**TRANSCRIPT**

# Monitoring your option trades: Exercise and assignment

*Presenters: Edward Modla and Bill Purvin*

**Bill Purvin**: Thanks everyone for joining our third session today. If this is your first session, we're going to go over monitoring your option trades, exercising assignment. For those of you cover the earlier sessions, there are quite a few questions that we're going to address in this deck that was more appropriate to bring them up now. But my name is Bill Purvin, I'm a regional brokerage consultant. There are colleagues like myself throughout the country for Fidelity. We're here to help you, you could reach out to your branch and scheduling a meeting if you'd like in person with any of us, we're here make sure that you're comfortable using the tools and resource we have here at Fidelity, and I will let Ed start with the next session.

**Ed Modla**: Thanks Bill, good to be here, and we covered a lot today, simple strategies, rights and obligations, calls and puts. A little bit on pricing, time decay, selecting strike, and actually we've done a lot. So we're going to finish up with session three here, first talking about exercise and assignment, what you need to know and how it works, what exactly it means. Also a little bit of commentary about the possibility of early exercise and assignment, where does that occur, and how often does that occur, and then also monitoring your trades.  I'm going to pick a few examples from our first session today and talk about what you can do give different stock price movements and what type of position management techniques are at your disposal to possibly consider.

First our disclaimers, OCC and Fidelity are not affiliated companies, and options are a complex tool that does require some study and understanding before using them in a live account.

Here is that simple outline for our educational portion of session three.  We'll talk about exercise and assignment, and then position management examples, focus on calls there, buying calls and the covered call, if the stock moves in various ways, what can you do, what are you looking at as far as managing those positions.  Options are not set-it-and-forget-it type of investments, you normally are managing and monitoring those positions every day.  You know, where is the stock today, what is my option price, do I need to do something about this, all sorts of different ways you can manage the position appropriately depending on new circumstances that occur every day.  And of course, within this session, like all others, we will get to the exciting part, which is when Bill will share his screen and we'll walk through the Fidelity platform and some of the things that you have at your disposal with respect to data and analysis, and what you can do, and take advantage of what Fidelity provides for you as you're trading and managing options.

First with exercise, the exercise process. Of course, this is consistent with option buyers, both call and put buyers have paid for the right to either buy shares, that's if they bought a call, or sell shares, that's if they bought a put, that is 100 shares for a standard option contract, each option representing 100 shares of stock, and they have this right to exercise that transaction at the strike price of the option, and they own that right up until expiration. If the buyer would like to exercise this right, they would issue or communicate an exercise notice to their brokerage firm proactively informing Fidelity that you would like to exercise your option contract, that's one way that you can exercise the contract that you own.

Or, we have what's known as auto-ex, let me explain what this is. Once an option has reached its expiration date, the industry has to have some kind of default process where it knows what to do with an option when the investor has not communicated any intentions to their firm. This process is called exercise-by-exception, and what the industry will do in that circumstance is it will exercise all options that are in-the-money by one penny or more, more on that in a second, and it will abandon all options that are out-of-the-money, or not in-the-money by a penny or more, and it will execute those exercise and abandons regardless of what the option holder intends to do, and that happens because the holder didn't communicate any intentions, didn't communicate with their broker at all. The industry then will take up these exercise-by-exception procedures which is also known as auto-ex. When I said that the in-the-money options by a penny or more will be exercised on the holder's behalf, even if they haven't communicated those intentions, that calculation of one penny or more is made by comparing the last traded price in the shares during regular trading hours, or you could say the closing price of the shares on that trading day, compare that value to the strike price of the option and then see if it's in-the-money by a penny or more. Notably what that excludes is after-hours activity. If something occurs five minutes or fifteen minutes after the closing bell, and the stock price makes a big move, the call or put holder is still subject to exercise-by-exception procedures if they communicate no intentions to their brokerage firm. If a call holder has an option that's in-the-money as of the closing bell on expiration Friday, and based on their observation of afterhours market activity, if the stock drops for some reason, and the latest price in afterhours is below their strike price, the call holder has the right to communicate contra exercise notice to their brokerage firm, saying I know this option closed in-the-money, but I still don't want to exercise. So it's a contract exercise, and you can do it on the flipside as well, if you had a call option, say the strike price is 75, the stock closes at 74.90, you're watching afterhours activity and for whatever reason the stock jumps up to 76, and you think to yourself, I want to exercise these calls, because come Monday morning, the stock's going to be way up above 75, contact your brokerage firm, contact Fidelity and say, yes, I want to exercise, I know it expired out-of-the-money, but I have a right to exercise or abandon, I paid for that right, I want to exercise anyway. That's a contra-exercise notice that you can communicate. It's also important to keep in mind all of this from the seller's perspective which we're going to get to in just a minute. But that's exercise-by-exception, auto-ex and the importance of communication.

But really exercise for calls is normally not going to occur in the absence of a dividend. Think about what it means to call, to own a call option. If you exercise it, you are buying shares of stock, you're paying for shares of stock. And remove the circumstance of dividends for just a moment. If you own a call option and you would like to continue to profit on the share price appreciation, you don't need to exercise before the expiration date to capitalize on that move, you can just simply hold the call option. You don't need to exercise and pay for shares before or earlier than you have to, just hold the call option. If you're ready to close this trade and move on to a different trade cause the stock's already made its move, you've made your money on it, again you don't need to exercise early, buy the shares and close the shares, you don't need to do that. You can just simply sell to close the call option that you own, and exit the position that way, not exercising early.

