TRANSCRIPT

OIC: Understanding option strategies for a bull and bear market

Edward Modla: Thank you, very much, Andrew. And thanks for having me here today. I'm very much looking forward to presenting with you. As Andrew said, I got my start in the business about 23 years ago, as a professional options market maker, on the floors in Chicago and New York. And my career has evolved in a few different directions -- but, for the last 6 years now, teaching options to the investing public. That's what we do at OIC. And my role centers entirely around doing just that. Looking forward to talking about some bull market and bear market option strategies today. First, the disclaimer: Options are a rather complex tool, that should not be used in a live account unless they are thoroughly studied and understood. And while we are speaking and working together today, there is no formal partnership between the Options Industry Council and Fidelity Investments.

Here's our outline for today. We're going to start with an overview of the industry and calls and puts, basically Options 101, ground-floor, elementary-level, to get you started. Plenty of new options users in the market today. So, we'll cover the basics, initially, and then get into some strategies. There's a number of bullish strategies in the option space. Going to specify here today

bull strategies with stock, some of the more popular strategies there -- and then get into bearish strategies as well. For those of you who tuned in to session one, Sam Stovall did mention some of the performance historically in the markets, that we've seen in September and October. It hasn't all been good, historically. And there has been elevated levels of volatility in the market. Options give you opportunities to get into more trades. And that's what we're going to cover here today.

First of all, before I define calls and puts, let's just do a little bit of industry history. Most investors are familiar with trading stocks and what it means to send an order to buy or sell shares of stock. You send your order in through your platform and it goes to a stock exchange, which then works that order and attempts to execute it against a counterparty. Well, separate from those exchanges entirely are options exchanges, where investors and market participants send their buy and sell orders to trade options.

On these exchanges, there are no shares of stock that are being traded, just the options contracts. And we're going to define exactly what those contracts are, in just a second. The motivation to trade options is many. And certainly, investors gravitate towards the risk reduction aspect to the product. Income generation involves selling options. Some investors are usually not used to

selling first and then buying back later. But with options, that is very common, known as income generation. And these two motivations tend to tie together. Some income-generation strategies also reduce risk. The idea here is to have less risk or be more conservative than if you just owned shares of stock. You can also use options to acquire stock, again, with risk management in mind. We'll discuss a strategy here today, at least briefly, where you can attempt to acquire stock but do so a little bit less aggressively than going in and buying shares. Can also speculate using options and take advantage of the leverage. All told, if you're bullish, bearish, or neutral, no matter what your market thesis is, there is an option strategy for you.

Options provide flexibility and the ability to get into more trades and participate in more market conditions. And, Andrew, this year we've seen incredible volume in the options industry, record-setting volume, a large number of new accounts and new investors trading options. So, what would you say, Andrew? When you talk to investors who are using options or those that are thinking about it, what kind of motivations do they have to go get into this space? And how successful or how accomplished have they been at doing so?

Andrew Rakowski: Yeah. Thanks for that, Ed. I would say the motivations are numerous, from the simple covered call, which is probably the most basic and common strategy that you touched on, from income generation for clients that have core holdings in individual names or ETFs where they kind of like that idea of creating additional cash flow, to more speculative, in the short term. I run into a good amount of clients that use options for the risk reduction, for almost a stock replacement. As a lot of these, kind of, large technology stocks have increased incredibly in price, it's onerous to buy a full share. I mean, now there is fractional trading at Fidelity and some of the major brokerage firms. But, you know, instead of buying a $400 or $500 equity, they could buy a $50 option or $20 option, whatever it may be, have that leverage, while limiting the potential downside.

Edward Modla: Yeah. You certainly touched on all of them there. And I think you're correct in what you alluded to, that I've also talked to investors that are a bit more apt to trading that speculative options trade this year than in years past, that I've seen. It's not the easiest thing to do to buy options and make money. And we'll cover that in a little more detail. And as you said, Andres, the covered call, very popular. And we'll dissect that trade, in a little bit.

Now, there are two types of options -- and now we're going to get into the education of these products -- two types of options. There's calls and there's puts. And you can buy or sell either one of those. That's it. That's all you can do. Those are the four sides available to you in the options industry. Let's start with equity call options. And equity call buyer pays up-front cash, that is debited out of your account immediately, nonrefundable. You pay up front. And the call buyer now owns the right to buy shares of stock at a defined price and owns this right for a certain length of time.

