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Bullish Strategies

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Bullish Strategies

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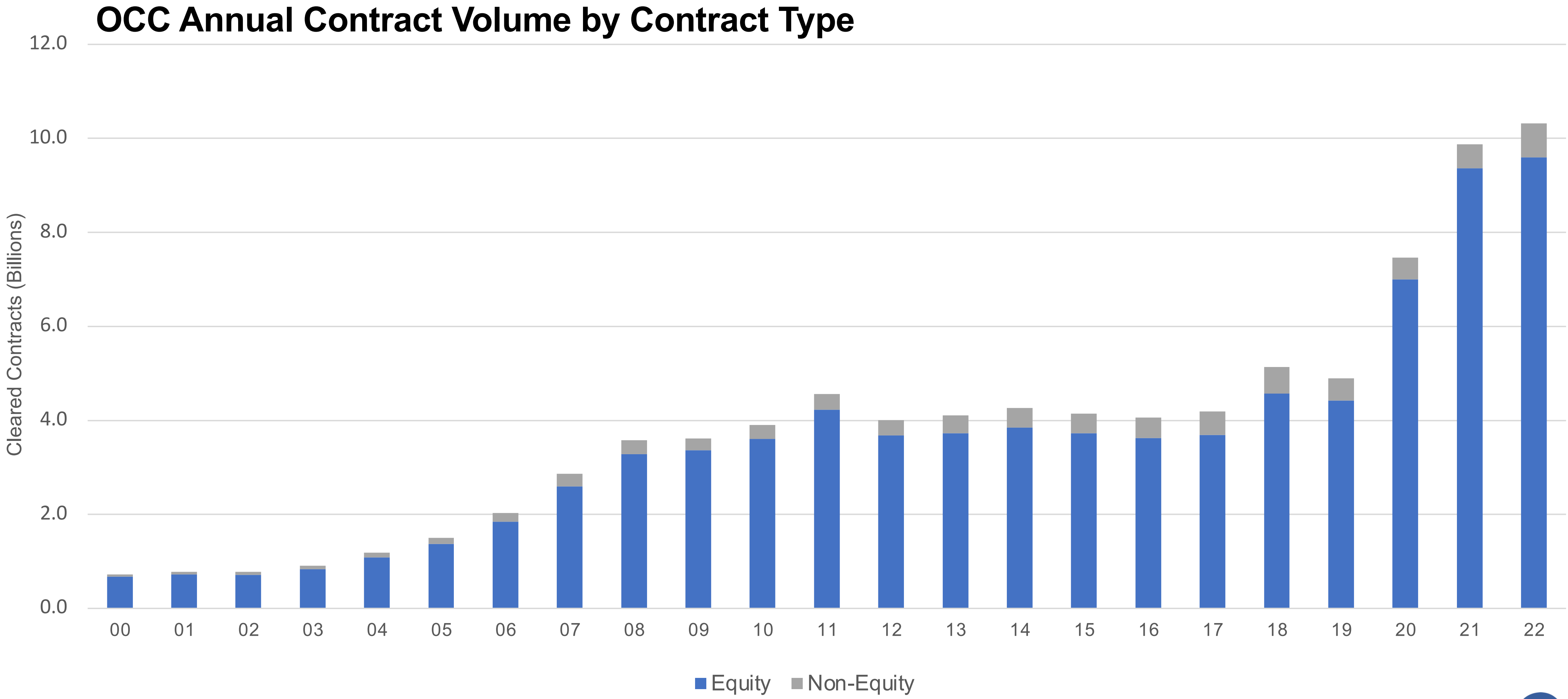
Annual Options Volume 2000-2022



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Presentation Outline

- Long Call
- Covered Call
- Selling Puts
- Q&A

Why Options?