The circumstance of a dividend changes things. Call option holders are not shareholders. Therefore, call options holders are not entitled to a dividend payment. We all know that on the ex-dividend date, the share price is going to drop by the dividend amount. If you own a call option, particularly if it's in-the-money, then your calls would suffer from that share price drop by the dividend amount. If you own a call option and it's in-the-money, on the day prior to the ex-dividend date, you might consider exercising early so you can become a shareholder of record on the record date, and therefore be entitled to the dividend payment. It can get a little more complicated than that, I'm not going to push it too far for this discussion here, but for those of you who are a bit well-versed with options, I'll just state that if you do exercise early to capture the dividend, you now have risk associated with long stock, you're no longer long calls, which has limited risk, you're long stock. So again this pushes the conversation a little bit further, if you wanted to maintain the same controlled risk profile of long calls, after exercising, you would also need to buy the corresponding put option. Long calls is equivalent to long stock and long put, so you might hear some traders say that they will exercise their call option if the dividend they are about to receive is greater than the cost of the put option that they need to buy to maintain the same risk profile.  That was pushing that conversation a little bit deep, but dividends can get that way, backing up a little more simplistic discussion, the day before the ex-dividend date is when you will see exercise activity for in-the-money call options, and that is call-holders attempting to become a shareholder of record on the record date and therefore entitled to the dividend payment.

We really exercise for puts.  I'll start the same way, it's not likely to occur if the put holder would like to get out of their trade, they can just simply sell the put to close.  For put options, early exercise becomes possible when the put becomes very valuable, it's deep in-the-money.  You have a strike price that's far, far, far above where the stock is currently trading.  The rationale for exercising early for puts is you have this extremely valuable put option, and it's sitting in your account as a position.  If you exercise the put, what that means is you're actually going to get paid cash.  Yes you deliver the shares, but you are paid cash.  You're exchanging a valuable put option for cash.  You know, often market participants might determine that it is worth getting the cash today rather than waiting until expiration, so early exercise for puts, very simplistic explanation there, possible if the puts go deep in-the-money and increase in value significantly.  Talked about this communication line and how important that is. We're going to compare exercise to assignment but for the exercise process, the communication starts with the investor who communicates with their clearing first, or communicates with Fidelity their intentions, whether it's exercise or abandon, the investor has the right to do whatever they choose, no matter where the stock is, no matter what the strike is, no matter what the moneyness of the option is, the investor has the right to decide if they want to exercise or abandon their option. If they communicate nothing, then the clearing member firm has no instructions to give to OCC, this is the clearinghouse, then the default process of exercise-by-exception would kick in, and all in-the-money options by a penny or more again calculated as the difference between strike price and last traded price during regular market hours, that process would kick in with in-the-money options being exercised, and all other options being abandoned. Bill, what do investors need to know specifically with respect to Fidelity's process here, communication lines, how Fidelity handles exercise, any unique details that investors need to be aware of?

**Bill Purvin**: Same thing that you mentioned there, penny in-the-money, they're exercised. I think if you're reading an older book, the numbers were different years ago. I think when I first got in the business, I think it was 25 cents in-the-money. A couple years ago, I think it was nickel on options that were equities, and a penny on the index options. Now it's pretty uniform, a little bit easier. So if you're reading content, just understand the rules have changed over time. So if you do nothing and they're a penny in-the-money, that will happen to your account, you'll see trading your account on Monday, share -- if you did a covered call, the position will come out of your account, based on the option exercise. If you want, so here's the thing I have to think, a lot of clients get a little confused if you're first starting to trade options. If you made money on your option, you don't have to exercise it to make the money. You can sell your option in the marketplace. I think some clients, and we've heard this numerous times where they think they have to exercise to make their profit. Your option's going to go up in value if the stock goes higher. Other things will move it, time and that, but just understand, the best trade might be just to sell your option. If you're long, you're selling options and you don't want to get exercised, you have to pay attention to next dividend dates, so we'll cover that in more detail.

**Ed Modla**: Yeah, and in fact that closing transaction you just referenced, that is what most investors do, said in one of the earlier sessions, about 70% of all options transactions that are opened are closed, never make it to expiration, never get exercised. It's really only about 10% of all open positions that go through the exercise and assignment process at some point, but it's imperative to understand it, what it means, and how it works, because if you're a buyer or seller or both, sooner or later at some point in time you're going to encounter exercise and assignment, and you want to make sure you understand completely what's going on in your account so you don't have a stock position on the next trading day that you didn't expect to have.

That leads us to assignment where that discussion becomes a little more important because assignment occurs for option sellers who've taken on obligations, and they don't have the choice that option buyers have.  Option buyer always can decide, do I want to exercise, or do I not want to exercise, and they have total control over whether they're closing the option or they're taking a stock position.  Option sellers have been paid premium up front and have taken on the obligation to facilitate the other side of that stock transaction at the discretion of the option buyer, and for a call option, that would be to sell shares of stock, for a put option, it's to buy shares of stock at the strike price.  Assignments are noticed, or are given notice from the brokerage firm, there will be a communication line, Bill will talk about that in a little bit, on the timing and how you know that you've been assigned, through what's a regulator-approved process that goes through a few different tiers. But if assignment, there's no control that you have assigned of, say, option-writers, don't have the ability to request to be at the front of the line for assignment, or the back of the line. There is a random process that occurs on a couple different levels that will ultimately assign an individual account, and when doing so, the obligation needs to be fulfilled, whether it's selling stock, or buying stock, fulfilling those obligations is something you have to be prepared to do.