The price and that length of time go a long way towards driving what the market value of this option contract will be. What is someone willing to sell it to you for? What price can you buy the shares? And how long do you own that right? Those are two major components to the price. Key takeaway is the buyer pays for rights. In this case, just looking at what you own, the right to buy shares at a defined price, if the share price were to move higher, the value of what you own would likely increase. So, this is a bullish strategy. Owning the right to buy shares at a defined price, if the stock does rally and rally significantly, you have an opportunity to profit. That would be speculating. That's what Andrew just referred to as speculating or taking advantage of that leverage in the options industry.

What about the other side of the call option? Equity call seller is taking the opposite trade from the call buyer. A call seller receives or is paid up-front cash. That's immediate credit into their account. And the call seller has now taken on the obligation to sell shares of stock, at that same defined price. And this obligation exists for that same defined period. Now undoubtedly, the call seller already owns shares of stock. And this is the covered call strategy that we're going to get to more deeply, in a few slides. The call seller owns shares of stock and is willing to sell those shares at a specific price. In order to take on that obligation that they're comfortable with, they would get paid the option premium amount into their account, to effectively work a limit order to sell the shares. It's not an exact duplication of a limit order but it's very close. And that's the motivation of the call seller, get paid, generate some income, and take on an obligation to sell shares at a price you're comfortable with. If the stock never gets to that price, that credit is still yours. Effectively, you've lowered your risk.

What about put options? You have equity put options on the buyer's side. It starts the same way as calls. An option buyer, in this case put buyer, pays up-front cash -- it's an immediate debit out of their account -- and now owns rights. In the case of calls, the buyer paid for the right to buy shares of stock. In the case of puts, the buyer pays a debit to own the right to sell shares of

stock. We're going to look at this from a few different perspectives, when we walk through the strategies. You may speculate on a downside move in share price. Or you may already own shares and want to protect against a major correction in the share price. Owning the right to sell stock at a defined price and having that right for a certain length of time could have a few different motivations.

And then the sell side, of a equity put seller, against our same-ways call... An options seller has paid cash up front. A put seller, specifically, is paid cash immediately, credited to their account. And the obligation that the put seller has taken on is to buy shares of stock at a defined price. This obligation exists for a defined period of time. You think about the motivation of selling puts, you might want to get into a stock, you're bullish, but maybe the stock price is a little bit higher than you're comfortable with. So selling a put option can give you immediate cash -- and that's income generation -- and has given you the obligation to buy shares at a price that you might be comfortable with -- so, again, receiving some cash and income into your account, regardless of whether or not you're assigned and have to buy shares. If you do buy shares, you're comfortable with -- that's the most common motivation to sell puts.

Now these are the four options trades. That's it. The entire universe of options strategy centers around these four pieces, buying or selling a call or buying or selling a puts. There are a lot of concepts that go beyond this, of course options pricing, exercise and assignment, time decay, volatility. There's a lot to know about options. But every strategy you're going to look at is going to involve these four pieces. And that's what we want to do right now. There are a number of bullish strategies out there. Some of them involve only options. But we're going to specify, and some of the popular strategies today, bullish option strategies that include a stock position. You own shares. You're bullish. Now you can use options around that stock position, to enhance your likelihood of success and possibly your returns, at the same time.

Andrew said it earlier. Covered call. We're going to start here, because this is arguably the most popular option strategy that exists. There's two pieces on the covered call, first of all, owning 100 shares of stock -- we'll call it ticker XYZ -- at 104. And the second piece is overlaying the sale of one XYZ call option -- we're going to have an example using a strike price of 110 and receiving this option premium of $3.50. Now maybe this option goes out two or three months in time. And maybe it's a bit volatile. And you get a nice premium here, $3.50. This means you're selling first. You're selling to open a call option, that you don't already own. You're selling the option first. And you

have the obligation to sell shares at a price you're comfortable with. On the risk diagram, you can see this is more conservative than if you just owned shares of stock. This green dashed line is owning stock. Break-even point's 104. You start making money above that and you lose below that, with risk down to zero. With the covered call, you've reduced your cost by the option premium amount. Breakeven is lowered by that level. So, the stock can actually drift lower, in this case, by about three percent, before you reach your breakeven. Now whenever you're comparing or looking at an option strategy, undoubtedly, for any benefit you receive there's a cost. There's a disadvantage and an advantage.

There's always two sides to that. For this rather significant advantage of getting paid up front, reducing your breakeven, you give up the tremendous upside potential. Once the stock goes above 110, you are obligated to sell shares at that level. And that's why the profit to the upside is maximized. There are ways to manage this position, maybe more complex techniques involved, with when and how to close this option, if you wanted to capture that upside, or roll it, which we're not going to get into today. But the classic construction of covered call looks just like this, reduce breakeven and maximize the upside. And as I put the math up on the screen -- so, if anyone wants to look at where the numbers came from, they can do that. Andrew,

you said it at the beginning. Covered call, very popular. How would you say this ties in with current environment? Are people using covered calls right now? Or this an environment where maybe this strategy's not amongst the most popular. What would you say about that?

