TRANSCRIPT

Strategies: All about Puts

Presenters: Allen Helm & Edward Modla

Allen Helm: Well, hello to all my new viewers, and thanks for coming back for those that attended the first session on calls. My name is Allen Helm. I'm the regional brokerage consultant for Fidelity Investments. I cover the Austin, North Texas, and Oklahoma markets. We have regional brokerage consultants spread throughout the United States. Our role is to help our self-directed clients meet their goals and objectives through using our different brokerage tools. I'm happy today to have Ed Modla from our OCC options group. Ed is just full of unprecedented knowledge and experience about going over different things. Today we'll talk about puts on this session. And then our third session if you can join we're going to diagram how you might do a stock selection and then some of the tools and things that we have available to help you trade options and look at different ideas. Before we go on, I have a few housekeeping items. At the bottom of the screen you can type in your questions. There is a survey at the bottom of the screen. We would appreciate it if you filled out the survey. It is anonymous. And then also if you do fill that out we'll send you some additional links that will have educational materials. And you can always download the presentation that we're covering for today's sessions. So now let me introduce Ed Modla. Ed, if you'd just give

us a quick background on your experience and we'll jump right into the session.

Ed Modla: Sure, looking forward to it, Allen, thank you for the introduction. And thanks as always to the Fidelity team for having me here. I got my start in the options business in the 1990s on a trading floor, open outcry pits both in Chicago and New York. Traded in a number of pits. But the last of which before I went to electronic was actually Amazon. I was a professional market maker in Amazon. And it's funny to look back on that. In the early 2000s. I left the Amazon pit because the stock was only 10 bucks and I was like, "Why am I bothering to trade this $10 stock? There's nothing going on. There's no strike prices here." So I moved off the floor at that time. It's interesting to look back and realize that. But traded electronically after that for a number of years. I was also heavily in the futures business. But for now over seven years strictly educating on the options product to anybody that will listen. Retail investors, individuals, financial advisers, money managers, institutional investors, family offices. We teach options to all of the above and I really enjoy what I do with OCC in their Options Industry Council department. So Allen, let's talk about puts in this session.

Allen: Well, and Ed, we're glad to have you here, so thank you for being here.

Ed: Yeah. My pleasure to be here. And again thanks as always. It's always a pleasure to speak with the Fidelity team. First I'll throw up our disclaimers. Options are a complex tool. You need to make sure that you educate yourself and understand them before using them in a live account. I often find that the investor who uses options in a responsible way tends to be a long-term user of the product as opposed to those who jump right in without understanding, get a bad experience, and never touch it again. But if you do spend some time in due diligence options can be a great benefit to your portfolio if you use them in the correct fashion. Also keep in mind that our examples today in this session are for educational purposes and are not intended to be guidance or advice. Here's the outline for this presentation focusing on puts. If you're familiar with call options this is just reversing everything in your mind and thinking about things from a different direction. The definition and motivation for using the put option. Basic strategies. There's a little more here for those of you who were in the first session. A few more strategies here because there's an added element that puts are often used for which is protection or hedging. We'll look at hedging both stock and portfolio positions. And then speculating with puts in one direction or the other. And potentially using put options as a way to get into a long stock position. A popular strategy known as the cash-secured put. Then we'll close things up with some considerations and some details that investors need to know regarding exercise and assignment if they are long or short put options, what they might need to

know. Let's start with the definitions first. Why put options are used. There's a variety of those. First of all equity put options, we're focused on equities here today, are contracts that give buyers who pay the option premium up front as a cash debit immediately out of their account, and in exchange for that payment the buyer of a put option has received the right to sell shares of underlying stock. That is likely 100 shares of stock. That is the underlier for a standard options contract. On the other side you have the seller of a put option who is paid cash, paid premium up front immediately into their account. And in exchange for that payment has taken on the obligation to purchase shares of underlying stock. This transaction in stock is going to potentially occur at a price that is defined within the contract. And the rights and obligations associated with put options are going to exist up until an expiration date. Whether you're a buyer or a seller you choose what price you're comfortable with and what expiration date you're comfortable with. If you're thinking about where does option premium come from, how much am I going to have to pay or how much can I receive if I'm a buyer or seller, those two details along with the market's perception of how volatile the stock might be between today and expiration date are the largest driving factors towards determining what is this price of the put option going to be. We'll get into a little more detail there as we walk through examples. Far as objectives and motivations for using puts, let's start from the long side. Buying put options. There is this added element that call options don't really have to anywhere