The communication line here is going to work in the opposite direction. As we mentioned before, it's that assignment process that comes to play here. All options positions are held ultimately at the clearing corporation, all long and short positions. Remember that exercise process, communication line went the other way, OCC gathers and puts together all of the exercise instructions including the exercise-by-exception exercises, and then knows which firms have open short assignable positions, and through a randomized mathematical process, again approved by industry regulators, OCC will assign a clearing member firm, or a number of clearing member firms randomly, of which Fidelity is a clearing member firm. So OCC might inform Fidelity that they have been assigned on a certain number of contracts. In turn, there's a second random process, regulator-approved, that Fidelity would implement to assign individual accounts, and then that's where that communication line comes down in the opposite direction to investors and traders. And you have to be careful, when you're short options, you don't have control. You are going to have to fulfill those obligations at the discretion of the option buyer who has the right to exercise their contract, that's the right they paid for, and being prepared and capable to either sell stock or buy stock depending on whether it's a call or put you received, sold, is something you have to look forward to and make sure you can handle.

So Bill, opposite side here, different risks. I know there's pin risk here, we didn't talk about that. But what kind of things come to mind that investors needs to know with the process, or just the risks involved with being short options that potentially could be assigned?

**Bill Purvin**: So the issue, like we said, if you're the owner of the option, you control it; when you're selling the option, you don't control it. And when we talk about, you know, your assets, you're talking about your capital, you're committing to trading. If you own a call and you say, well, I made some money here, I want to exercise that, why would you not want to do that? Because you're committing more capital, more cash. You don't typically do that. If you're going to exercise your call early, and you want to get the stock, you're doing that because you want to commit more capital, which you typically don't want to do, and you think it could go a lot higher past your expiration date, or something like that. You could just buy another call further out. That's a challenge that I think clients -- I get very concerned when a client wants to exercise a call. Why would you exercise a put now, because now you know the stock's completely broken down, I owned it, I bought that for protection. You've got capital committed to that. Maybe you want to put that capital into something else with more opportunity, so you might want to do an early exercise. If you're going to get early exercise too, if you sold covered calls, you have to know the ex-dividend date. Remember that date, very, very important. When you look at the option chain, we're going to show you that date, and we'll go over that later when we pull up the deck, I mean get off the deck and we pull up the trading platform.

**Ed Modla**: And I want to ask you, I was going to say, I was going to ask you, because this idea of being short options, having an assignable position, and there's a term called "pin risk" that really only applies to options sellers and the possibility for being assigned, and that's the uncertainty that investors have when they have a short position that could be assigned and the stock's trading close to the strike price. When that's the case, investors really don't know if they're going to be assigned or not, and so they're not sure what position they may have come the next trading day, now certainly possible that your position is well-constructed and you can tolerate assignment or not, and you're fine either way. But if you find yourself in that position of the stock trading close to the strike, assignment being something that you need to know to manage appropriately, you know Bill, it's really lucky, you have to close the option, you have to buy to close, otherwise there's really nothing else you can do without taking on the risk of having an assignment, or having the option abandoned, and having a position you didn't want.

**Bill Purvin**: And here's the benefit of trading at Fidelity. So when you have sold a covered call, like Ed mentioned, you run the risk of getting assigned. Maybe the goal is not to get assigned, and it's trading right near your strike price, and you'll see it fluctuate up and down, up and down that last day. What you can do here at Fidelity that you can't do with any of our competitors typically is actually buy back your option at no charge. So if it's trading at 65 cents or less, there's no contract charges. Where in the world now, there's no commission charge for the most part, but your contract charges are typically 65 cents a contract. If you buy them back to close, and they're trading at 65 cents or less, there's no charge. So to take the risk off, because it is a risk, you do that here, where it's a little bit harder to do that somewhere else. So when you've got a penny or two pennies or three pennies, and you don't want that, just take it off.

**Ed Modla**: Yeah, that certainly is a tremendous benefit, and for any option sellers out there, I agree. Sometimes it can be difficult to buy it back because you see an option trading for 40 cents or a quarter, and you're thinking, it's going out worthless, I want to squeeze every penny I can out of this trade, I've been there myself, many, many times. But there are certainly circumstances where its' best to close, pay that little bit, you know as Bill said, to not have that options transaction cost, and you're paying those low premium amounts, and eliminate the potential for something bad to happen, you know, you can squeeze every penny out nine times in a row, ten times in a row, 20 times in a row, but that one time something bad happens, it can really hurt. In my 20-plus years in the business, it can happen to me, I could probably count on my fingers how many times it's happened, but it has happened. And you know, one, the worst instance that ever occurred for me I recall having a covered call trade on, the short call option was about 50 cents in-the-money at the closing bell. I didn't bother doing anything with it, I let it go, figured my shares were getting called way, and afterhours activity, market crashed down, and opened up Monday morning, unassigned with the long stock position, and it was trading down about 6% that next trading day, it was really painful. I could have just closed the position out. Didn't do it, was squeezing pennies out of it, and it ended up costing me. So it can happen if you trade options long enough and often enough, it will happen that you either are assigned or you're not assigned, and it's a surprise to you, and you have to be prepared for that.

