

## What Rising Rates Could Mean for Your Money

When the Federal Reserve raises its benchmark federal funds rate, there are a number of ways it could affect you as a consumer and investor.

### What is the federal funds rate?

The federal funds rate is the interest rate at which banks lend funds to each other overnight to maintain legally required reserves. It applies only to funds that stay on deposit within the Federal Reserve System. The Federal Open Market Committee (FOMC) sets a target range for the funds rate, usually a 0.25% spread, and then sets two specific rates that act as a floor and a ceiling to push the funds rate into that target range. The rate may vary slightly from day to day, but it generally stays within the target range.

Although the federal funds rate is an internal rate within the Federal Reserve System, it serves as a benchmark for many short-term rates set by banks and can influence longer-term rates as well.

### Why does the Fed adjust the federal funds rate?

The Federal Reserve and the FOMC operate under a dual mandate to conduct monetary policies that foster maximum employment and price stability. Adjusting the federal funds rate is one way the central bank can influence economic growth and inflation.

The FOMC raises the federal funds rate in an effort to slow the economy and hold back inflation, which can rise rapidly when an economy grows too quickly. The Fed has set a 2% annual inflation goal as consistent with healthy economic growth.

### How will consumer interest rates be affected?

The prime rate, which commercial banks charge their best customers, is typically tied directly to the federal funds rate. Though actual rates can vary widely, small-business loans, adjustable rate mortgages, home equity lines of credit, auto loans, credit cards, and other forms of consumer credit are often linked to the prime rate, so the rates on these types of loans typically increase with the federal funds rate. Fed rate hikes

might also put upward pressure on interest rates for new fixed rate home mortgages, but these rates are not tied directly to the federal funds rate or the prime rate.

Although rising interest rates make it more expensive for consumers and businesses to borrow, retirees and others who seek income could eventually benefit from higher yields on savings accounts and CDs. However, banks have been faster to raise rates charged on loans than to raise rates paid on deposits. This may change as rates continue to rise and the economy continues to improve. Theoretically, the "tipping point" for savers will come when banks have to compete for deposits in order to meet higher demand for loans.

### What about investors?

Interest rate changes can have broad effects on investments, but the impact tends to be more pronounced in the short term as markets adjust to the new level.

When interest rates rise, the value of existing bonds typically falls. Put simply, investors would prefer a newer bond paying a higher interest rate than an existing bond paying a lower rate. Longer-term bonds tend to fluctuate more than those with shorter maturities because investors may be reluctant to tie up their money for an extended period if they anticipate higher yields in the future.

Bonds redeemed prior to maturity may be worth more or less than their original value, but when a bond is held to maturity, the bond owner would receive the face value and interest, unless the issuer defaults. Thus, rising interest rates should not affect the return on a bond you hold to maturity, but may affect the price of a bond you want to sell on the secondary market before it reaches maturity.

Bond funds are subject to the same inflation, interest rate, and credit risks associated with their underlying bonds. Thus, falling bond prices due to rising rates can adversely affect a bond fund's performance. However, as underlying bonds mature and are replaced by higher-yielding bonds within a rising interest rate environment, the fund's yield and/or share value could potentially increase over the long term.

Equities may also be affected by rising rates, though not as directly as bonds. Stock prices are closely tied to earnings growth, so many corporations stand to benefit

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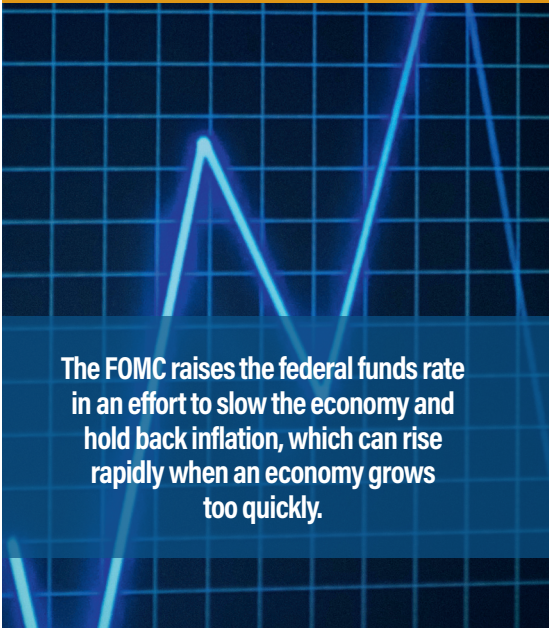
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from a more robust economy. On the other hand, companies that rely on heavy borrowing will likely face higher costs going forward, which could affect their bottom lines.