near the extent that puts do. Which is protect either a stock position or a portfolio position. You can also use long puts in the absence of a stock position or portfolio to speculate on the downside. The right to sell stock at a certain price as the share price moves lower will likely or potentially become more and more valuable. So speculation to the downside that you otherwise couldn't get is what the long put is sometimes used for. Then we'll talk short puts. The term short means you have sold an option that you do not previously or had not previously owned. So you're short the option. Taking on the obligation to buy shares at a particular price within a certain timeframe. And you may be very willing to take on that obligation. This could be used as a method to acquire stock on a share price pullback below its current levels. There are alternatives towards using puts as protection, towards selling puts to acquire stock. And we'll talk about those as well as we walk through the examples. So starting with hedging here. And we'll get into a few different types of methods for hedging. Using put options first with a stock position. Now this slide is a little bit busy so let's just focus on the left side here. What do we have? A long stock position from $84. And maybe we've made money on this stock. Maybe it's rallied from our entry level. Or maybe this is where we bought the stock and it's consolidating perhaps where we're sitting at a support level. And you think the stock is going to bounce. But if it doesn't, if it breaks support, things could get ugly. So you want to buy protection against this position. Buy the 60-day or two-month 80 strike put. You're going to pay

for this, which adds to your total cost of the trade. Now you own the right to sell these shares at 80 no matter what happens. Now some of you might be looking at this and think this is an alternative to using a stop loss. I'm actually paying for this. Wouldn't a stop loss be better? I don't have to pay for a stop loss. It doesn't expire. And certainly the stop loss is a viable alternative to this strategy. The reason why puts might be preferred is because the put option is working for you as protection 24-7. And what I mean by that is after hours. Overnight. Over the weekend. For those of you following the market the last couple of days, it is possible for a company to announce earnings and drop 25 percent overnight. If that happens to a position you have, and you're using a stop loss, thinking you're maximizing your exit or potential loss on the position, you might not have that stop loss working as intended. The put option is going to –

Allen: The other thing to that, Ed, too is sometimes they halt the stocks even in the live session. And when they're halted and they open back up they're off 25 percent or whatever. So you have that risk.

Ed: Yeah. Halts can occur. You're right. Big moves. Major news. Something unexpected. Halts can occur. True. Absolutely. Then when that stock opens back up if you're using a stop loss you don't know where your execution price might be. The put option doesn't have that risk. But you're paying for that

privilege. You're paying for this put option to work for you round the clock round the weekends and it's going to cost you some money. So Allen, as we look at this we've got a higher breakeven point. We paid more for this position because we bought stock. Now what circumstances would you say? We just talked about a little bit, we talked about alternatives. How often and what circumstances, motivations might you say investors are mostly talking about when they decide to protect stock with puts?

Allen: Yeah. So typically it's something to do with they're looking at potentially maybe leaving the position but they want to know that they have a price certain by using a protected put. So they know that they're going to get that $80 if that stock were to drop, I don't know, down to 40 or whatever that is. Where a stop doesn't cost anything, but to your point it's a risk that if something bad happens in those pre- and post-markets or the stock is halted. And the other thought is maybe you think the stock from this price point in the next 60 days will go up another 10, 15 points. And you just want to hedge some of that risk. And you want to have that price certain below you to use. So that's how clients will use this. It's just a hedging strategy to protect yourself.

Ed: Yeah, absolutely. And one thing as a closing thought comparing this to a stop loss for example. Within this window of two months if you get a quick sharp

move down to say 80 or 79 and the high seventies and you're using a stop loss, you're triggered. You're out. It's done. The put option is there for two months. If the stock runs down quickly you don't have to do anything. You know you've got the protection in place for two months. If it does find a support level and bounce above 80 and continue to rally you've still got the long shares to capitalize.

Allen: Ed, and you bring up another wonderful point because the other piece of that, so let's say you do buy that and two weeks later it drops to 60 bucks a share. As the holder of the long put you got two choices. You can either deliver the shares and just get rid of it, and take that $80 if you want to. I would assume you'd probably take that out to close to that 60-day window to see. But you can always deliver those shares if you want to and get your $80 and be done with it. Or you would have probably a gain on that options position. You could close that options position at a gain and keep those shares potentially. But it gives you the freedom to make those choices.

Ed: Absolutely, yeah, should have mentioned that as well, you're absolutely right. If you get that drop in share price. Now look at the price of the put by itself. And just sell the put. And then the protection is gone but you've gained. You've profited on the option piece. And just hold the shares from there.

Again that would be if your perception changed a bit and you thought this stock has found a floor.

Allen: But you have a lot of freedom to make those decisions.