- Options give you more ways to implement your market research
- Options make it possible to target a variety of investment objectives:
  - ***Risk Reduction***
  - ***Speculation***
  - ***Income Generation***
  - ***Stock Acquisition***

- Options offer **FLEXIBILITY!**

Long Call

Equity Call Options

- An equity call **buyer:**
  - Owns the **right to buy** underlying stock/ETF
  - Bullish on underlying
  - Needs stock movement > time decay

- An equity call **seller**:
  - Has the **obligation to sell** underlying stock/ETF
  - Likely already owns shares

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Long Call – Speculating on Upside

- An investor has a bullish outlook on the share price. How can they capitalize on the move without buying shares?
- Strategies they might consider:

1. **Buy a Call**
   - With consideration to time decay, profitability will generally require the market outlook to be correct on direction, magnitude, and timing
2. **Buy a Call Spread**
   - Purchase a call and simultaneously sell a lower priced call to reduce cost and manage risk in exchange for limited profit potential

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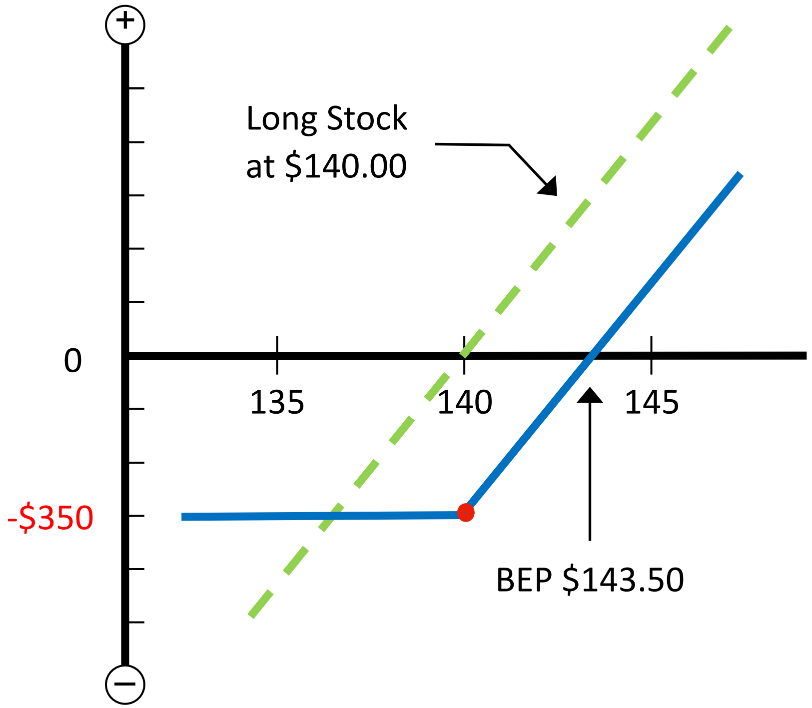
Long Call Example

Buy 140.00 strike call at $3.50

(30 days to expiration, 25% implied volatility)



Break-even at Expiration:
Strike Price + Call Premium Paid
$140.00 + $3.50 = $143.50

Maximum Loss:
$3.50 Call Premium Paid
$350.00 Total

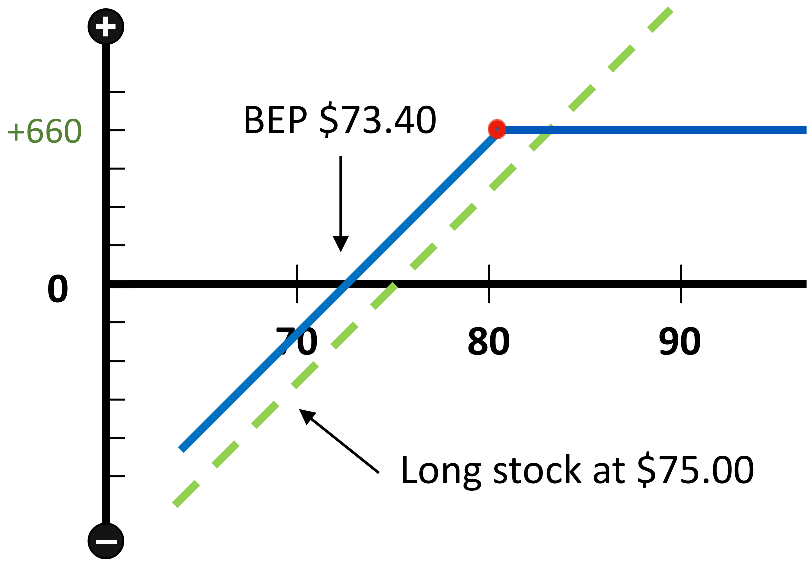
Covered Call

Covered Call – Moderately Bullish

- An investor has enjoyed a nice gain in their stock position. As further upside potential becomes limited, how can they use options to lower risk?
- Techniques they might consider:
  1. **Sell slightly out-of-the money (OTM) calls**
     - Sell call options at a strike price that is considered resistance for the shares (select strike as low as possible)
  2. **Stagger strike selection and sell fewer calls than shares owned**
     - Allows the investor to scale out of the position as the stock rallies and realize healthy gains on a small portion of their position should the stock price rise dramatically