Let's look at position management. Here, we're going to go back to our first session on the day focused on calls, just to showcase, again, that flexibility of the options product, and different things you can do, different choices you have as the stock price moves and you're monitoring your position. Now what are the different things that I can do? We're just going to reflect on this example again compared to long stock, which you have here at 60, remember this would be buying 100 shares of stock, paying $6,000, that's a significant cash outlay, that's much more monetary risk, but a clean breakeven at 60, and the potential to make money right away as the stock moves up, that's your benefit to the long stock, long a call option is going to cost you far, far, far less capital, in this case we buy one call option that represents 100 shares, we pay $300, that's a lot less than $6,000. However, the call option needs the stock to move higher, the stock needs to move higher by a certain magnitude, and it needs to occur within a certain timeframe. All of those things need to happen, otherwise we risk losing 100% of our investment. This is the long call, and let's say for example we have this trade on, stock's at 60, we're long the 60 strike call.

What do we do if the stock moves higher, it moves in our favor, certainly you're monitoring, holding for further gains.  You can start to set limit orders out there on the option to try to get out of your trades, and I'll ask Bill about this in a minute, but investors that I speak to tend to exit their trades on a more imminent fashion, they're putting in their orders, they're getting in, they're getting out.  They're not resting as many orders out in the option space, that's just my experience, but you can continue to hold for further gains, as the stock price appreciates, if you think and you truly believe those further gains will come to fruition.  Selling to close could be selling all or some of your position, it's always easy to forget, but something everyone should be familiar with and always consider is starting to scale down your position.  Sell to close the call option that you won to start capturing those gains and those profits.

Rolling up to a higher strike, this one is interesting, if the stock were to rally significantly, and you have a call option now, that is very valuable, its premium is extremely high, you have a huge gain on your hands, and you'd like to continue this trade, because you think the stock's still going, but you don't want to risk giving back all of this premium that is sitting in the option you own. Well one thing you can do is roll up.  When we say "roll," there's a lot of different terms that are attached to the word "roll," roll up, roll out, roll up and out.  All rolling means, is you're closing the existing position and opening up a new one, that's all you're doing, that's all rolling means. So rolling up to a higher strike, let's say for example, you buy the 70 strike call, stock was trading 65, and who knows what, buyout rumor, something comes out, stock shows up to $100, and you're long the 70 strike call, it's worth over $30, you think it's still going to go higher, you could sell the 70 call for $30, and buy say the 90 call for $11 or 12. Put all of that money in your pocket, and now still own a call option at a higher strike price. You're going to give up a little bit to do that, I remember you rolled up, say from 70 to 90 in my example, that's $20 of value. You're not going to capture $20 if you do that, you'll have to give up a little bit, but this is a little bit more complex management technique, but rolling up, particularly when the call option has moved in your favor in a significant fashion, you can sell the option you own, buy a higher strike price, you'll get a credit, put money in your pocket to do that, and now you'll own a higher strike price. That's an interesting one that people tend to overlook.

And the of course, exercising at expiration, you can hold the trade. This is not as common. But let's say maybe you bought a call option because you didn't want to pay for the shares, you weren't too confident in the price movement, but by the time you get to expiration, all of a sudden your opinion has changed. The stock has moved, it's looking strong, it's looking stronger, and you're comfortable going ahead and exercising, experiencing that cash outlay and buying shares, something you can consider. And then of course as we discussed, if there's an ex-dividend date upcoming, then you might want to consider that.

Before we move on there, you know, Bill what do you think about this, as far as order entry, and my comment there about, you know, leaving limit orders, sort of dangling them out there, maybe using stops, I don't see investors doing a whole lot of that with options. But I think everyone's experience is a little different, so I was wondering what you thought about that.

**Bill Purvin**: When I try to get in and out of my option trades, I prefer doing limit orders. I just prefer having some control, a little bit more, especially if this spread's like 15, 20 cents wide, and say it's like 10 cents to 30 cent, bid offered, 10 cents to the bid, 30 cents to the offer, I'll go below offering, offer 25. Does it trade, you know what was the last trade at? Is it trading a couple hundred a day, or thousand a day, I would try that. If it never trades, you run the risk of not getting a trade. But I'm always trying to put more money in my pockets, so I like doing limit order, I always like narrowing the spread if I can. You'll often see you'll get joined on the offering sometimes when you go low offering. So just understand that.

A lot of questions too about managing the trade. Like here's the option chained on a stock, and you see there's a big E here on the option chain here, and I just want to discuss a trade, like the mechanics of the trade, why you do the trade, and how you evaluate it after the fact. Say for argument's sake that you think the earning's going to really crush it. And I had a situation in my own account where I saw the stock, I'd beat the last couple of times, earnings numbers are coming out for companies similar in the business that were all gapping up, big numbers. And I had a trade going into earnings. And the one thing you know when they release earnings, they're going to release future guidance too, and when the future guidance can be the big deciding factor. And I bought it with a pop, and I'm making money on my option before they release the earnings. I could have locked in more profit. Earnings came out, because I did the trade based on the earnings data coming out and beating, and knowing how volatility gets impacted by earnings too, volatility is going to push option price to go into earnings a little bit higher. After the option, if the earnings get released, you're going to see the volatility get sucked out of those options after that. They're going to move a little bit lower because of that. But when I did the trade, they came out with the earnings numbers, and stock didn't gap up like I thought it would. And then it started to sell off. I took myself out of the trade, because my idea was, we're going to really beat on the earnings number, and I think I'm going to do really well when that happens. It didn't happen; my thesis didn't work. I made money on the trade, but I didn't make as much money as I expected to do when I initially did the trade. And the key thing here is if you're in the trade and the thesis was this, and then you're saying, well now I'm hoping this comes, hope isn't a strategy. So if you've changed your whole thesis because of what's happened, you're probably in the wrong trade. So I think it's always good to be reflective, understand why you did it, and what's changed since you've done it, and what could potentially happen going forward. Because there -- I was not going to be in that option for the next earnings date. And I already had -- my options had the earnings date that came into play already, so I was done, moving on to the next trade.