Ed: Really, Allen, it's what makes options so useful, so versatile, but also so fun to use, and when investors are using them the right way it does become something, as I said before, they use long-term. Because it does open up a lot of doors that you otherwise couldn't get into. We're going to look just quickly here. And I'm going to tap into your knowledge here, Allen, as we look at hedging a portfolio using put options. Just the ultimate question that I get here often is how many puts do I buy once I have the option chosen. So let's just walk through that quickly as you have a portfolio value say of $1 million. You're willing to give up say 10 percent to the downside but you want to protect the rest. In case there's a massive drop in the overall market. So you're trying to protect $900,000. So Allen, as you look at choosing what index or ETF you're going to use, a strike price, the expiration date. What do you think investors are thinking about as they make these decisions on underlier strike expiration?

Allen: So as they look, if it's a broad-based portfolio they may look at different exchange-traded funds that might match that. Maybe the S&P 500 or the

QQQs or something like that where they could hedge the portfolio. Or you could hedge the individual positions inside that portfolio. But it's a strategy that you can incorporate where you would use a broad-based index and you can buy the protection to offset some of that downside risk on the portfolio. Now it's just like the deductible, Ed, on this 10 percent that you're using. The more risk you're willing to assume on that portfolio, whether it's 10 percent, 15 percent, 20 percent, the less that cost would be. So if you've had a portfolio for the last 10 years and you have 10 years' worth of market action on those stocks that you've held, you may be willing to take more downside risk to hedge the portfolio. So you can always call us. We can help walk you through the portfolio sizing piece of that if you're looking at and trying to figure out does it make sense to use an ETF to hedge some of the risk or does it make sense to look at individual positions because maybe they're concentrated or those type of things.

Ed: Yeah, absolutely, Allen, and in our example here once you have those decisions made, you've got your ETF, let's say it's trading at 400. You're going to give up that first 10 percent. You want protection below that. So you just drop 400 by 10 percent, gets you to the 360 strike. Then your expiration date. This is subjective. How much protection do you want? Is it a technical concern that you have? Is it a fundamental concern you have? A micro- or macroeconomic concern? Whatever that is drives you to some timeframe

where you want the protection in place. And then you can just look up how much is that going to cost me and evaluate from there. The question I get here is how many options do I need to buy once I know which one that I want to buy. And the math on this is actually rather simple. If you take the total portfolio dollar amount that you want to hedge, that is our $900,000, I think about it this way when I explain it in layman's terms. If everything went to zero, the entire market went to zero, we would have lost $1 million. That's our portfolio. We wanted to protect 900,000. So our notional value or total dollar amount that we receive from the put option we purchase needs to bring back $900,000. We chose the 360 strike. We know that the payment there for the 360 strike is going to be multiplied by 100, the multiplier of a standard contract is 100. So if you just do this math, full protection on a $900,000 level of protection would be 25 put options. That's your starting point. That's full 100 percent protection based on the option we chose. From here you can then evaluate how much is this going to cost me in premium, do I think that's too much, maybe I think it's rather cheap for the concern that I have in the market. And then you can evaluate do I want to buy less than 25, do I want to change my expiration date or my strike price to change that premium amount one way or the other, until you find that premium level that you're comfortable with. Have to say that when you're hedging a portfolio and you've chosen your ETF, we do assume a one-to-one correlation as we're looking at these numbers that will often not be the case, at least not exactly a one-to-one correlation. That's

just how you calculate a little bit on putting together a put option to protect a portfolio position.

Allen: Yeah, and Ed, you can always buy, you don't necessarily have to do 100 percent of the portfolio. You could do half of the portfolio. But it arrives to but if you want total protection then you would absolutely go that route. But there's different ways to back into that. Also you could choose on your example rather than 25 puts maybe you do 15 on one month and then you do some more further out and ladder that type of protection in the cost where maybe you got three months' worth of protection along with six months, and you stagger that out. Because you're thinking there's an event that might happen but you're not sure exactly when that event might happen. So you can maybe stagger that out into different months.

Ed: Further showcasing the flexibility that options provide is what you're doing right there. Buy fewer puts. Maybe hedge half the position. Or like you said a nearer-term expiration date is going to lower the total premium amount. Can do different things with options to tailor the position exactly the way you want it with consideration to how much all of that is going to cost. That's hedging, that's using options to protect stock and portfolio. Let's look more on the speculation side. First starting with the bearish outlook. Bearish speculation. Buying a put option. Just reminding ourselves. We're paying premium. And

we have the right to sell shares of stock at the strike price that we've chosen. As the stock price drops that will have a positive influence on the price of the put option. The passage of time and the perception of volatility will also play a role. That might work against us. But the drop in the share price will certainly be working in our favor if we are long puts. Most investors I speak to, Allen, are not going to be shorting stock. So if you do want to capitalize on the bearish outlook the option piece is really one of the few ways you can do that. If you're just a stock trader and you don't like shorting shares and you're bearish, you're really just focusing on maybe the balance of your cash position and increasing your cash position and staying away from the market for a while while it potentially pulls back. A long put might actually get you an opportunity to capitalize on that bearish move. But like any long option you do have to be careful here because as options are a decaying asset with each passing day, and there is potential to gain on that bearish move, if you are incorrect the passage of time will start working against you. So this long put, to be profitable, needs to be correct on timing and direction. And I can say this as well. A little bit different from calls. The put buyer likely does not ever intend to exercise. This is a speculative put buyer by the way. Not the hedger but the speculative put buyer, if they exercise, is going to have short stock. Probably not what they wanted to ever have. So the put buyer most often is looking for the price of the put to go higher and then capitalize on that by selling to close the put. So you bought to open. Subsequently you sold to

