

# The complete and useful guide to selling puts

Learn when it's best to utilize short put strategies, how to build, evaluate and manage these strategies.



*Presented by:*

**Trading Strategy Desk**

## Disclosures

- ✓ Options' trading entails significant risk and is not appropriate for all investors. Certain complex options strategies carry additional risk. Before trading options, please read [Characteristics and Risks of Standardized Options](#), and call 800-544-5115 to be approved for options trading. Supporting documentation for any claims, if applicable, will be furnished upon request.
- ✓ Examples in this presentation do not include transaction costs (commissions, margin interest, fees) or tax implications, but they should be considered prior to entering into any transactions.
- ✓ The information in this presentation, including examples using actual securities and price data, is strictly for illustrative and educational purposes only and is not to be construed as an endorsement or recommendation.

## Goal of this webinar:

To educate traders on when they can utilize short put strategies. Also to show how to build, evaluate, and manage these trades.

## What we will cover:

- Explanation of the strategy
- Different reasons for selling puts
- Ways to generate put selling opportunities
- Choosing the appropriate strike and expiration to match your outlook and objective
- Evaluating the risks of the strategy
- Discuss different ways to manage the strategy

# Short Put Strategy

## Outlook:

Bullish/Neutral

## Construction:

Selling a put (cash-covered or naked) in return for premium

## Max Gain:

Premium received

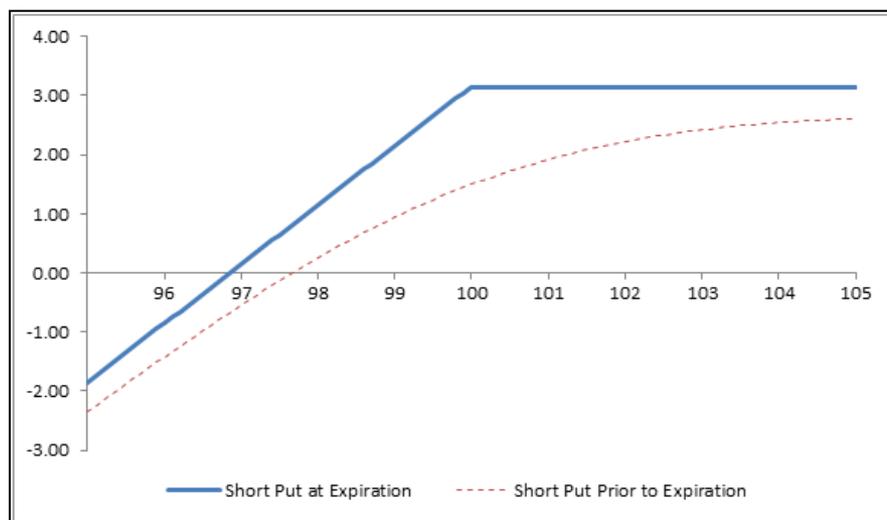
## Max Loss:

Substantial (but limited to the strike price)

## Breakeven @ expiration:

Strike price – Premium received

Profit/Loss diagram and table: Short 100 Put @ 3.15



A full explanation of this strategy is available using the *Option Strategy Guide* in Fidelity's Learning Center

## Trader's View:

- Short puts have the same profit/loss profile as a covered call strategy. Therefore, the short put can be used as a covered call alternative potentially reducing commissions while simplifying position management.

## Goals of the strategy

### Why do traders sell puts?

- **Generate income**
  - Take in premium on a bullish neutral outlook
  - Generate returns in a sideways market
- **Take advantage of relatively high implied volatility (IV)**
  - If you are expecting a decrease in IV, the value of puts will be reduced making them less expensive to buy to close
- **Allows for higher probability trades when compared with other bullish strategies, such as a long call**
- **Alternative to using a limit order to buy the underlying**

### Trader's View:

- The short put allows the trader to take advantage of high volatility in a way that is easily quantifiable.