**Ed Modla**: I completely agree with what you were saying there about limit orders, I should have been more clear. Limit order is by far and away the most popular way to go, splitting the difference between the bid and ask, working your prices, what I was trying to refer to were more or less, good 'til cancel limit orders that go from one day to the next to the next, those are a little less popular, because if you're good 'til cancel, that works one day, you run that gap risk of the market being a little bit wider, or having a big move and getting filled at a level that you were not comfortable with. So limit orders for sure, the most popular in my experience. Day limit orders tend to be a preferred approach.  But good 'til cancel, certainly, is something you can consider as well.

That was the interesting part about long calls is when they're working in your favor, there's all sorts of different things you can do.  The other two possibilities, you know, there's not as much.  Of course if the stock is unchanged and you're long this call option, it's going to suffer losses.  You're going to have days pass, and that effect of time decay work against you.  Do you hold and risk everything that you paid?  In our example on the previous slide, we paid $300.  Are we willing to risk $300, or are we going to watch to see what happens if the stock isn't moving as I expected it to move.  Do I see the option premium get down to 250, 200, 150, and do I cut my losses somewhere?  Your decision on when and if to cut losses might be a result of your continued analysis of the stock itself, if you have maintained your confidence level that the stock is going to rally, you might be willing to hold onto that call a little bit longer and give yourself more risk of loss from your original premium paid.  But if your confidence level is fading, that might be when you set a level, as soon as you see the bid-ask reach a certain point, you cut your losses, and you move on, and that's what managing risk is all about, mitigating loss, sell-to-close to prevent that time erosion from continuing to work against you.

If the stock is down, this is of course what you don't want to happen, this is not what you expected to happen, you're bullish if you're long call, if the stock's moving lower, then the stock price action is working against you. If days are passing, that's also working against you. You can hold in anticipation of a rally, you can sell-to-close to prevent further loss, but at some point, selling to close just might not even be feasible if there's not enough premium there to capture. Sometimes investors will ask, you know, I bought a call option, it didn't go the way I wanted. I lost almost all the value in this call. What can I do to salvage this trade? And there's nothing you can do. Once the trade is gone, once the money has been lost, and the value of your call has gone all the way down close to zero, the trade's over. Anything further that you do is not trying to salvage a loss or prevent a loss, it's an attempt to initiative a new position to make back the money that you lost. There really is no way to manage the position once it has gone far and away from you. Now when it is down, there's one little intricacy that I will point out with long calls, is just getting out of your trade, you know, when you look at your stock and your premium, when the stock goes down, your calls are falling further and further out of the money, your premium is dropping rather sharply. Once you get down there, it's similar to that analysis from a call-sellers perspective. Is the premium I'm selling worth it? Even if the stock's selling off, even if days are passing, is the premium worth selling, or should I just hold the call option and see if we can get a turnaround, if you've lost it, and it's gotten to that level, then you might have to consider just moving on or just holding the trade.

Let's look at covered calls now and do the same type of thing where we're going to discuss, what do we do if the stock moves higher, unchanged, or lower. Back to our example from earlier, we bought shares at 75 thinking the stock was going to rally, and we'll say it didn't happen, the stock has sort of sat here and consolidated around 75. Our confidence is a bit more faded. If we were long calls, we're very aggressive, we're very confident, covered calls are going to be more conservative here, not so sure the stock is going to go too much higher, but still bullish, still at least somewhat bullish, but now that big move we don't think is coming, so we willingly take on the obligation to share our shares at a strike price of 80, selling one call option at a strike price of 80 obligates us to sell the shares we own at 80. We're happy with that, because we bought the stock at 75. We'll gladly sell them at 80, and we are paid the option premium to take on that obligation. It changes our risk profile from being long stock with your clean breakeven at 75, to having a new breakeven point, our new cost is $73.20, $75 cost of the shares, $1.80 received in option, $73.20 breakeven cost basis, better likelihood of being successful, and we outperform long stock at every price level until we reach $81.80, 81 spot 8, and then above that level, the long stock outperforms the covered call.

Let's look at the three different situations. Stock is up, it's moving in our favor, we're watching this trade work out as we expected, what do we do? What we're going to want to track the value if we can, the net value of the position, that's the stock and the option. Remember the stock, of course, is an asset, we own it, and it's going to have a positive value in our account. The option was sold; we are short the call option. That's going to have a debit value attached to it. If the stock is up and it moves above our strike price, we're going to want to watch the difference between the positive value of the shares and the negative or debit value of the stock, and once that net different reaches very close to our maximum gain, we might want to close that position. We're going to hold to an attempt to get maximum gain, but if we observe a week or two weeks or three weeks prior to expiration, that right now, we have almost reached maximum gain, we're very close to our maximum potential, that might be a time to think about closing the position. You would do so by selling stock and buying the call option back likely at the same time as a simultaneous trade at one singular price. But again, the reason why you're monitoring and thinking about doing that with the covered call, is because once the net value between the two has reached your maximum gain, you have nothing left to profit. You do have risk if the stock were to sell off and move in the other direction, you still would stand to lose and possibly significantly if something terrible happened in the market, with nothing left to gain. All risk, no reward, that is a time to consider closing and moving your capital into a new position, or just sitting in cash waiting for a new position that is appetizing to you.