The broader market may react when the Fed announces a decision to raise rates or not to raise rates, but any reaction is typically temporary. Fundamentally, what matters is how the economy performs as interest rates adjust. As always, it's important to maintain a long-term perspective and make sound investment decisions based on your own financial goals, time horizon, and risk tolerance.

The FDIC insures CDs and bank savings accounts, which generally provide a fixed rate of return, up to \$250,000 per depositor, per insured institution. The return and principal value of stocks and investment funds fluctuate with market conditions. Shares, when sold, may be worth more or less than their original cost.

Investment funds are sold by prospectus. Please consider the fund's objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

# Bonds, Interest Rates, and the Impact of Inflation

There are two fundamental ways that you can profit from owning bonds: from the interest that bonds pay, and from any increase in the bond's price. Many people who invest in bonds because they want a steady stream of income are surprised to learn that bond prices can fluctuate, just as they do with any security traded in the secondary market. If you sell a bond before its maturity date, you may get more than its face value; you could also receive less if you must sell when bond prices are down. The closer the bond is to its maturity date, the closer to its face value the price is likely to be.

Though the ups and downs of the bond market are not usually as dramatic as the movements of the stock market, they can still have a significant impact on your overall return. If you're considering investing in bonds, either directly or through a mutual fund or exchange-traded fund, it's important to understand how bonds behave and what can affect your investment in them.

## The price-yield seesaw and interest rates

Just as a bond's price can fluctuate, so can its yield - its overall percentage rate of return on your investment at any given time. A typical bond's coupon rate — the annual interest rate it pays — is fixed. However, the yield isn't, because the yield percentage depends not only on a bond's coupon rate but also on changes in its price.

Both bond prices and yields go up and down, but there's an important rule to remember about the relationship between the two: *They move in opposite directions, much like a seesaw.* When a bond's price goes up, its yield goes down, even though the coupon rate hasn't changed. The opposite is true as well: When a bond's price drops, its yield goes up.

That's true not only for individual bonds but also for the bond market as a whole. When bond prices rise, yields in general fall, and vice versa.

## What moves the seesaw?

In some cases, a bond's price is affected by something that is unique to its issuer - for example, a change in the bond's rating. However, other factors have an impact on all bonds. The twin factors that affect a bond's price are inflation and changing interest rates. A rise in either interest rates or the inflation rate will tend to cause bond prices to drop. Inflation and interest rates behave similarly to bond yields, moving in the opposite direction from bond prices.

## If inflation means higher prices, why do bond prices drop?

The answer has to do with the relative value of the interest that a specific bond pays. Rising prices over

time reduce the purchasing power of each interest payment a bond makes. Let's say a five-year bond pays \$400 every six months. Inflation means that \$400 will buy less five years from now. When investors worry that a bond's yield won't keep up with the rising costs of inflation, the price of the bond drops because there is less investor demand for it.

## Why watch the Fed?

Inflation also affects interest rates. If you've heard a news commentator talk about the Federal Reserve Board raising or lowering interest rates, you may not have paid much attention unless you were about to buy a house or take out a loan. However, the Fed's decisions on interest rates can also have an impact on the market value of your bonds.

The Fed takes an active role in trying to prevent inflation from spiraling out of control. When the Fed gets concerned that the rate of inflation is rising, it may decide to raise interest rates. Why? To try to slow the economy by making it more expensive to borrow money. For example, when interest rates on mortgages go up, fewer people can afford to buy homes. That tends to dampen the housing market, which in turn can affect the economy.

When the Fed raises its target interest rate, other interest rates and bond yields typically rise as well. That's because bond issuers must pay a competitive interest rate to get people to buy their bonds. New bonds paying higher interest rates mean existing bonds with lower rates are less valuable. Prices of existing bonds fall.

That's why bond prices can drop even though the economy may be growing. An overheated economy can lead to inflation, and investors begin to worry that the Fed may have to raise interest rates, which would hurt bond prices even though yields are higher.

## Falling interest rates: good news, bad news

Just the opposite happens when interest rates are falling. When rates are dropping, bonds issued today will typically pay a lower interest rate than similar bonds issued when rates were higher. Those older bonds with higher yields become more valuable to investors, who are willing to pay a higher price to get that greater income stream. As a result, prices for existing bonds with higher interest rates tend to rise.