## Short put vs. Buy limit order

Short puts may be used as an alternative to placing buy limit orders.

### Example:

**YHOO current market price = 49.70**

**Trader wants to own 100 shares of YHOO if price goes down to \$49**

*Example assumes you sell the put at current bid price*

YHOO		Last	Bid	Ask
49.705 ↑ 0.755 (1.54%)				
Strike		Last	Bid	Ask
▼ Jan 30	PUTS			
47.5		1.12	1.04	1.06
48		1.24	1.23	1.26
48.5		1.46	1.44	1.46
49		1.73	1.68	1.69

### Option 1: Place a buy limit order

Buy 100 shares of YHOO @ 49

**Cost basis = 49**  
(if order is filled @ 49)

### Option 2: Sell a \$49 strike put

SPO -YHOO150130P49 @ 1.68

**Cost basis = 47.32**  
(if the put is assigned )

*\*If you are not assigned on the short put, you still get to keep the premium!*

## Risk Management

The Greek exposure of a short put might be the reason a trader chooses this strategy over another bullish strategy, such as a long call.

**Delta (+)** Bullish directional bias : 32 long share exposure

**Gamma (-)** Accelerated losses, decelerated gains

**Theta (+)** Profit \$4.45 with each passing day

**Vega (-)** Profit \$12.58 with each 1% decrease in IV

Strategy	Qty	Bid	Ask	Delta	Gamma	Theta	Vega	IV
Feb 20 2015 121 Put	-1	1.57	1.60	31.975	-4.884	4.448	-12.581	20.80
Summary				31.975	-4.884	4.448	-12.581	

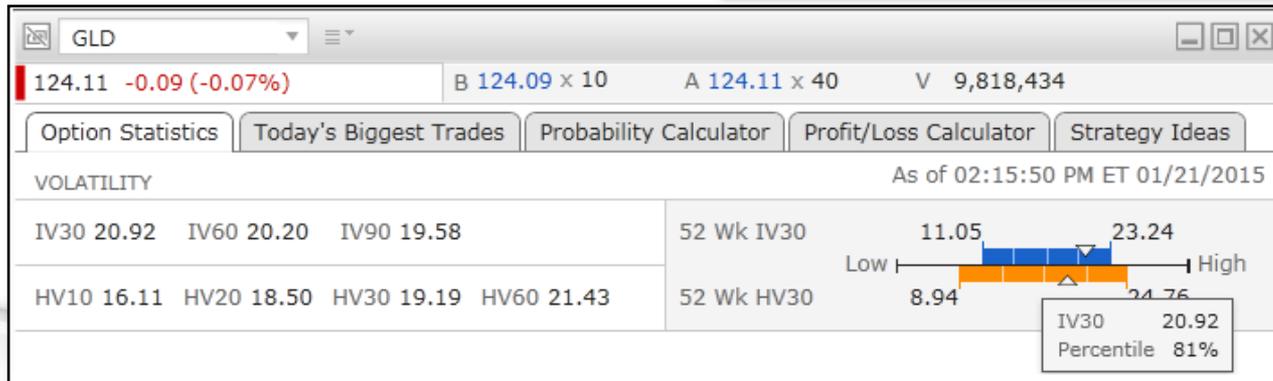
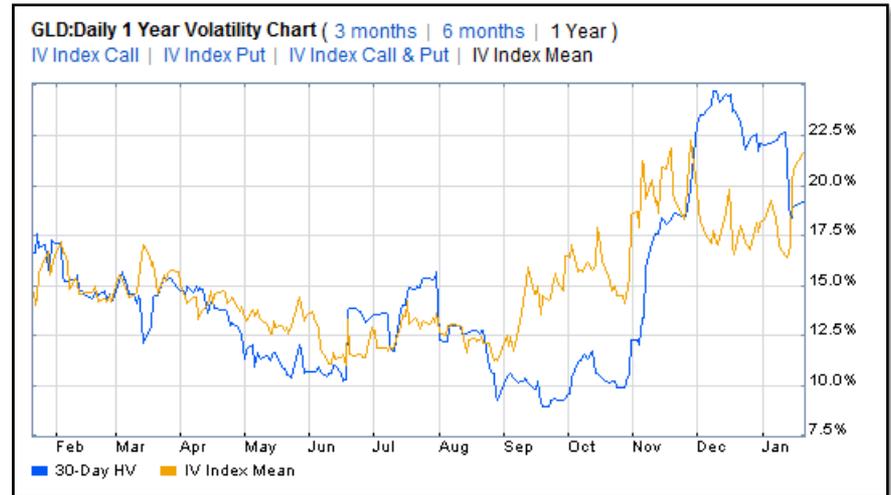
*Profit/Loss calculator in ATP: Simulated a short GLD Feb 20 121 Put, GLD trading @ 124.31*