And then of course as opposed to closing it, you can wait for assignment to occur. This is an attempt to squeeze out every single penny of your maximum potential gain from the covered call position, hold it, wait 'til assignment, get called away. There's a bit of a difference between these two, a subtle difference. Again, I've done both of these in my career, I've gone back and said, well there's not much left to gain in this trade, I'm getting out, because there's still risk. There have been other situations where I thought I'm squeezing every penny, I have no risk, no concerns, let assignment occur, let the shares get called away and move on. Just know that if you accept assignment, you are trying to squeeze out every single penny that you can get out of that trade, whereas closing it is mitigating risk, accepting that you're not going to quite get to that maximum level. You're going to get very close to it, but take your risk off the table. Some of that decision might be, you know, how much time is there left until expiration, you might want to consider that.

The longer you have until expiration, if you're close to maximum gain, the more you might be interested in closing, and moving on.

You know, Bill, I'll bring you in here as well, because this is again, the more interesting part of the covered call management position, when stock's up, you know, when it's moving up and it's above the strike price, there's different things you can do and consider, so you know, what are your thoughts on what investors realize here, and what have you observed? Are they making the appropriate decisions and looking at the right things when they're analyzing position management when the stock's higher?

**Bill Purvin**: Well again, I think it goes back to when did you do the trade, and what was your thought process when you did the trade. I think the biggest challenge I think is when you do a covered call and it's going to get called away from you, and I don't want to sell my stock, you fall in love with your stock and you don't want to sell your stock. You do a covered call, you're going to be selling stock. Unless you manage it very aggressively, typically now that will be called away. And what's the benefit? The benefit is, you kept your premium, and you no longer have risk in the market. You have all the cash from the strike, you can go -- it's an IRA, you can buy it back, any stock you take a profit in, you take a loss in, if you take a profit, you can always buy back your stock too. I don't like doing that, but I think some clients do get challenged with that, is losing stock. The nature of a covered call is you're willing to sell it at the strike. You could roll out, try and buy back one that's maybe expiring in February, sell one out in March with a higher strike, not getting much money, you have to put in play to buy that back. Sometimes you construct them for maybe no out-of-pocket expense, and maybe get some cash. But you know, there's nothing wrong with getting called away. You never go broke taking profits, and that's really what the trade is designed to help you do. And I think the other thing that helps, you get a range-bound stock, and you sold it at upper range you get called away there, sometimes you could buy it back cheaper a month later. I did it my own account one time, I'm like, they called it away, I have no idea why they wanted it early, sold it next month out. You'll get called away again. That doesn't always happen, but if you have a stock that's going to want to rip, it's gonna rip. And you know, you're gonna miss out on opportunity, but that's the nature of the trade, you understood that going into the trade.

There were some questions about actually doing the trade, like how do I do these buy writes? So, if you already own the stock, you go to the option chain and you click on the bid here, it'll build the trade automatically, you just have to fill in how many shares you have. If it's 200 shares, you're going to do two contracts.  You could do one, you could do one of one strike and one of another, but if you have 200 shares, you can do at most up to two contracts for a covered call.  If you don't have it, can I do a prior?  If you go out here on the option chain, there's a buy write choice right here.  It'll build all the different options you can look at here, for this month.  If I click under here, I can do the trade that way too, so it'll build out the whole trade together where you're buying a stock and selling a call together.  When you do the trade together, you're doing it at a net cost.  Your net cost is what's coming out of your pocket.  So the buy the stock, sell the option, and net-net, this is my price per share.  So, I like doing trades that way too.  If you're looking at the option strategy tool over here, it actually has that built in here.  So just say, for example, it was this stock right here, here's the buy write, I've already built in there with the back test for the past two years what trade works better.  So this is a tool that can help.  We're covering a lot of specific tools to show you what the program can do, the website can do this to.  If you're not sure, you go onto help here, and we'll explain these different topics, whatever link you click on here, you'll get to that particular area about that.

One other question that came up in the question, the Q&A is, how do I figure out do I buy the stock, or do I buy a call here?  There's actually a very useful tool called the profit-and-loss calculator, it's at the top here.  I've prepopulated it just to make it a little bit easier to look at here. But this is the tool, there's a lot going on here. We could spend an hour just going over this tool here, but I just want to know, you to know it's there, and where it can be helpful. On the bottom here, you can add [assimilated?] position, so when you click on here, you can actually add a stock trade in here, because one of the questions was, should I buy the stock or buy the option? You could add the option in here too, or put. They're actually, in the tool down here on the bottom, I've entered both trades in here. Buying the stock here, a thousand shares, or buying ten options, which represents ten shares. And if I have this in here, I can put in my theoretical price, where do I think it's going to go? You have to have an idea where you think the stock will go, to figure out what trade to do. How long should it take? You can put in any timeframe you want here. We talked about volatility in the decks today, you know, is volatility going to change? I think it's going to say constant, you can put a value in for that. Historical volatility is volatility of a stock, implied volatility is option pricing, different numbers. So if the stock got to 25 on this date here, you can make in theory $3,000 on a little bit over a $3,000 investment, you almost double your money here. On this here, you know, 1,000 shares of a stock at 20, you make $5,000. Percentagewise, you do better with the call option. What if it took longer? You can change the timeframe, because if it doesn't happen within the expiration date of this, it's going to change everything. So this option going up to 2023. Cause options can go up pretty far. So this can help you evaluate, does it make sense? Well if it gets there, I think it's going to get to, you know, '22. Would I be better off with the stock, or would I be better off with the option, so. You see here your theoretical value goes down a tremendous amount when we add more time here. So it's better to look at this to get an assessment of what will happen, rather than just blindly guessing. So this lets you put in different metrics to see what would make sense.