### Example:

Jane buys a newly issued 10-year corporate bond that has a 4% coupon rate - that is, its annual payments equal 4% of the bond's principal. Three years later, she wants to sell the bond. However, interest rates have risen; corporate bonds being issued now are paying interest rates of 6%. As a result, investors won't pay Jane as much for her bond, because they could buy a newer bond that would pay them more interest. If interest rates later begin to fall, the value of Jane's bond would rise again, especially if interest rates fall below 4%.

When interest rates begin to drop, it's often because the Fed believes the economy has begun to slow. That may or may not be good for bonds. The good news: Bond prices may go up. However, a slowing economy also increases the chance that some borrowers may default on their bonds. Also, when interest rates fall, some bond issuers may redeem existing debt and issue new bonds at a lower interest rate, just as you might refinance a mortgage. If you plan to reinvest any of your bond income, it may be a challenge to generate the same amount of income without adjusting your investment strategy.

## All bond investments are not alike

Inflation and interest-rate changes don't affect all bonds equally. Under normal conditions, short-term interest rates may feel the effects of any Fed action almost immediately, but longer-term bonds likely will see the greatest price changes.

Also, a bond mutual fund may be affected somewhat differently than an individual bond. For example, a bond fund's manager may be able to alter the fund's holdings to try to reduce the impact of rate changes. Your financial professional may do something similar if you hold individual bonds.

Note: Bond funds are subject to the same inflation, interest rate, and credit risks as their underlying bonds, and if interest rates rise and bond prices fall, that can adversely affect a bond fund's performance. Before purchasing a mutual fund, you should carefully consider its investment objective, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing.

## Focus on your goals, not on interest rates alone

Though it's useful to understand generally how bond prices are influenced by interest rates and inflation, it probably doesn't make sense to obsess over what the Fed's next decision will be. Interest rate cycles tend to occur over months and even years. Also, the relationship between interest rates, inflation, and bond prices is complex, and can be affected by factors other than the ones outlined here. Remember, investments seeking to achieve higher yields also involve a higher degree of risk.

Your bond investments need to be tailored to your individual financial goals and take into account your other investments. A financial professional may be able to help you design your portfolio to accommodate changing economic circumstances.

In addition to being affected by monetary policy and economic events, a bond is subject to the risk of potential default by the issuer. There is no assurance that working with a financial professional will improve investment results.

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## The Power of Dividends in a Portfolio

It wasn't so long ago that many investors regarded dividends as roughly the financial equivalent of a record turntable at a gathering of music streamers, a throwback to an earlier era, irrelevant to the real action.

But fast-forward a few years, and things look a little different. Since 2003, when the top federal income tax rate on qualified dividends was reduced from a maximum of 38.6%, dividends have acquired renewed respect. Favorable tax treatment isn't the only reason, either; the ability of dividends to provide income and potentially help mitigate market volatility is also attractive to investors. As baby boomers approach retirement and begin to focus on income-producing investments, the long-term demand for high-quality, reliable dividends is likely to increase.

### Why consider dividends?

Dividend income has represented roughly one-third of the total return on the Standard & Poor's 500 stock index since 1926. According to S&P Global, the portion of monthly total return attributable to dividends has ranged from a high of approximately 68% during the 2000s - in other words, about two thirds of that decade's return resulted from dividends - to a low of 14% during the 1990s, when investors tended to focus on growth.\*

If dividends are reinvested, their impact over time can become even more dramatic. When you reinvest dividends, you are buying more shares of the dividend-paying stock. The reinvested dividends can then start earning returns and dividends of their own, using the power of compounding.

If a stock's price rises 8% a year, even a 2.5% dividend yield can push its total return into double digits. Dividends can be especially attractive during times of relatively low or mediocre returns; in some cases, dividends could help turn a negative return positive, and also can help mitigate the impact of a volatile market by helping to even out a portfolio's return. Another argument has been made for paying attention to dividends as a reliable indicator of a company's financial health. Investors have become more conscious in recent years of the value of dependable data as a basis for investment decisions, and dividend payments aren't easily restated or massaged.

Finally, many dividend-paying stocks represent large, established companies that may have significant resources to weather an economic downturn - which could be helpful if you're relying on those dividends to help pay living expenses.