close. Hopefully at a higher level. And you profit that way. Here's an example P&L graph. Again you have the calculations here for your reference. With the stock trading 92 you're bearish. You're not going to be shorting stock. That's not something you do. But you do want to capitalize on the bearish outlook because you're very confident that it's going to occur. You can buy a 90 strike put in this case for say $350. That's 3.50 in premium times the 100-share multiplier, $350. That's the most you can lose is 350. But you do need the stock to move lower in your favor within that timeframe. And continue to move lower as you're trying to get profitable on this trade. Allen, I want to bring you in here. But I'll just quickly tweak this before we do. This long put can also be transitioned or moved into a bear put spread by adding a short put to it. What you're doing here is still at the same motivation as above. Bearish. We do need that timing to be correct. We do need the direction to be correct. But by selling another option you're mitigating your cost in exchange for a calculated return. Compared to what we just went through this looks the same at the beginning. You have a cost, a premium. That's your maximum loss. You have a long put here that's going to start to profit for you. But remember what these rights and obligations are. We have the right to sell stock here because we bought the 90 strike. We are obligated to buy them back here. So the most we can pull out of this position is that $5 difference. We also paid less overall for this. So Allen, we talked about the spread here. Long and short options. When you look at the risk profile what kind of things

do you think investors need to be considering, especially maybe with stock between strikes as they need to maybe manage things?

Allen: Yeah. Couple things to think about. So you mentioned the long put. And you can use the long put to speculate or you can use it to hedge the risk on maybe a position that you own. But the other thing, Ed, particularly the lesson that we saw here over the last year, is if I short a stock, in theory I have unlimited risk. And I short a stock at 50 bucks and it goes to 500 bucks, I've got a lot of risk potentially. And with a long put if I want to speculate I can just buy a put and the most that I would risk would be the premium. So I understand the reasons you short a stock. You get dollar for dollar. And that type of thing. But from a risk standpoint if you were looking at shorting an individual company a put gives you some limited risk from that aspect if you get it wrong. So that's one thing. On the spread, on that piece of it, in the example that we looked at on the other spread, we are capping that profit. That is capped. But that also helps protect us and we define that potential maximum loss. So both strategies can be incorporated depending on the direction. If you really didn't like the stock and you thought it was going to drop from 90 down to 50 or 40 or whatever that is, then I don't know that you'd want to cap it. But you do have choices and options. All pun intended on that.

Ed: Yeah. Exactly. I use that same phrase there often.

Allen: I think I got it from you, Ed.

Ed: Yeah, sorry about that. So yeah, as far as position management here it's a little different. You do have to be careful when you put this spread on. Some investors think okay, I've maximized my gain, I've maximized my loss, I can just sort of see how that plays out. I don't have to do much. But because you have a long and short option, considering what these rights and obligations are, if the stock is in between these two prices of 85 and 90, you are going to have to take some sort of action to avoid –

Allen: Yeah, you do have to manage it, absolutely.

Ed: Yeah, and I get this question and this comment even with long option, say long put or long call, buyers who say, "Listen, I thought the most I could lose was what I paid." And the answer is yes. The most you can lose is what you pay during the life of the option. But if that option turns into a stock position, that changes entirely. If the stock is sitting here at 87 at expiration your 90 put option if you do nothing will likely be exercised on your behalf leaving you with a short stock position for at least one day until you can cover that. And that leaves you with a lot of exposure that you might not want to have. So keep that mind. Allen, how often do you see that happen? Do investors really

grasp that concept of the potential of an option exercising into stock and now having more risk than they ever wanted?

Allen: When they get to the spread piece I think the vast majority of investors understand that. But yeah. And once again you can manage a lot of that. We have different tools like alerts and things like that that you can do. And you can always look at your account live and see. You can always call us for help. But yeah, that is valid on that aspect of it, something that you would have to think about.