So, we have about 13 minutes before the end of the session. We'll be covering a couple more questions. But just realize too, you can actually download the decks from this. There's a survey again at the end, you want to give us some information about what you thought of this, what you're asking, what you'd like to see. So your content, your interest in content will drive what we build going forward, so just let us know. Ed, did you want to contribute anything to --

**Ed Modla**: No, yeah, that tool you're looking through, I mean it would be useful for an investor to just stay there all day long, and move the different variables, the price, the days to expiration, change volatility a little bit, and compare different strategies to each other. Have the stock move where you think it's going to move, have it move the wrong way, change volatility in different directions, just to see the difference in P&L, and as you're seeing here with call versus stock, the monetary difference of the stock is going to be more significant, but the percentage gain, or percentage loss in the option could also be more significant. And Bill, I was glad you brought up buy write, I didn't mention that earlier, you know, for those of you not too familiar with the terminology, the buy write and the covered call are the same thing, long stock, short call, but in practice, buy write refers to buying the stock and selling the call option simultaneously, as Bill showed it, at the same time at one singular price. Covered calls more or less refers to owning shares, having owned them for a while, and then at some point later in time, deciding you wanted to sell a call or overlay that short call on top of a long stock position. That execution at two different time frames is what's commonly referred to as the covered call position, as opposed to the buy write, which is the simultaneous transactions.

**Bill Purvin**: And the first trade with the option is an opening trade. If you have no existing position, you're opening a position. So you can buy to open, you can sell to open. Covered call is going to be sell to open. You want to buy a call, you think it's going higher, it's a buy to open. Once you're in it, then you're going to do the reverse. You're going to close out the position, if you're long, you're going to sell it to close. If you sold a covered call, buy it to close. So when you're on the website, or the trading platform, all your positions are here.  You can show them by expiration date.  I think this account has a couple of Bank of America positions here.  So here it is right over here, long a call.  If you click here, you can actually close out or maybe you want to do a roll, so you can cover these positions.  So if you wanted to do the roll here, you click over here, you do roll, you choose which one you want to roll to, and it builds the two trades together.  So one you'd be selling to close, one you'd be buying to open.  You can change them right over here, it shows you the leg quotes that option prices together.  Again, a net trade, red, I have cash coming out of my account, green, I have cash coming into my account.  So it just helps you figure out what to do and how to monitor them here, especially with options, you want to know when they're getting ready to expire, or what type of strategy do I have here, so these are just long calls here.

So any questions you have about this, always reach out to our trading teams.  We have a lot of resources here internally, so I'm going to show you one thing on the website here that a lot of clients I don't think notice.  Because again, this is a tough topic; there's a lot to know.  You go onto news and research here, when you go to the option choice here, we talked about it early in the other session, let me just move this, the Zoom session is just kind of in the way here.  So when I click on "News and Research," when I click on "Options," you can get third-party content, and if you're looking for coaching sessions, right over here, "Learning Center." So you got coaching sessions here. I'd like to do a little bit deeper dive here, find a session. We do market briefings, option trading. So easy way to find the content, easy to overlook it. So it was under "News & Research," "Options," it was a little tiny link over here, so. Probability Calculator, we went over that P&L calculator, so other ideas on here, so the website has great content for third-party providers.

So one thing too -- did you have something Ed you wanted to say?

