls Are A Popular Option

(NAPSA)—Closed-end funds have become an increasingly sought-after investment product. This is evidenced by the fact that there are now over 650 such funds traded on the exchanges, with more than $250 billion in total assets. Boston-based asset manager Eaton Vance has been the biggest issuer of closed-end funds for the past two years, and in 2005 year-to-date. Eaton Vance's ability to develop products that meet investors' ever-changing needs as market conditions vary has been a key to this success.

One reason for the increased recent popularity of closed-end funds may be the thirst for yield of the 77 million "Baby Boomers." Closed-end funds can be appealing to people at this life stage because many funds provide a high level of income. As investors head into retirement, they look to tap into their portfolios, rather than continuing to accumulate assets. Closed-end funds are predominantly income vehicles and can provide the potential for higher-than-average yields thanks to their use of leverage.

The ability to employ financial leverage to boost yields and returns has been a key feature of closed-end funds. Leverage allows a fund to borrow money on shareholders' behalfs and thus increase assets. A closed-end fund may borrow assets at a lower rate than the rate at which it can invest those assets, and use this "spread" to enhance its yield to shareholders. Short-term interest rates regularly go through cycles of rising or declining, and leverage is a strategy that serves investors well at points when interest rates are low.

However, in the current environment of increasing short-term interest rates, the delta between borrowing costs and potential returns decreases. In an effort to provide investors with an alternative closed-end fund structure that can meet the demand for yield, Eaton Vance introduced last fall its first fund using a covered call option strategy. This approach can produce high yields from equity-based portfolios but requires no leverage to accomplish this.

How do covered call options work? First, all stocks owned by the Fund are selected based upon fundamental research and the assessment that they have the potential to increase in value. Through a covered call option strategy, a Fund sells the right—or "option"—for another investor to buy—or "call"—a stock already owned by the Fund, at a specific price higher than its current value within a certain time frame. The Fund is paid an option premium for selling this right to the buyer.

In three out of the four investment outcomes possible, the Fund, as seller of the option, is likely to profit. If the market goes down, is flat or rises modestly, the Fund keeps both the optioned stock and the premium received. In a strongly rising market, the Fund must sell the stock at the price agreed to and thus loses any further appreciation the stock may gain. Nonetheless, the Fund still receives the premium for selling the option. This strategy is seen as conservative—it can protect a decline in value of the stock through the option premium received.

Eaton Vance now manages four funds that use covered call options and does so in association with Rampart Investment Management, a firm that has specialized in this strategy for more than 25 years. These Funds are Eaton Vance Enhanced Equity Income Funds I and II, Eaton Vance Tax-Managed Buy-Write Options Fund and Eaton Vance Tax-Managed Buy-Write Opportunities Fund.

Eaton Vance Corp. is a Boston-based investment management firm whose stock trades on the New York Stock Exchange under the symbol EV. Eaton Vance and its affiliates managed $101.5 billion in assets as of May 31, 2005, for more than 100 investment companies, as well as individual and institutional accounts, including those of corporations, hospitals, retirement plans, universities, foundations and trusts.

Before investing in any Eaton Vance Fund, prospective investors should consider carefully the Funds' investment objectives, risks, and charges and expenses. For more complete information about a Fund, please contact your financial advisor. The Funds involve a number of risks, including the risks associated with leverage, trading discount and income variability.

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