Ed: Allen, let's look at the cash-secured put, very popular strategy here. This is the one we're going to cover just from the puts, the short put or selling put side. In this case selling the option is going to receive premium. We're going to bring that in. That's $200 in our example. Stock is at 118 selling a 115 put, $200 cash into our account. And in exchange for that payment taking on the obligation to purchase stock at 115. Cash-secured meaning we have the cash in our account to cover the cost if we're assigned and need to purchase shares. And further with this example we'll say most likely this investor is interested and wants to buy stock at 115. That's why they're selling the put in the first place. If that happens then their cost basis or average cost is going to be the strike price they paid if they're assigned and have to buy shares minus the up-front premium that they were paid. And there's your breakeven point

of 113. This is comparable to using a limit order to buy shares. But I'll point out one key difference between the two. Me and Allen, we're always trying to talk benefits and risks, not trying to sell options on anybody. We talk both sides of things. What's the benefit of a limit order? If that stock which is at 118 drops to 115 and it doesn't really go much lower and it pops right up above that, your limit order is filled. You got the shares where you wanted them. If the stock rallies sharply you capitalize on that. Options are not going to operate the same way. Stock is at 118. We are obligated to buy shares at 115. But we are likely not going to be assigned and buy anything unless the stock is below 115 and stays below 115 until its expiration date. Otherwise we are likely not going to be assigned. If the stock rallies up above 115. All of which happens before expiration. We may never get the shares that we wanted. Now you could manage this position. Allen keeps talking about different ways to manage the strategy. We can do that here. If you're concerned about that you can close this open short position, buying it back. And then just go in and buy the shares outright before they start to rally sharply. There are things you can do. But as this is sometimes called an alternative to using a limit order to buy shares, which I wouldn't completely disagree with, it does not function exactly the same, particularly if the stock drops and then rallies sharply up above it. Popular strategy, Allen. What comes to your mind when you think about cash-secured puts?

Allen: Yeah. So to your point investors a lot of times will ask the question. So I sold a put at 115, I saw it go down to 114.50, it rallied back, now it's at 116. Why didn't I get the shares? And it doesn't work that way. It's not a limit order. But on the flip side of that, Ed, when you put in a limit order do you get paid to put that order in when you put in a limit order? This is a way to get paid to say, "Hey, I'll buy XYZ stock. I'm willing to buy it if it gets to 115 at expiration." So if it closes below 115 you're going to own the stock, you got paid $2 to do that. In the last 10 years with the current interest rate environment when cash was virtually not earning much it was a way to generate cash and buy underlying stocks or exchange-traded funds at lower prices and take out a shopping list and say, "Hey, market is off today 300, 400 points, where do I potentially or what stocks do I potentially maybe want to buy at better prices?" And set in some selling puts to generate that cash in. The other thing too, it goes back to the spread. You can always sell the 115s and then buy the 110s or 105s below you if you wanted to put in a floor.

Ed: Yeah. Manage risk that way. Yeah, absolutely, Allen, you're exactly right. The premium really does work for you as opposed to the limit order. If you're buying shares at 115 you're filled. There's your cost basis, 115. On this option strategy if you are assigned at 115, cost basis 113. The stock may never have potentially ever gotten low down to 113. But that's still your cost basis because of this premium. And before we move on, Allen, one other minor

thing to mention. I thought about it as you were talking there about the premium. One of the motivations here for using the put as opposed to limit order is what if the stock just sits here at 118, 117, 119, or drifts higher. You're wrong. It doesn't pull back. It just drifts higher. That premium is still yours. You can either keep selling puts as they expire or you can take some consolation in knowing you made something. You brought in some capital. Again income generation. You brought in the capital and it worked for you to a certain extent. And the stock never got there. Limit order would just fade away and disappear. The option actually had some profit and gain for you. So something else to consider as well. Let's look at exercise and assignment as it pertains to puts. If you're long the put option of course you have the right to exercise. But most options do not reach expiration. They are sold prior to expiration. If you're long a put you may set a floor on how much premium you're willing to lose before you cut your losses. Or if it's a gain again most likely not looking to exercise and shorting stock. So at that point you might sell to close and capture your gain by executing this sell to close transaction. Most positions fit into this category. Exercising at expiration. Again this is probably more likely for the put hedger who has shares and just wants to deliver them as they protected their position. The put speculator is likely not going to be exercising into short stock. Prior to expiration this is more unlikely. We talked about calls in the first session if you were there. The circumstance of dividends provides a little motivation for the call holder to exercise early. For put options

it's different. It's less likely to have early exercise with puts. The circumstance of deep in the money, very highly priced put options is when that would occur. Just a few things if you're curious about that. You think about what a put option is, it's the right to sell shares and receive cash. If your position is long a put that has a lot of value to it, a lot of premium to it, at some point you might want to exercise and get that cash into your account so you can do something with it as opposed to having this position that has a lot of value that's just sitting there but you can't do anything with. So deep, deep-in-the-money put options is when early exercise might occur. Of course you can always just hold the option, risk all your premium, and if it's not there let it expire without value. But Allen, I highlighted one thing here. Very big difference between calls and puts. If you don't own the shares, I mentioned this a few times. Exercising a put will result in a short stock position. If you don't want that or you don't have the ability to deliver into a short stock position, you may have to take some other considerations which include potentially selling to close or in some unique circumstances if you can't sell to close for whatever reason and you can't deliver and borrow shares, you might be in a more difficult position with what you can do with your put option. Difficult situation, Allen, but it does occur.