# Implied Volatility

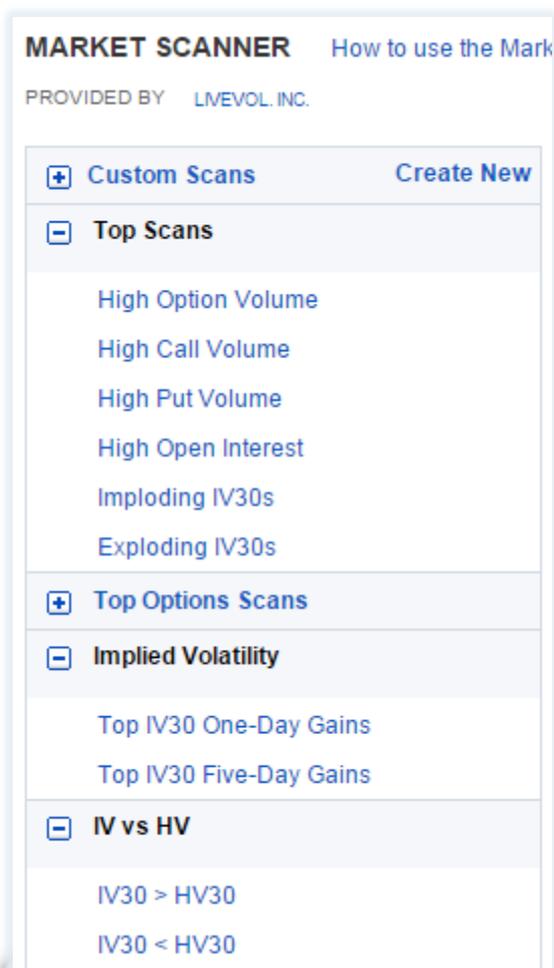
Short puts allow the trader to capitalize when anticipating a decrease in implied volatility (IV).

## Short GLD Feb 121 Put

- Vega = -12.57
- Strategy **gains \$12.57** with a 1% decrease in IV
- Strategy **loses \$12.57** with a 1% increase in IV



# Idea Generation



## Which Fidelity tools and resources can you use to find put selling opportunities?

- To find potential bullish positions
  - Equity Summary Score / Analyst options
  - Stock Screeners (Preset or custom)
  - Trade Central's technical analysis report
  - Recognia event and pattern recognition
- To find underlying products with relatively high implied volatility (IV)
  - Market Scanner
  - Strategy Ideas tool
  - ATP Filter

# Idea Generation

## ➤ Strategy Ideas tool – Cash Covered Puts

**+ Cash Covered Puts**   

**Top 50 Results**

Adjust Scan Parameters

Enter Underlying  Days to Expiration

[Find a Symbol](#)

High yields on out-of-the-money puts. AS OF 12:30:27PM ET 01/26/2015 [Refresh Data](#)