Covered Call Example

Own 100 shares XYZ at $75.00
Sell 1 XYZ 80 call at $1.60
(40 days to expiration, 35% implied volatility)



Break-even at Expiration:

Stock Price Paid –

Call Premium Received

$75.00 – $1.60 = $73.40

Maximum Profit if Assigned:

Effective Stock Sale Price –

• Stock Price Paid

($80.00 + $1.60) – $75.00 = $6.60

• $660.00 Total

Does not include commissions, fees, margin interest or taxes.

Covered Call – Management Techniques

- **Stock Rallies:**
  - Close position (likely when option has little or no time value)
  - Hold and prepare for assignment

- **Stock Consolidates:**
  - Close position by selling stock after option expires OTM
  - Sell another call?

- **Stock Declines:**
  - Close position before losses become too large
  - Roll down strike price of call (possibly to a later expiration)

Selling Puts

Equity Put Options

- An equity put **buyer**:
  - Owns the **right to sell** underlying stock/ETF
  - If speculating, is bearish on underlying
  - If shares are already owned, is buying protection

- An equity put **seller**:
  - Has the **obligation to buy** underlying stock/ ETF
  - Generate potential income while waiting for share price drop

Selling Puts – Cautiously Bullish

- An investor is bullish on the long-term prospects for share price appreciation but considers current levels too expensive. How can their account benefit while waiting for a share price pullback?
- Strategy they might consider:

  Sell a Put

  - Receive premium while accepting the obligation to purchase shares at a carefully selected strike price

Cash Secured Put Example

Stock XYZ at $146

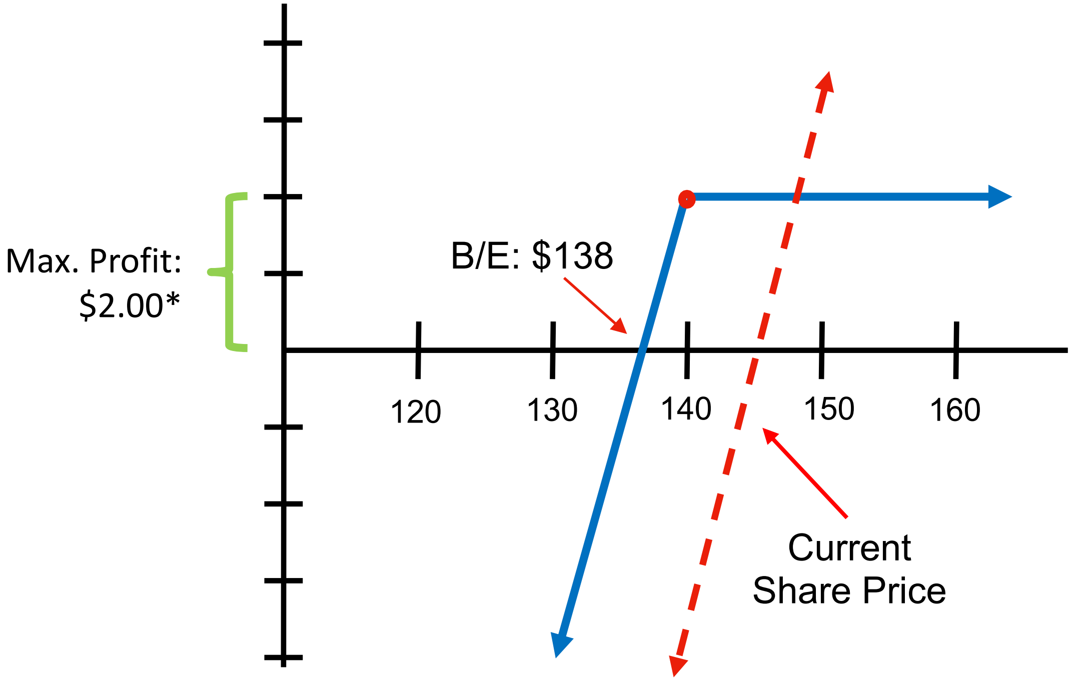
Sell 140 put at $2.00

(30 Days until expiration, 25% Volatility)