Allen: Yeah, and that's something to consider. And the exercise early typically, like you're saying here, it's deep in the money. It may be a situation where we've

had bad earnings. Stock drops 25, 30 percent. And it's let's get it out of the portfolio. Take the cash and move on. So it just really depends on the situation.

Ed: Yeah. Exactly. Some viewers might be thinking if that happens wouldn't I just sell the option. Certainly yes.

Allen: You could. Yeah.

Ed: Yeah. You certainly could do that. We're not going to get too deep into this concept. But sometimes when the option is that far deep in the money you would have to be selling that option below its parity level, something maybe you can look into later on. If you have to give up too much to get out of that option contract you may decide to exercise it instead. And deep-in-the-money highly priced options, high delta options might have a wider bid-ask spread that don't give you the execution price that you're looking for. As far as put writers. The put seller can be assigned on any trading day. Just like calls. The option does not have to be in the money to be assigned. A put holder can decide to exercise at their discretion for whatever reason they want. And again consistent with calls. If you don't want to be assigned on your put option the only way to completely avoid that is to not have an assignable

position. So buying to close. Buy to close the open short position will remove you from that obligation and potential assignment.

Allen: And the vast majority of people that are writing puts honestly, they probably don't want to buy. But if they do then a lot of times they'll convert that into a covered call strategy. But they're looking at stocks that they might know, they like. Or exchange-traded funds. Well, if this index gets to this price I'm a buyer. And they may like 5 or 10 percent below current price and sell puts. So it's something to consider. But it does happen.

Ed: Yeah. I'm glad you mention that, Allen, as we go to your demo here. Yeah, should have mentioned that earlier. A lot of people like to write puts and collect that premium. And if they get assigned they will have the shares. And then they start writing calls. Some of you may I think have heard that called the wheel strategy. Some people claim that they coined that term. But it's been around for quite a while, pretty widespread. To sell puts. If assigned start selling calls. And continue to sell premium that way. Just remember whether you're writing puts or you turn it into covered calls if the market sells off significantly either way you've got that downside risk.

Allen: You do. And it only cushions it so much. So you maybe take some of the pain off but the pain is still there. So it's not a be-all, end-all strategy. But it does

add up over time and honestly when you're selling puts you're hopefully trying to do that in a market that you think is neutral to slightly bullish. And so your job is really to try to collect premiums and then sell puts maybe on days when the market is off.

Ed: Yeah. You said it exactly as I often do. That risk mitigation element is relatively small. You are getting premium. It does help your cost basis. But sometimes it just takes one really bad experience to realize it isn't a whole lot of protection to the downside, maybe I need to be a little bit more concerned. So certainly a few things to consider from the writer's perspective.

Allen: Well, Ed, why don't I go ahead? And I'll share my screen. Let me know when you can see it.

Ed: Okay. And it looks good.

Allen: You guys see it. Okay. So the question comes up. And we covered this in the first session. How do I add options to my accounts? Once again, Ed, if we just go into investment products inside Fidelity.com right here. So we choose investment products. And if you just choose options this'll take you into our applying for options page right here. So apply to trade options. You can go right in here. Apply for an options application. This is going to list all the

different accounts. You can apply. If you don't have options it'll say apply. And if you do have options and you want to update or ask for different strategies you can go in and update your options application there. Typically it's probably less than a week. I would say when you apply to get some sort of an answer or approval on that application either way. So you go in and apply there. Now as far as some of the tools to analyze or look at some of the research that you can do on Fidelity for put strategies or cash-secured put -- which by the way the vast majority of the clients that I talk to will do cash-secured puts. So they actually have the money in the account. They're willing to buy the stock if it gets to a certain price, and they're selling puts to generate that income. So we have some tools that'll actually run some ideas. Either based on specific things that you're looking at or it'll run a table of those ideas. So where you would find that. If you go to Fidelity.com and just go to options right here. This is going to actually take you into our options page. There's three tabs. You'll notice quotes, market overview, and trading ideas. If we just select the trading ideas, go from there, we can actually go into the strategy ideas tool from right here. And what we've done is we've diagrammed, or we show the different strategies that you might want to consider. On the first session we did covered calls. So I could click into covered calls as an idea from right here. It'll allow me to run some rates of returns. Or I can go into cash-covered puts. Now Ed, we mentioned this briefly on the first session about covered calls and cash-secured puts. But if you really think about it

they're directionally very similar. They're looking for neutral to slightly bullish markets. Got any color on that you might add?