Stock Symbol	Stock Price	Expiry 1	Low Strike Price	Put Bid	Yield to Strike (YTS)	Annualized YTS	Put IV	HV30	
<input type="checkbox"/> ESI	7.97	03/20/2015	6.00	0.56	9.30%	64.05%	123.18	72.80	<a href="#">Action</a> ▼
<input type="checkbox"/> WAC	15.47	03/20/2015	13.00	1.20	9.20%	63.36%	103.62	51.25	<a href="#">Action</a> ▼
<input type="checkbox"/> OCN	7.41	03/20/2015	5.00	0.45	9.00%	61.98%	144.70	171.06	<a href="#">Action</a> ▼
<input type="checkbox"/> JDST	9.03	03/20/2015	5.05	0.45	8.90%	61.29%	175.10	207.95	<a href="#">Action</a> ▼
<input type="checkbox"/> W	20.21	03/20/2015	17.50	1.25	7.10%	48.90%	82.63	62.80	<a href="#">Action</a> ▼
<input type="checkbox"/> HLSS	13.26	02/20/2015	10.00	0.70	7.00%	102.20%	157.50	90.12	<a href="#">Action</a> ▼
<input type="checkbox"/> SGY	14.44	03/20/2015	12.00	0.80	6.70%	46.14%	82.80	89.64	<a href="#">Action</a> ▼

Looks for high yields on OTM puts by comparing Yield to Strike (YTS)  
 $\text{Bid/Strike price} = .56/6 = .093 = 9.30\% \text{ YTS}$

## Strike Selection

Consider tradeoffs when choosing strikes :

UNG					
15.03 0.48 (3.30%)					V 6,821,52
Strike	Last	Bid	Ask	Delta	
Feb 20 PUTS					
13	0.30	0.28	0.31	-0.1831	
13.5	0.42	0.38	0.45	-0.2415	
14	0.53	0.54	0.60	-0.309	
14.5	1.15	0.73	0.81	-0.3835	
15	0.98	0.97	1.03	-0.461	
15.5	1.28	1.26	1.36	-0.536	
16	1.59	1.58	1.69	-0.6072	
16.5	1.98	1.92	2.06	-0.6728	
17	2.38	2.32	2.45	-0.7279	
17.5	2.86	2.62	2.93	-0.7847	

ITM \$16 Put	<ul style="list-style-type: none"> <li>➤ Premium received = \$1.58</li> <li>➤ Break-even = \$14.42</li> <li>➤ <i>Probability of assignment 61%</i></li> </ul>
ATM \$15 Put	<ul style="list-style-type: none"> <li>➤ Premium received = \$.97</li> <li>➤ Break-even = \$14.03</li> <li>➤ <i>Probability of assignment 46%</i></li> </ul>
OTM \$14 Put	<ul style="list-style-type: none"> <li>➤ Premium received = \$.54</li> <li>➤ Break-even = \$13.46</li> <li>➤ <i>Probability of assignment 31%</i></li> </ul>

### Trader's View:

- Selling an ITM put is a strategy which may be used in an attempt to acquire the stock at a discount. Be careful though – if the price goes up, you could miss out on the opportunity.