Break-even at expiration:

Strike price – Premium

$140 - $2.00 = $138.00



** Max profit of $2.00 does not reflect resulting long stock position should assignment occur*

Not including commissions

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Appendix: Options Basics

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Calls and Puts

Options contracts **give…**

	Call	Put
Long (buyer or holder)	**Right** to buy	**Right to sell**
Short (seller or writer)	**Obligation to sell**	**Obligation to buy**

- 100 shares of the underlying
- at the strike price
- any time before expiration

Exercise: Buy or Sell Underlying Stock

- The option **buyer** has the **right**:
  - to buy (for a call) or sell (for a put)
  - 100 shares of underlying stock/ETF
  - at the strike price per share
  - **if he/she exercises a long contract**
- To exercise, the buyer issues an exercise notice to his/her brokerage firm (or Auto-ex)
- Only option buyers may exercise an option contract

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Assignment: Buy or Sell Underlying Stock

- The option **seller** has the **obligation**:
  - to sell (for a call) or buy (for a put)
  - 100 shares of underlying stock/ETF
  - at the strike price per share
  - **if he/she is assigned an exercise notice**
- Assignment notice is received from seller's brokerage firm
- Only option sellers may be assigned on an option contract

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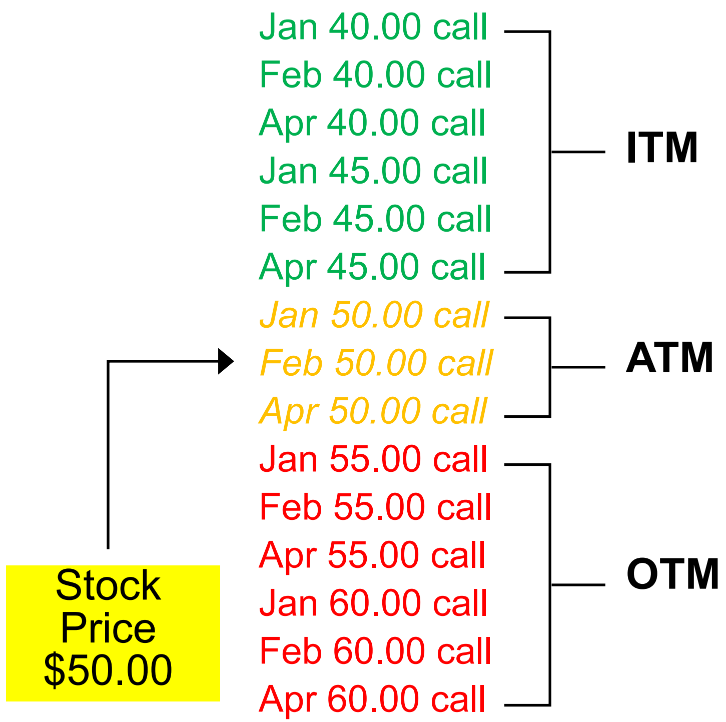
Calls: In-the-Money, At-the-Money, Out-of-the-Money

- Call is in-the-money (ITM)
  - Strike price **below** stock price
- Call is at-the-money (ATM)
  - Strike price **same** as stock price
- Call is out-of-the-money (OTM)
  - Strike price **above** stock price



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Puts: In-the-Money, At-the-Money, Out-of-the-Money

- Put is in-the-money (ITM)
  - Strike price **above** stock price
- Put is at-the-money (ATM)
  - Strike price **same** as stock price
- Put is out-of-the-money (OTM)
  - Strike price **below** stock price

Jan 40.00 put
Feb 40.00 put
Apr 40.00 put
Jan 45.00 put
Feb 45.00 put
Apr 45.00 put
OTM