Ed: And I'm going to just simplify again. That buy-write term. Which is also called covered call. But executing the stock and the call simultaneously, buy stock, sell call. Compare that to the cash-covered put, and they are synthetic to each other. The risk profile looks exactly the same. Just to further that example. If you are thinking about doing a buy-write using an in-the-money call, buy shares and sell an in-the-money call, often the superior trade is to sell the put instead. It's exactly the same. They are synthetics to each other. The only difference might be execution prices. Now if it's a covered call, a true covered call where you own the stock and overlay the call later, you don't have that choice to maybe do a cash-secured put instead because you're doing the two pieces at different times. Allen, spot-on. The buy-write as I call it and the cash-secured put. Synthetics to each other. Same trade. Same risk profile.

Allen: And you can choose the cash-secured put or the covered call here. It'll run a list of ideas. But then you can also plug in your own ideas. So let's say Microsoft. So we type in Microsoft. We can choose the timeframe that we want to go, whether that's 60 days or less. We want to look 60 to 180 days, 180 days or more. Now Ed, you and I, we've done several events over the years together. But I know you have some thoughts maybe on timeframes that

there are some sweet spots when you take a look at timeframes. Do you have any input or feedback on that? Would you think maybe 60 to 180 days? Or maybe around the 60-day timeframe? Because there is a sweet spot in that area.

Ed: I'm going to take this a couple different directions. For long option buyers the timeframe has a tendency to be consistent with your market outlook. Why are you bullish or bearish? What are you looking at? Is it technical? Is it fundamental? Fundamentals of course lead you to longer timeframes than technicals do. But it's a little more interesting when we talk about selling options. Sellers are trying to capture premium. Get that decay to work for them. The decay of that premium, which we didn't get into, Allen, in this presentation. Very quickly the decay over time is not linear. The decay of options increases right around that 40-to-45-day level. And the rate of decay continues to increase as you get closer to expiration all the while. Evaluating the premium you receive. So when it comes to selling options you'll see most activity choosing the shorter 60-day or less timeframe to do their analysis.

Allen: So if we plug that in and take a look at that you'll notice that I've just plugged in Microsoft as the example here. And it's showing me what the current price of Microsoft is. And the strikes. And I can sort these strikes on Microsoft. And then I can look at the put premiums that I take in. A yield to strike calculation.

And then it'll give me an annualized rate of return. So this is just a table that I take clients to to take a look and say, "Okay, so are you willing to buy Microsoft, I don't know, in June at $240 to get paid $3.50? And what's your profile or what do you think about Microsoft?" Of course you go to Fidelity.com and look at our analyst reports and see what the ratings are on the different stocks. You can look at earnings information, see those type of things. But you can actually run this model. And you can kind of go in and say, "Well, I don't know, 23 points below the current price if I do the Junes I'm going to pick up 700 bucks to agree to buy Microsoft at 260, 23 points below the current market. And here's my yield to strike. And then a rate of return." Now I'm always cautious on the rate of return, Ed, because stocks do three things. They either go up, they go down, or they stay the same. So it's not necessarily static. The calculations are static but in the real world it's not especially static. So that's just a quick tool that you can take a look at various ideas. If you want to run and take a look at different individual stocks, exchange-traded funds, or whatever that is. So if I go in now to Active Trader and for those that are new into the session, if I go directly here to Fidelity.com and I go -- let me just shut that down. We'll go back to Fidelity. You can download our streaming real-time platform called Active Trader Pro. And right here if you go into Active Trader Pro you just download it from right here. My network is kind of slow here. Hang on, Ed, we'll get there.

Ed: We'll get there.

Allen: Let's try again.

Ed: As you're pulling that up I was looking at annualized return. Very useful but you do need to get some familiarity with annualized returns. It's helpful to compare apples to apples. Annualized return neutralizes things. But some level of familiarity with that before you start using it in analysis probably is justified.