### The corporate incentive

Financial and utility companies have been traditional mainstays for investors interested in dividends, but other sectors of the market also offer them. For example, the S&P 500 Dividend Aristocrats Index identifies and tracks the performance of companies within the S&P 500 that have consistently increased dividends for at least 25 consecutive years. As of 2025, the index represents 69 securities, diversified across 10 sectors.\* Companies may seek to point to stable or increasing dividends as an indication of confidence and investors frequently see such dividend history as a sign of corporate maturity. Some investors may also believe that pressure to maintain or increase dividends imposes a certain fiscal discipline on companies that might otherwise be tempted to use the cash to make ill-considered acquisitions (though there are certainly no guarantees that a company won't do so anyway).

### Differences among dividends

Dividends paid on common stock are by no means guaranteed; a company's board of directors can decide to reduce or eliminate them. The amount of a company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events. However, a steadily growing dividend is generally regarded as a sign of a company's health and stability. For that reason, corporate boards tend to be reluctant to send negative signals by cutting dividends.

That isn't an issue for holders of preferred stocks, which offer a fixed rate of return paid out as dividends. However, there's a tradeoff for that greater certainty; preferred shareholders do not participate in any company growth as fully as common shareholders do. If the company does well and increases its dividend, preferred stockholders still receive the same payments.

The term "preferred" refers to several ways in which preferred stocks have favored status. First, dividends on preferred stock are paid before the common stockholders can be paid a dividend. Most preferred stockholders do not have voting rights in the company,

but their claims on the company's assets will be satisfied before those of common stockholders if the company experiences financial difficulties. Also, preferred shares usually pay a higher rate of income than common shares.

Because of their fixed dividends, preferred stocks behave somewhat similarly to bonds; for example, their market value can be affected by changing interest rates. And almost all preferred stocks have a provision that allows the company to call in its preferred shares at a set time or at a predetermined future date, much as it might a callable bond.

### Look before you leap

Investing in dividend-paying stocks isn't as simple as just picking the highest yield. If you're investing for income, consider whether the company's cash flow can sustain its dividend.

Also, some companies choose to use corporate profits to buy back company shares. That may increase the value of existing shares, but it sometimes takes the place of instituting or raising dividends.

If you're interested in a dividend-focused investing style, look for terms such as "equity income," "dividend income," or "growth and income." Also, some exchange-traded funds (ETFs) track an index comprised of dividend-paying stocks, or that is based on dividend yield.

Note: Bear in mind that past performance is no guarantee of future results. The performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in any index. All investing involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful.

Note: Exchange-traded funds are sold by prospectus. Consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from the fund company.

### Taxes and dividends

It depends on your taxable income, but qualified dividends are generally taxed at special capital gains tax rates of 0%, 15%, and 20%, depending on your marginal tax rate. And depending on your income, dividends you receive may also be subject to a 3.8% net investment income tax (also referred to as the unearned income Medicare contribution tax).

Qualified dividends are those that come from a U.S. or qualified foreign corporation, one that you have held for more than 60 days during a 121-day period (60 days before and 61 days after the stock's ex-dividend date). Form 1099-DIV, which reports your annual dividend and interest income for tax accounting purposes, will indicate whether a dividend is qualified or not.

Some dividends aren't taxed at the same rate as qualified dividends, and a portion may be taxed as ordinary income. Also, some so-called dividends, such as those from deposits or share accounts at cooperative banks, credit unions, U.S. savings and loan associations, and mutual savings banks actually are considered interest for tax purposes.

\*Source: S&P Global, February 2026

# Blockchain Isn't Basic: Here's Why You Should Wrap Your Head Around It Anyway

A blockchain is a digital ledger of transactions secured by cryptographic techniques and shared by a network of computer systems, so the records can be accessed simultaneously by multiple parties. This type of distributed ledger technology (DLT) was initially created for the peer-to-peer exchange of Bitcoin, but the opportunities for innovation extend far beyond cryptocurrency.

Theoretically, blockchain technology increases trust in business relationships by providing a transparent and tamper-resistant way to process and record transactions. Because no third-party intermediary is needed to settle transactions, they can be completed instantaneously and at a lower cost. Blockchain applications can also be programmed to automate how assets and/or contract obligations are issued, traded, and transferred from one owner to the next.