**Ed Modla**: No, I was just going to say, as we were maybe gathering some more questions, I was going to pop through the remaining consideration at different stock price movements. Let me just grab the screen just to finish that up, and then we can finish up with the questions in our time remaining. So there was a lot there that Bill walked through. You know, the flexibility of options really comes to fruition when you're watching those different demos that Bill was doing, and for those of you who are newer to options, you might think it's a lot to absorb, but hopefully you're recognizing that they're not too difficult. Everyone has the ability to understand options, understand how they operate and what you can do, and because of all these different choices and ways to manage positions, it really is what makes using options so much more exciting versus not using them. So we talked a lot about the stock moving up with covered calls. And similar to that long call position, there's not as much to say with the other stock price movements if the stock's unchanged. You know, what are you doing? You're just reevaluating your position. The call option worked in your favor, you got that premium, that's good for you. But now just reanalyze and decide are you going to sell more calls? Are you going to hold the shares because now you're more bullish and you don't want to take on the obligation associated with the selling of the call? Maybe you do a different position altogether. Just reevaluate, I think I mentioned this earlier, one of the, sort of the kneejerk or routine issues that investors can find themselves in sometimes is doing a strategy that works, and it works two, three, five, ten times in a row, and then they just start doing it out of habit. And there's nothing wrong with doing that if you like a strategy and it's working for you and you're making money at it, you know, who is anybody to say stop doing it. But I just want to throw up that word of caution, every time you reintroduce a strategy, you know, take a step back and make sure it's still consistent with your market opinion. It can work ten times in a row, it's the 11th time you have to worry about. So make sure if you continue to sell calls, cause they're working, they're expiring worthless, and you keep getting this premium, every time you do that, just make sure that the position you end up with is still consistent with your market outlook, and then stock down, you know, Bill as I get ready to kick it back over to you, not much you can do here. Your risk is to the downside. There's a limited amount of protection that the covered call provides to you in the amount of the premium you receive for the option, but it looks like being long stock, if the shares are selling off. There's your risk, there's where you stand to lose money. At what point do you get out of this trade, that's the same question as when would you get out of it if you were just long stock, because you have the same kind of risk there. The only little intricate detail I'll offer here, since you have long stock, short call, is you're going to exit the trade and get out, cut your losses and move on, undoubtedly you will not be able to sell the shares, unless you buy the callback at the same time, or buy the callback first. I think Bill showed earlier today a level 5 is to have an uncovered call position. If you don't have level 5, you're probably going to get rejected on your order trying to sell stock, because it would leave you with an uncovered call position. Just be aware of that, probably not a position you wanted to begin with. But stock down, there's where your risk is, and not too much you can do there, it's very similar to just managing that long stock position that isn't working out in your favor. So Bill, that covers everything here, we'll see if there's any more questions, I'd be happy to take them.

**Bill Purvin**: Thanks, Ed. So just to just provide a little bit more clarity too, when you're looking at the -- let me just share the screen here for a second. So when you're on here, as I mentioned, you know, all of the tools you're trying to access in terms of, using for the options, if you click on here, they're over here, there's a summary page, maybe you're just getting started here, there's a tool here to help you build a trade, you know, just from scratch. If you have the idea on here and you know, you're bullish or bearish, check this here, try to make it simpler to start the process here. We talked a lot about cash-covered puts, covered calls. Maybe just want to do straight buying a call here, no -- it tells you what this trade will do here. And there's a choice in here to go to the next screen. Because again, you have to have an opinion. So, when people say what should I do, the first thing that's going to happen in the conversation is, what do you think will happen? If you tell me what will happen, then we can start building out the trade here. This is what this tool is designed to help you do, and to give a sense of, you know, does it make sense, do I need a different option approval level for the trade I'm trying to do here, and again, build a trade ticket. So, that was under here, this option trade builder. That tool to help figure out, you know, which trade makes more sense, there's a profit and loss calculator. We spent a lot of time, if you only attended this session and not the other sessions, there is a strategy tool to look at which stocks, when we look at a specific stock, which covered call strategy might work over time. 30-day, 60-day, 180-day, and maybe it's not a covered call, maybe it's selling a put. So, different strategy with the same basic philosophy, I think we're going higher, and I'm trying to make some income from doing that trade. That's what these are designed to do. Nice thing about selling calls, you have time in your favor. That erosion of time helps you when you're the seller of the option.

So, anything else you wanted to contribute here, Ed, to this conversation?

**Ed Modla**: You know, as we're wrapping it up on the day, you know, I just always like to reiterate that education and dedication to studying options is very important, and it does take some time. You know, me and Bill walked through so much over the last three hours. If this was new information to you, I wouldn't expect anybody to be able to repeat it after we just went through it here. It takes repetition, hearing things over and over again, time and time again with respect to the exercise and assignment process, with premium, with volatility, time decay. You're going to need to hear those things over and over again, but I am confident based on my experience and seven years now strictly devoting my career to education, that anybody is capable of learning options. It's just a matter of taking the time and being dedicated to learn them, accepting the fact that you have to hear the same thing a half dozen, ten times over and over before it sinks in. That's just the way it works here with options. But if you do that, and you have the patience, certainly you will get there to the point where you're comfortable enough using them, implementing the right strategies, managing the positions, and hopefully using the product successfully, that's our goal here at OIC and I'm sure at Fidelity as well.

**Bill Purvin**: Thanks, Ed. We appreciate everyone taking the time to attend this session today.

END OF AUDIO FILE

***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](). Supporting documentation for any claims, if applicable, will be furnished upon request.***

Any screenshots, charts, or company trading symbols mentioned are provided for illustrative purposes only and should not be considered an offer to sell, a solicitation of an offer to buy, or a recommendation for the security.

There are additional costs associated with option strategies that call for multiple purchases and sales of options, such as spreads, straddles, and collars, as compared with a single option trade.

A covered call writer forgoes participation in any increase in the stock price above the call exercise price, and continues to bear the downside risk of stock ownership if the stock price decreases more than the premium received.

The information provided in this communication is solely for educational purposes and should not be construed as advice or an investment recommendation. Fidelity Investments is a separate company, unaffiliated with The Options Industry Council. There is no form of partnership, agency affiliation, or similar relationship between The Options Industry Council and Fidelity Investments, nor is such a relationship created or implied by the information herein. Fidelity Investments has not been involved with the preparation of the content supplied by The Options Industry

Council and does not guarantee or assume any responsibility for its accuracy or completeness.

Fidelity Brokerage Services LLC, member NYSE, SIPC, 900 Salem Street, Smithfield, RI 02917.



1008089.1.0