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The Income Illusion

ZWB BMO's Covered Call Canadian Bank ETF — why the headline yield can cost you

An honestly framed version of the BMO Covered Call CDN Bank ETF (ZWB) would read: you will likely earn a lower total return over time, and pay a higher fee, in exchange for slightly more predictable monthly cash flow and marginally lower volatility. That is not a great marketing slogan — which is exactly why you never see it on the front of a brochure.

Frontwater has long incorporated disciplined option-overlay strategies across both our active and passive portfolios. It would be reasonable to assume we therefore endorse ETFs that package these strategies, such as BMO's Covered Call Bank ETF (ZWB). **We do not.** When you pull back the curtain and dig into the data, it becomes clear that automated covered-call ETFs like ZWB function as long-term wealth **eroders** rather than wealth **builders**.

As is often the case with bank-packaged products, the marketing shines while the real-world results fall short. True, the economics are perfectly defensible — but the narrative leaves out the crucial context that would materially change how an informed investor evaluates it.

ZWB has consistently underperformed its plain-vanilla counterpart, the equal-weight Canadian bank ETF **ZEB**, for over a decade. An investor would have been better off in the simpler ZEB, paying its lower fee. How BMO justifies ZWB's higher MER is, frankly, beyond us. The problem is structural, not bad luck.

THE MAGNETIC HEADLINE

ZWB advertises a distribution yield around **6%** — roughly double the **3%** you would earn just holding the same banks through ZEB. For an investor who wants cash flow, that number is magnetic. The catch is that the robotic covered-call program erodes your *total* return. The extra income is not free money layered on top; it is your own future growth handed back to you early — and taxed, capped, and fee'd along the way.

Understanding why requires looking under the hood at what these funds actually do. On the next page, a near-perfect natural experiment: two BMO funds holding the same banks, differing mainly in the option overlay.

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The scorecard: ZWB versus ZEB

The two funds are an almost perfect natural experiment, because they hold the same banks and differ mainly in the option overlay.

Metric	ZEB — plain index	ZWB — covered call
What it holds	The big Canadian banks, equal-weighted	The same banks, but sells call options on them
Headline yield [†]	~3%	~6–7%
Management fee (MER)	~0.28%	~0.72%
Annualized total return since 2011 inception	~ 10.7% /yr	~ 8.3% /yr
Return correlation (ZEB vs ZWB)	~ 0.98 — near-perfect; the two move in lockstep	

[†] Distribution yields as of June 30, 2026.

Since their 2011 inception, the plain index fund has compounded at roughly **10.7%** per year versus about **8.3%** for the covered call version — a gap of more than two percentage points annually.

TWO POINTS A YEAR IS NOT TRIVIAL

On a **\$100,000** investment held for 15 years, compounding at 10.7% rather than 8.3% is the difference between roughly **\$460,000** and about **\$330,000** — a shortfall of over **\$130,000**. The covered-call fund tends to capture only about **80–85%** of the plain fund's total return, and that gap compounds relentlessly.

Three forces working against the strategy

1 Very low option premiums on Canadian bank stocks

Most investors view Canadian banks as exceptionally safe, so implied volatility — and therefore option premium — tends to be low. Selling calls on these names generates relatively little income while still capping the double-digit appreciation you give up on the upside.

2 A robotic, rules-based program

The automation creates a systematic **sell-low, buy-high** cycle, repeated month after month — the exact opposite of what a skilled investor does. The process is mechanical, not strategic: no discretion, no ability to step aside when volatility is cheap, no judgment about whether a stock is breaking out. Over time this clips the strongest rallies, forces repurchases at unfavourable prices, reduces participation in long-term compounding, and quietly erodes total return. It is a structural headwind baked into the design.