According to one forecast, global spending by corporations and governments on blockchain solutions is expected to surge from about \$108 billion in 2026 to more than \$9 trillion in 2033.<sup>1</sup> Just about any business or organization that depends heavily on a database might see potential in this emerging technology, but the financial services industry seems poised to lead the way.

## How blockchain works

When a new transaction is added to a distributed ledger, the related data is encoded into a numeric string called a "hash" and recorded in a "block." The key feature is that each new block contains the hash for the current transaction, along with the hash from the prior block, forming a chain that links all the data from every previous transaction together in chronological order. After each addition, the ledger is synchronized so that all network participants have an updated replica. This structure makes it extremely difficult to hack or cheat the system, because any bad actor trying to manipulate the record would have to get past security measures and alter the data - not just once but many times.

A permissionless (public) blockchain has no central authority, which typically means that any user may join the network, often anonymously. A permissioned (private) blockchain is managed by one authority or a group, so access to the data could be restricted for security, privacy, or general business reasons. The largest public blockchains, like Bitcoin and Ethereum, have thousands of "nodes" (the computer systems belonging to the network's stakeholders), whereas a private blockchain may have only a few. Either way, a network's nodes are relied on to "mine" new coins and order or "validate" transactions.

Transaction requests are broadcast to the entire network, then each of the nodes works to validate the legitimacy of the transactions and group them into their own separate blocks, while racing against the others to solve a complex mathematical puzzle through trial and error. The first node to determine the answer earns the right to add its validated block to the permanent record and is rewarded with a pre-set amount of cryptocurrency. This consensus protocol - the way in which network participants reach an agreement on the state of the ledger - is called "proof-of-work."

## A critical shift

One common criticism of blockchain technology is the immense amount of energy it takes to mine cryptocurrency and validate transactions. That's because the proof-of-work method described earlier provides a strong incentive for miners to run the biggest, fastest, and most powerful computer systems available. It also results in a vast amount of electronic waste, as major mining operations constantly upgrade warehouses full of specialized machines to keep up with the competition.

However, some blockchains - Ethereum included - are taking an alternative approach known as "proof-of-stake." With this method, nodes that contribute (or stake) some of their own cryptocurrency to the network are entered proportionally in a lottery to become validators. The bigger the stake, the better the chances of being chosen to validate transactions (and earn more crypto).

Ethereum is an influential, open-source blockchain that was designed to accommodate smart contract functionality, so applications can be coded to execute or enforce the terms of an agreement automatically when certain conditions are met. In addition to its native currency, Ether (the second-largest cryptocurrency by market cap after Bitcoin), there are thousands of projects operating on top of the Ethereum network. These include businesses that create and exchange nonfungible tokens (NFTs) and decentralized finance (DeFi) applications that let users trade, borrow, and lend among each other without third-party intermediaries such as banks.

Ethereum tested and transitioned to a second blockchain that operates by proof-of-stake in September 2022. This change reduced Ethereum's energy consumption by 99.9598%, as it's no longer necessary to mine new coins solely as rewards for validating transactions.<sup>2</sup>

## Why it matters

Businesses and governments worldwide are exploring and investing in blockchain technologies for both financial and nonfinancial applications as they seek to solve complex problems, improve efficiency, and reduce costs. Other than cryptocurrency and NFTs, some promising applications include real-time securities trading, public real estate registries, identity verification, fraud prevention, electronic medical records, supply-chain tracking, and online voting, to name just a few.

Industry consortia are working together on joint projects, while individual companies are trying to influence what might become common standards. But despite the heightened levels of interest and investment in blockchain, widespread adoption could be years away. Some factors slowing the pace of deployments are regulatory uncertainty, scalability challenges, and transaction costs.<sup>3</sup>

In the longer term, however, blockchain could be a transformative or disruptive force that creates a new set of winners and losers. Speedy and successful implementation may deliver a competitive advantage to some companies, while punishing others that don't keep up with the pace of change. And even if efforts to reduce the technology's environmental impact are successful, there may be other societal costs, such as its potential to displace a significant number of human workers.

All investing involves risk, including the possible loss of principal, but new technology ventures are especially risky. Some blockchain projects may turn out to be viable and profitable, but many others could fail. It's important to be skeptical when evaluating a claim made by a company about its entry into this arena. Rising interest in blockchain and crypto is also being exploited by scammers, so steer clear of unsolicited investment offers - and never wire money to pay for an offer or service.