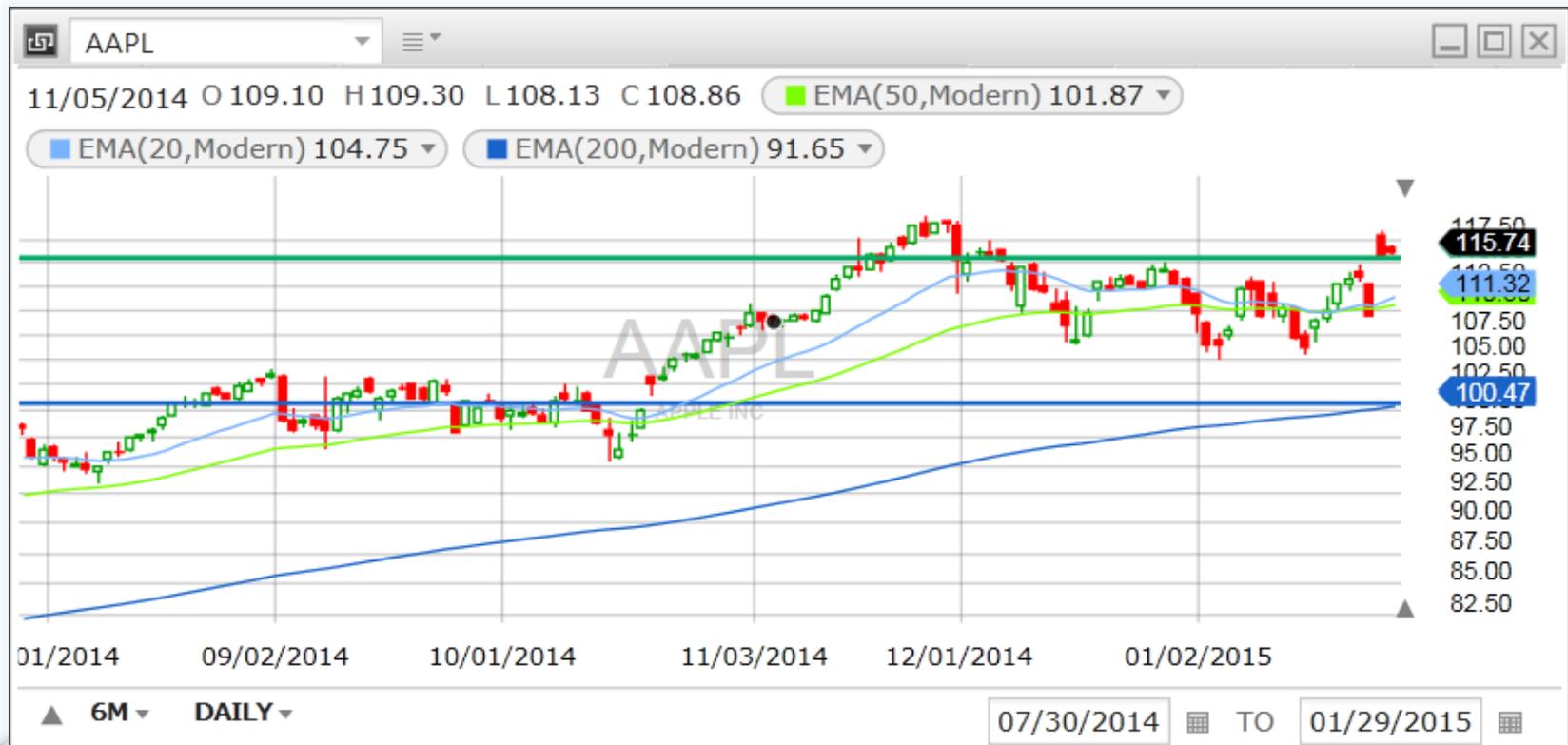
## Strike Selection

Consider your goals and objective for the trade:

	<b>In-the-Money (ITM)</b>	<b>At-the-Money (ATM)</b>	<b>Out-of-the Money (OTM)</b>
<b>Common Use</b>	An alternative to placing a buy limit order	ATM options have the most time value	Income generation Premium selling
<b>Probability</b>	Highest probability of being assigned	Probability of being assigned $\approx 50\%$	Lowest probability of being assigned
<b>Premium/ Risk</b>	Highest premium received	Offers the most exposure to time decay (highest Theta)  Highest gamma risk	Lowest premium received
<b>Position Management</b>	More Aggressive (More bullish)	Balance exposure to small price moves by $\approx 50\%$	More conservative (Less bullish)