Allen: Yeah. Absolutely. And what's the risk relative to the asset class? But anyways if you go to Fidelity.com, you go at the very top. Accounts and trade. Active Trader. Here's where you would actually download the software. And then also if you need help with either downloading Active Trader Pro and/or you need help with options you can call that 8005640211 number. That goes into my Active Trader teams. And they're here to help you. Now once you've downloaded the software once again you use your same user ID and password. It'll ask you to set up a layout. If you're new to options or a pro. You can go to a setup already created by Fidelity that says options trader. It'll take you into an options layout and then from here you can go in and start looking at some of the various options tools that we have. A couple tools that I'll highlight. We'll take a look at some of the options chains. We'll look at the

options building tools. And then maybe run a spread on one of our profit-loss tools that we have in Active Trader. So let's take a look at the options trader tool. Once again if we plug in our stock, so let's use Microsoft as the example in this one. Once again I can go into the strategies that I'm thinking. So if I'm bullish, buy calls, cash-covered put, or covered calls. If I'm neutral on the idea covered calls or cash-covered puts. If I'm bearish it's buying a put, Ed. That's what we're looking at. So let's say we're neutral on the idea. We have money in the account. We're willing to potentially buy Microsoft if it gets to a certain price point. We get the cash-covered put here. We go in. We just hit the next button. And by the way, Ed, it tells us what the strategy is. It gives us the idea of what we're doing. Some of the risks associated with the idea. If I hit next it's going to take me into the grid here. And then from here I can say, "Okay, I'm willing to go out to the Junes, what we saw on our diagram that we looked at. So the June 17s. We were looking at strikes around the 260s." I can just go to 260 here. And then I can go ahead and select that. Notice, Ed, it loads that position up. Gives me a probability of finishing below that 260 mark. So it'll diagram that. Maybe I don't feel comfortable with that. So I can go up and say, "Wow, let's look at, I don't know, the 250s." And if I click the 250s now I've got roughly a 23 percent probability of finishing within that range. Actually I'm in the Julys. Let me do the Junes right here, 18 percent, Ed. So from there we can go in. Hit next. It's going to load up our trade window. We can choose the number of contracts. I don't know that we -- I guess we did. But

one contract is standard one contract times 100 times the amount that you take in. So we're taking in $495 to potentially buy Microsoft at 250.

Ed: Yeah, the premium for sure is there. This is a very slick nice tool to use. You probably can see that I had to put the glasses on to read it. I hit that fun stage in life. But as you're walking through this, Allen, hitting the different expiration dates, different strikes, that probability aspect really can help you make a trading decision, all the while keeping in mind what you're doing. Selling an option. Potentially buying stock. Below its current level. And taking in premium to do so. Knowing what that entails. It's why selling puts is such a –

Allen: If the market is down you're like, "Okay, I'll sell puts." If the market is up, okay, I'll sell calls. You can strategize a strategy and make a list of things that you maybe want to do. All right. Let's jump into some questions here. We can always spend some more time looking at tools. Is there a difference between buying puts and selling calls?

Ed: Yeah, pretty big difference. So yeah. Again we talk about selling calls from a certain perspective. That was the covered calls. And maybe this was where the confusion came in. We're talking about covered calls, long stock, short a call. And compare that to the buy-write. The buy-write that I just described. Compare that to the cash-secured put. Those are synthetic trades to each

other. But selling calls in general versus long puts are two very different trades. What we were talking about earlier was the two-piece strategy. Long stock, short call. Compared to selling puts. Not sure if that got flipped around when we were explaining it.

Allen: Yeah, and I think probably if you're thinking about buying puts probably in some degree you should be thinking either playing the stock bearish, you think it's going dramatically down, or you're wanting to hedge. The selling the call. Maybe they were thinking if you're selling the call you're taking in the premium so you're getting some money so that's giving you a little bit of downside protection. But it's a little bit of downside protection if you were doing it from a covered call standpoint. When you purchase puts or calls what's the maximum term of a contract? When would it make sense to go long-term versus short-term?

Ed: Different terms for different stocks. Some have LEAPS that go out years in time. Some have shorter timeframes. As far as what you're choosing and when it's a function of two things. What's your market outlook and objective? And then how much are you going to pay? So you're considering both of those things. Some long-term investors might use say call options, Allen, as a stock substitute. They might go deep in the money. Buy some call options. Longer-term to pay less to get that bullish exposure without having to buy

shares. So there might be an idea for going longer-term. Most options activity in general takes place within the first several months in your at-the-money options whether it's outrights or spreads. But by and large choice of expiration date. I always keep coming back to what are you trying to accomplish, what's your outlook, what's your objective, and what brought you here. Technicals can be a little more precise than fundamentals. I mentioned that earlier. Fundamentals may push things out a little bit longer in timeframe. To let ratios and multiples come to fruition. But generally it starts with that first step of what you're trying to accomplish.

Allen: Well, Ed, I need to thank you for your insights and joining us today. We've got to wrap. Also would like to thank all the people that participated in the session. And then also we do have the third session that's going to go over some idea selections and evaluating the trades. So Ed, you're more than welcome to join us.

Ed: I'm super looking forward to it. It was great to be here to speak with you, Allen, today, I enjoyed it very much, and I am indeed going to stick around for session three, I'm looking forward to listening in on that one.

Allen: And thanks as always for doing this education for our clients and prospects. So thanks again, Ed.

END OF AUDIO FILE

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