Cryptocurrencies are not a traditional investment, are highly speculative instruments, carry a significant amount of risk, and are not suitable for all investors. Cryptocurrencies are not typically subject to the same reporting and data integrity requirements that apply to more traditional investment products, and they lack many of the regulations and consumer protections that apply to legal tender currencies and regulated securities.

1, 3) Grand View Research, 2026

2) Ethereum.org, 2026



# Options Trading Is Having a Moment: Consider the Risks Before Following the Crowd

A record 15.3 billion options contracts were traded by U.S. investors in 2025, up from 12.3 billion in 2024. It was the sixth year in a row that options traded at record rates.<sup>1</sup>

Options are contracts that allow investors to buy or sell shares of a security, such as a stock or exchange-traded fund, at a predetermined price (the strike price) on or before a certain date. Some investors use options to speculate on the future price of a stock, tapping into leverage to amplify the potential return — and the level of risk — associated with the investment. Other investors may rely on options to help hedge their portfolios against severe market declines.

A notable surge in options trading began in 2020, when millions of retail brokerage accounts were opened by new investors trading securities through smartphone apps, and it continued through the social-media driven meme stock craze of 2021 and beyond.<sup>2</sup> Low trading costs and account minimums made it easier and more affordable to experiment with stock picking — and various options strategies — during the pandemic, when many people were stuck at home with little to do. Meanwhile, economic and market uncertainty has offered tempting opportunities for options traders (amateur and professional) to bet on anticipated price movements.

The options trading trend could lead to painful losses for some aggressive and/or novice short-term traders, but it could also impact the stock portfolios of more traditional long-term investors. A look behind the scenes suggests that high levels of options trading may intensify stock market volatility.

## Options explained

There are two basic types of option contracts. Call options give investors the right, but not the obligation, to buy shares under certain terms in the future, and put options give investors the right to sell them. In practice, investors generally buy call options when they believe the underlying stock will rise and purchase put options when they anticipate a drop in the stock price.

Put options may also be purchased to help protect investments against losses that might occur due to sudden changes in market conditions.

The relatively low cost of options contracts — called the premium — allows investors to control more shares with a smaller initial investment. One option contract usually represents 100 shares of the underlying investment, so if an option charges a premium of \$1, the contract would cost a total of \$100 (plus any commission charged by the broker).

The break-even point is the price at which the contract would not make or lose any money if it were to be exercised by the buyer. For a call option, the break-even point is calculated by adding the cost per share (premium and commission) to the strike price. For a put option, the cost per share is subtracted from the strike price.

Options contracts must be exercised on or before the expiration date. If not exercised, they become worthless and the buyer loses the premium, while the seller keeps the premium and the underlying shares. Selling (or writing) an option contract assumes a much higher level of risk because the investor may be obligated to buy or sell the security at an unfavorable price.

**Hypothetical example 1:** Lucy is excited about the prospects of a news-making tech stock (LAFF) trading at \$90 per share, so she buys a call option to purchase 100 shares in the next three months at a strike price of \$100. The cost for the contract was \$1.00 per share, so the break-even price would be \$101. If the price rises to \$110, Lucy has the option to purchase the shares at the \$100 price. She can then turn around and immediately sell them for \$110 to make a profit of \$10 per share, or \$1,000, less the \$100 cost of the option contract. If the stock price drops or fails to rise above \$100 in the next three months, the option will expire "out-of-the-money," and Lucy loses 100% of the money she paid for the contract.

**Hypothetical example 2:** Ricky is more pessimistic, and he believes the price of LAFF is going to fall in the next three months. He buys a put option for 100 shares at \$85 per share when the stock is trading at \$90. The cost for the contract was \$1.00 per share, so the break-even price would be \$84. If LAFF were to fall to \$80, Ricky could purchase the shares and then exercise his right to sell them at \$85 for a profit of \$500, less the

\$100 cost of the option contract. If the stock continues to trade above the \$85 strike price, the worthless option expires, and Ricky loses all of the \$100 he paid for the contract.

**Hypothetical example 3:** Michael has been purchasing discounted shares through his company's employee stock purchase program for many years, so his net worth is now heavily invested in company stock. He would like to retire next year, and he wants to protect some of his nest egg against an ill-timed market downturn. To do so, Michael purchases put options for the company stock at a price of \$95 (below the current trading price of \$100). The cost for the contract was \$1.00 per share, so his break-even price would be \$94. If his stock were to lose 20% and fall to \$80, Michael can exercise his options and sell the position for \$95 per share, limiting his downside losses. If the stock price doesn't fall, the \$100 he paid for the contract will be lost, but it may be worth the cost if he worries less about what might happen to his retirement portfolio.