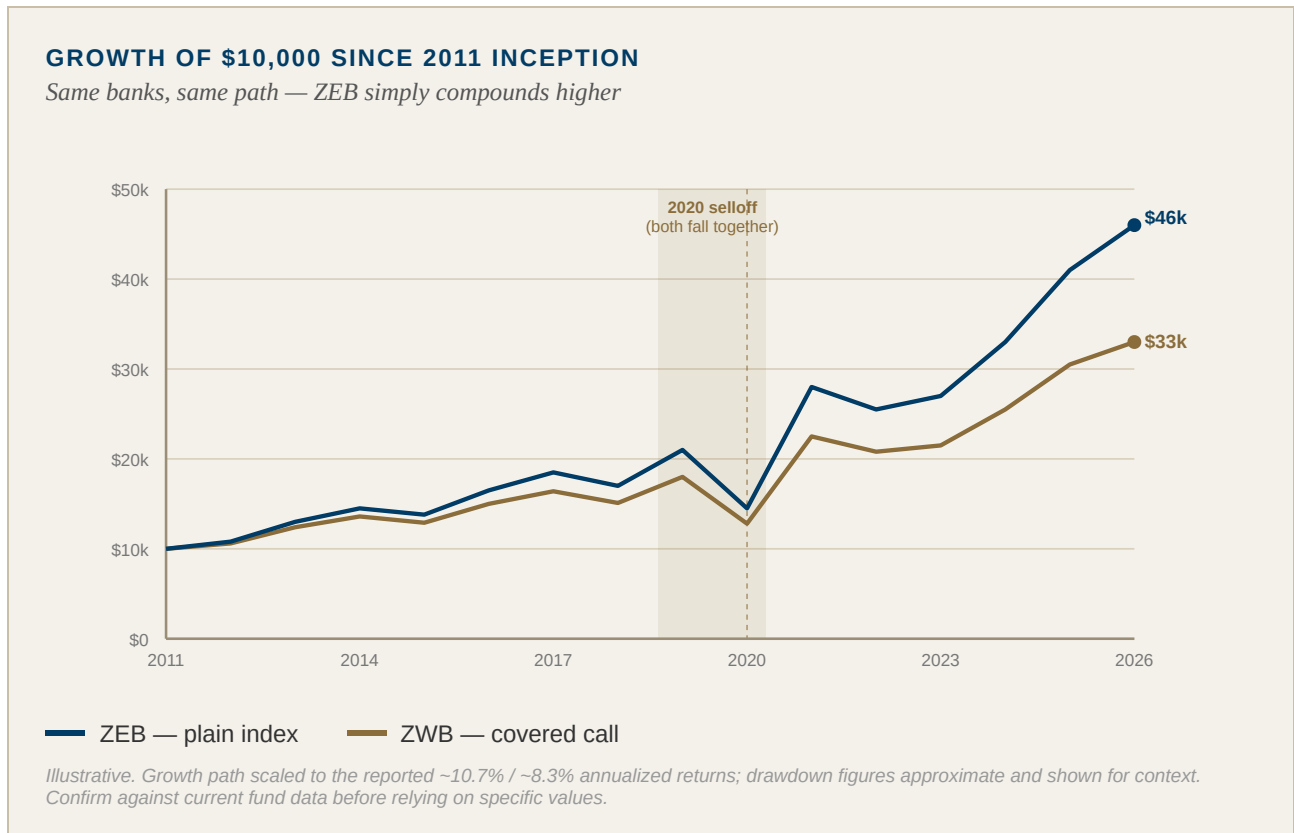
3 Higher fees

Running an options overlay costs more to manage. ZWB charges roughly **0.72%** a year against about **0.28%** for ZEB — an extra ~0.44% annually for the privilege of capping your own upside. Fees are one of the few near-certainties in investing, and here the more complex, lower-returning product is also the more expensive one.

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Two funds, one path

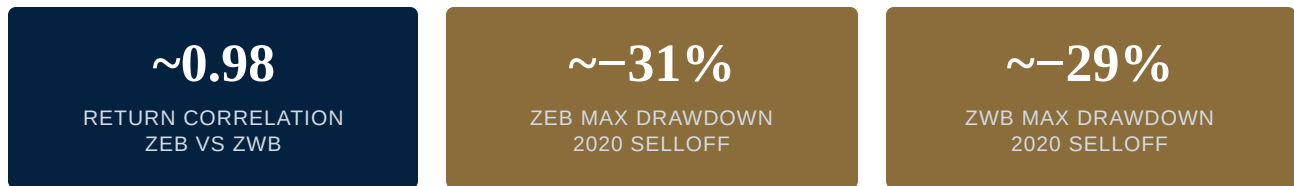
If the covered-call overlay genuinely reduced risk in a meaningful way, you would see it in the chart: ZWB should fall less when markets drop. It barely does. Because both funds hold the same Canadian banks, they rise together, fall together, and bottom out together. The overlay changes the *level* of the line — it does almost nothing to its *shape*.



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The correlation no one mentions

Two funds that hold the same securities cannot diversify away each other's risk. Their returns move in near-lockstep, and the small premium ZWB collects on low-volatility bank stocks provides only the thinnest of cushions when it matters most. In the 2020 selloff, the covered-call fund fell almost as far as the plain index — a difference of roughly two percentage points of drawdown, not the meaningful protection the “lower risk” framing implies.



WHY THIS MATTERS

For risk purposes, ZEB and ZWB are very nearly the same fund. They rise together, fall together, and bottom together, with a correlation close to one and almost identical drawdowns. The covered-call overlay shaves only a sliver off the worst declines — nowhere near enough to justify being sold as a lower-risk product. **The downside protection most investors believe they are buying is, in practice, marginal — and any risk mitigation is significantly exaggerated.** What you keep, reliably, is the lower return and the higher fee.

The yield illusion

The most important mental shift is to stop treating a distribution as a return. A 6% distribution *feels* like a 6% gain, but a chunk of it is often just option premium and, at times, **return of capital** — the fund handing your own money back to you. That payment is not magic income; it lowers the fund's net asset value, so you have effectively sold a sliver of your holding to pay yourself. A high yield paired with sluggish price growth can leave you worse off than a lower-yielding fund that quietly compounds.

“Total return is the only number that matters for measuring whether your wealth is actually growing.”

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Are banks being forthright about ZWB?

It is worth being precise, because technically this is not fraud. The big bank-owned option-overlay ETFs are legitimate, fully disclosed products. The strategy does exactly what the prospectus says, the distributions are paid as promised, and nothing is hidden from a reader willing to dig through the fund facts. The issue is not honesty in the legal sense — it is honesty in the **emphasis**.

These funds are marketed in a way that obscures the trade-off rather than spotlighting it. The pitch is emotional and reassuring — *monthly income, with less risk* — and that framing does a lot of quiet work. It pulls your eye toward the part that feels good (a steady cheque every month) and away from the part that costs you money (a lower long-term total return, paired with a higher fee). Both are true at once; the marketing simply turns the volume up on one and down on the other.

The bottom line

WHAT TO TAKE AWAY

ZWB has underperformed its plain-vanilla counterpart for a reason that is structural, not bad luck: these funds sell off the best part of the return — the big up moves — while keeping the full downside, and they charge more to do it. The eye-catching yield is largely a repackaging of growth you would have earned anyway, paid to you sooner and capped along the way. The funds are not dishonest; the marketing just leads with the cheque and whispers the cost.

None of this means a covered-call strategy is never appropriate — for the right investor, with the right objective, the trade-off can make sense. The point is to choose it with eyes open, measured against total return, rather than be drawn in by a headline yield. That is the difference between an overlay applied with judgment and one applied on autopilot.

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