Jan 50.00 put
Feb 50.00 put
Apr 50.00 put
ATM

Jan 55.00 put
Feb 55.00 put
Apr 55.00 put
Jan 60.00 put
Feb 60.00 put
Apr 60.00 put
ITM

Stock Price $50.00

Intrinsic Value vs. Time Value

Option Premium: Intrinsic Value (if any) + Extrinsic (Time) Value

- Intrinsic value
  - in-the-money amount
- Extrinsic value
  - any premium in excess of intrinsic value
  - decays with time as expiration approaches ("time decay")
- At expiration option worth only **intrinsic value**
  - no time remaining
  - when exercised, only the intrinsic value of an option is received/delivered—extrinsic value (if any) is **lost**

Option Premium and Volatility

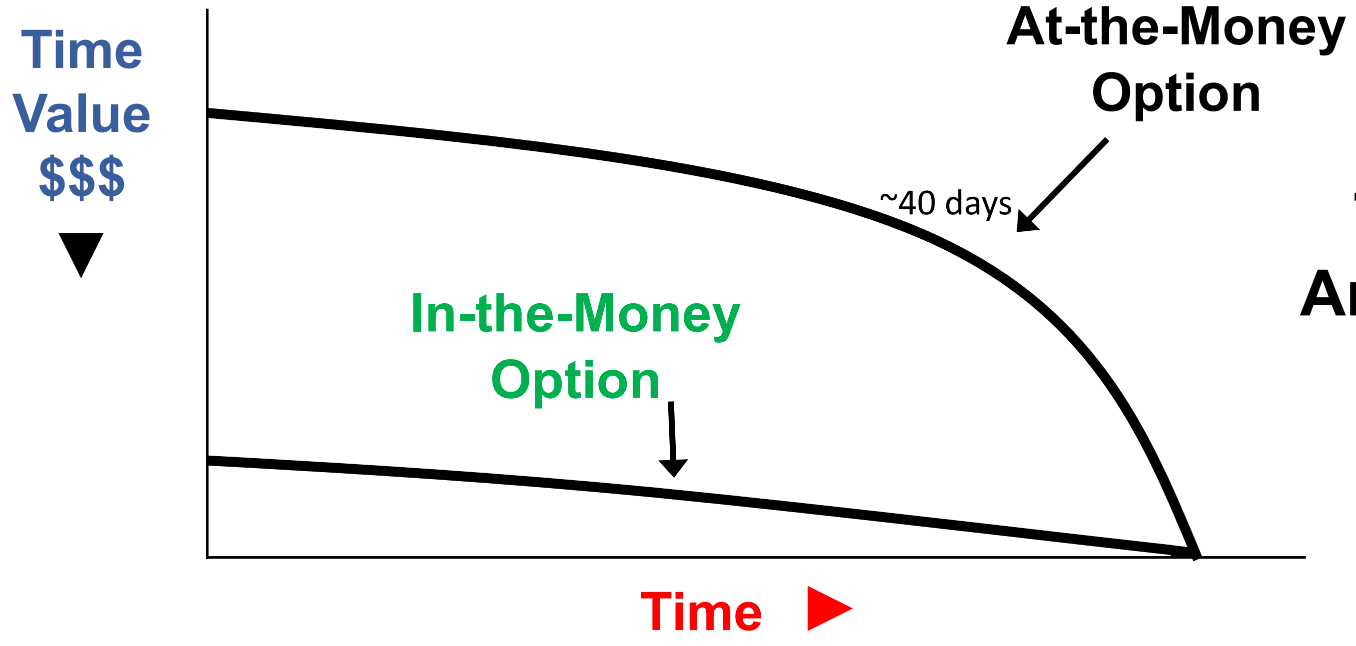
Option Premium:

- Driven by supply and demand from all market participants
- Quoted on a per share basis
- Consists of intrinsic value and extrinsic (time) value

Volatility:

- Historical Volatility (HV) reflects past movements in the stock price
- Implied Volatility (IV) is forward looking and is derived from option prices
- Changes in Implied Volatility have a positive correlation with changes in option prices

Option Theta and Expiry



Theta
Amounts

Overall rate of time decay is exponential (**accelerates** towards expiry)

ATM = decay exponential = volatility is key decay factor

ITM = decay linear = cost-to-carry is key decay factor

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