## Leverage-fueled market volatility

How could the popularity of options trading be driving up market volatility for traditional long-term investors? An investor who purchases an option may not buy stocks directly, but the "market maker" that sells the contract must typically have access to enough shares of the underlying stock (or related securities) to offset that position.

This creates a significant amount of leverage embedded in every trade. Even though the amount spent on an options contract might be relatively small, the writer may need to buy shares worth many times that amount to be able to cover the buyer's trade, in case it pays off.

Surges in trade volume related to the buying and selling of stock shares by the financial institutions that execute options trades may affect the supply of available shares, exacerbating price swings in either direction.

## Tax surprises

New investors may be caught off-guard by the tax bill associated with their trading activity (if it takes place in taxable brokerage accounts). Investment income is taxed differently than wages, and brokerages don't withhold taxes like employers do. For this reason, traders who sell winners may need to set aside money so they will be prepared to pay the taxes due. Estimated quarterly payments may be required to avoid underpayment penalties. State tax may be owed as well.

Taxpayers who hold investments longer than a year before selling generally qualify for favorable federal tax rates on long-term capital gains. In 2024, long-term capital gains (and qualified dividends) are taxed at 15 percent for single filers whose taxable (Continued on back)





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*(Continued)*

incomes range from \$47,026 up to \$518,900, and for married joint filers whose taxable incomes range from \$94,051 up to \$583,750. Lower-income filers pay zero tax, and higher-income filers pay 20 percent.

However, many active traders sell their positions within a year, and short-term gains are taxed at higher ordinary-income rates ranging from 10% to 37%. High-income taxpayers may also be subject to a 3.8% surtax on net investment income.

For investors who incur losses, these capital losses can offset capital gains or ordinary income in the following order: (1) capital gains in the same category, i.e., short term or long term; (2) capital gains in the other category; and (3) up to \$3,000 of ordinary income (\$1,500 for married taxpayers filing separately). Any remaining losses can be rolled over to the next year and treated as though they occurred in that tax year.

However, capital losses can't offset gains if the investor buys the same holding within 30 days before or after selling it at a loss, even if the stock is in a different account. The IRS calls this a "wash sale."

Options contracts are securities, so the same tax rules apply. If an investor buys a call option and then exercises it, the purchase price of the option may be added to the cost of the stock for the purpose of figuring any capital gain. If the option expires worthless, the investor has a capital loss for the price of the option.

After the end of each year, investors with taxable accounts receive a Form 1099-B that lists their trades. When it comes time to file a tax return, it may be helpful to seek the guidance of a tax professional.

Trading in options is always risky and is not suitable for all investors. It's possible to lose every penny of your initial investment, and sometimes more. For this reason, you should only place funds into an options account that you can afford to live without.

These hypothetical examples are used for illustrative purposes only and do not represent the performance of any specific investment. Fees, expenses, and taxes are not considered and would reduce the performance shown if they were included. Actual results will vary.

All securities trading, whether in stocks, options, or other investment vehicles, is speculative in nature and involves substantial risk of loss. Strategies that employ options are generally not appropriate for someone with limited financial resources, limited investment or trading experience, and/or low risk tolerance. Each investor should carefully consider whether trading in options is appropriate based on their own experience, resources, objectives, and other relevant circumstances.

Buying calls and puts can be done in a cash brokerage account. Selling calls and puts, as well as more complex strategies, typically requires a margin brokerage account. Margin accounts can be very risky and are not appropriate for everyone. Before opening a margin account, you should fully understand that: you can lose more money than you have invested; you may have to deposit additional cash or securities in your account on short notice to cover market losses; you may be forced to sell some or all of your securities when falling stock prices reduce the value of your securities; and your brokerage firm may sell some or all of your securities without consulting you to pay off the loan it made to you.

Prior to buying or selling an option, a person must receive a copy of "Characteristics and Risks of Standardized Options." Copies of this document may be obtained from your financial professional and are also available at [theocc.com](http://theocc.com).

- 1) Options Clearing Corporation, 2026
- 2) CNBC.com, Jan 27, 2026

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