# Strike Selection

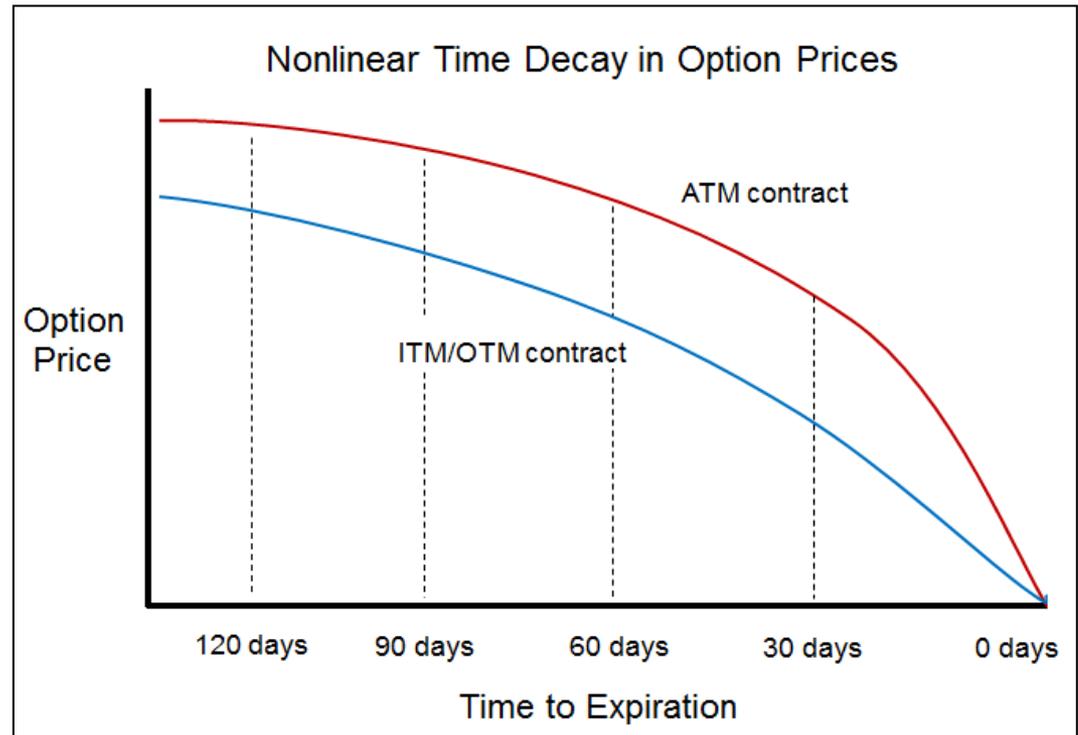
Additional forms of analysis may cause a trader to be more aggressive or passive in their strike selection...looking at key support levels is one example



# Expiration Selection

Strike	Last	Bid	Ask	Theta
<b>GLD</b>				
<b>Feb 20 PUTS</b>				
122	1.58	1.61	1.66	-0.0437
122.5	1.88	1.81	1.86	-0.045
123	2.06	2.03	2.07	-0.046
123.5	2.38	2.25	2.30	-0.0466
124	2.52	2.50	2.55	-0.0471
124.5	2.78	2.74	2.82	-0.0473
125	3.00	3.00	3.10	-0.0471
125.5	3.50	3.30	3.40	-0.0469
126	3.68	3.65	3.70	-0.0467
126.5	4.00	3.95	4.05	-0.0461
<b>May 15 PUTS</b>				
120	3.25	3.10	3.25	-0.0212
121	3.29	3.50	3.65	-0.0218
122	3.73	3.90	4.05	-0.0221
123	4.25	4.35	4.50	-0.0224
124	5.13	4.85	5.00	-0.0226
125	5.65	5.40	5.55	-0.0228
126	5.64	5.95	6.10	-0.0226
127	6.20	6.55	6.70	-0.0225
128	7.05	7.20	7.35	-0.0222
129	8.25	7.85	8.05	-0.0219

Time decay typically accelerates as expiration comes closer, meaning shorter term options have the highest time decay.



# Building the Trade – Choosing an Expiration

Rolling shorter term contracts\* vs. selling one long term contract

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122	1.58	1.61	1.66	-0.0437
122.5	1.88	1.81	1.86	-0.045
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Over a 4 month period....

Write an  $\approx$  30 day option 4 times?  
 $\$2.50 \times 4 = \$10$

Write an  $\approx$  120 day option 1 time?  
 $\$4.85 \times 1 = \$4.85$

All things equal, due to accelerating time decay, rolling shorter term options offers a higher potential annualized ROR

## Trader's View:

- Rolling shorter term contracts gives you potentially higher annualized returns, where longer term contracts gives you income certainty.

\*Please note commissions will be charged for each trade.

## Capital Requirements

Return on Capital (ROC) =  
Premium received / (Capital requirement – Premium received)

### Cash covered puts

- Capital req = Exercisable value

Example: Selling a cash covered GPRO put

- -GPRO150220P47 @ 2.40
- Capital requirement = 4460

(4700-240)

- ROC =  $240/4460 = \text{aprox } 5\%$

### Naked puts

- Capital req = Margin requirements detailed in FAQs on Trading page on Fidelity.com

Example: Selling a naked GPRO put

- -GPRO150220P47 @ 2.40
- Capital/margin requirement = 935

(1175-240)

- ROC =  $240/935 = 26\%$

# Position Management

A trader has 3 ways they can manage any strategy:

## Option 1: Leave the strategy alone

- **Makes Sense When:** I would put the same trade on today

## Option 2: Close the strategy

- **Makes Sense When:** The strategy no longer aligns with the outlook

## Option 3: Adjust the strategy

- **Makes Sense When:** The existing strategy can be altered to better align with the outlook

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## Trader's View:

- Be honest with yourself when re-evaluating an existing trade and manage accordingly. Don't fall into the trap of making adjustments without considering the end objective of the trade.



# Position Management

## Exit strategy:

- Upside: If stock is above strike price, you can potentially keep the full premium.
  - Trader receives max gain if put is held to expiration - No commission charged
  - Establish a predetermined profit target to close trade
    - Less profit potential but the trade off is a higher probability of profit
- Downside: Potential for substantial loss if stock falls.
  - Have predefined risk levels in place should this happen (i.e., percentage of loss you are willing to accept, falls below major support level or change in trend)

## Potential adjustments:

- Let stock be assigned, potentially sell covered calls against it
- Roll the option out (new outlook on stock should match strategy)
- Define risk from the beginning by creating a spread

## Key Takeaways

- **Selling puts is a popular strategy used to generate income on an underlying product that a trader has a neutral to bullish outlook and a bearish volatility outlook**
- **Selling a put can be used instead of placing a buy limit order when a trader is looking to establish a long stock position at a specified price. The benefit is that the premium can potentially reduce the cost basis of the long shares if assigned. However, like a buy limit order getting the long shares of stock is not guaranteed.**
- **Fidelity has tools and resources to help you generate ideas for this strategy whether your objective is to generate income, establish bullish directional exposure, take advantage of decreasing implied volatility or to get long shares of the underlying.**
- **Tradeoffs should be considered during the strike selection process. Consider the potential rate of return vs. the risks being taken (probability of assignment, probability of profit, etc.)**
- **Proper risk management is being able to look at a strategy and determine if it makes sense today and going forward – ignore the past**

# Put Selling

## Resources used in this presentation:

- ATP option chain
- ATP option analytic tools,
  - Option Statistics
  - Probability Calculator
  - Profit/Loss Calculator
- Option Strategy Guide (Fidelity Learning Center)

## Additional Resources:

- Fidelity.com Learning Center
- Option Strategy Guide (Fidelity Learning Center)
- Recorded webinars from Fidelity

## Put Selling

**This concludes today's presentation.**

**Thank you for attending.**

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at (877) 907-4429.