Andrew Rakowski: I would say it depends. Right? Because there's been an extreme amount of volatility. I think it goes back to what the individual investor's timeframe is. So, with... I mean, the markets have calmed down a little bit. But as kind of that idea of a core position being paid today, to potentially sell it, in your example here, you know, if we do the quick math, it's going to be $6 to 110 plus the 9.50 on the 104. You know, your maximum upside, roughly eight percent. Some clients that I deal with and talk with, they may not want to give away all of their position, up eight percent. So maybe on a hypothetical thousand shares, they'll do a covered call on half, to generate that additional income. I would kinda point out something too, that you said, Ed, that a lot of beginning option traders kind of forget about, is that you can always exit the trade prior to expiration. So, I've definitely had conversations with clients that were holding on to make that extra dollar of time decay or 50 cents, when they've actually turned neutral to bearish on the stock. And that's where you still have some substantial downside in the strategy. And I would suggest that,

if that changes, about your outlook, then you just unwind the trade. And you buy back the short call. You sell the long stock.

Edward Modla: Yeah, certainly. And I'm glad you mentioned that flexibility aspect. This example is drawn at the lowest denomination, 100 shares versus one option. And you're absolutely correct. Oftentimes, investors find themselves with 200, 500, or 1,000 shares. And with this idea of income generation, if you were not comfortable giving up all of the upside, you can sell as many call options as you want. Doesn't have to cover that whole position. Whatever you sell is going to bring cash into your account and lower the break-even point. This is rather obvious, but I always like to point out. Lowering the break-even point means you are giving yourself a better chance of being successful on the trade -- more likelihood of profitability with a better break-even point.

Now the second strategy we want to walk through is the protective put. I'm going to do this from a few different perspectives, first looking at a stock position. Now, this is long shares of stock -- that's the precondition we have on our bullish strategies today -- long stock and bullish on the shares but concerned about downside. So, a protective put also has two pieces. Buy 100 shares of stock, say at 84 -- and here's your stock profit-and-loss graph -- but

concerned about the downside. So, buying 180-strike put for 3.10, what does that do for you? Well, first of all, you have to pay 3.10 up front. And now the investor owns the right to sell shares at 80. If the stock drops from 84 to 60, 50, or went down to zero, the investor owns the right to sell shares at 80. This is going to maximize the potential loss on the trade. Here's how the numbers would have broken out. The break-even point is your stock entry point, $84 cost, plus the further cost of buying the put options. Now 87.10, at expiration, that's where the stock would need to be to break even. You give up... That's the disadvantage, the cost. What you give up in this strategy is that cost you pay for the option and that higher break-even point. The benefit here is maximizing the loss. The stock can go from 84 down to 80. That's a $4 loss. You can't lose any more on the stock position than that. The 3.10 is the cost up front, which also would be lost. And you've now maximized potential loss on the trade of 7.10. This is an effort to help you feel more comfortable and sleep easier at night.

Now, one of the common questions I get with protective put is, "Well, why wouldn't I just use a stop-loss at 80?" There are certainly a few very big advantages to using a stop-loss. First of all, a stop-loss order doesn't cost you anything. You don't have to worry about paying more for an option. Your break-even point's still going to be here at 84. Put in a stop-loss at 80. Doesn't

cost you anything. It doesn't expire. An option is going to expire. We paid 3.10 for 60 days. Sixty days rolls by and we're still sitting here at 84, 85, we might have to do something else, if we wanted to protect the position. So, two huge benefits to a stop-loss, doesn't cost anything, doesn't expire. But there's advantages to the put option, as well, first of which, it's working for you 24/7. A stop-loss is not going to work during after-hours activity. It doesn't work over the weekend. We've seen many occasions where there's an event that takes place over a weekend, then, come Monday morning, the market is much, much lower. Your stop-loss at 80 might not help you, if the stock opens up in the low 70s on Monday morning.

Also, if you're working a stop-loss, once the stock gets to that level, 80, 79, 78, your order's going to get triggered. You'll be out of the trade. With the option, there's no need to get out of this trade early. If the stock drops to this level, in the high 70s, mid-70s, and you've still got couple weeks, a month left till expiration, you can just wait this out and maybe wait for a bounce. This might be further highlighted with the example -- the flash crash. Flash crash down to 78 and you're out of this trade, if you got a stop-loss. With the put option, you can just wait it out and wait for this to bounce in your favor and not have to worry about further losses. Couple advantages and disadvantages to

using a put versus a stop-loss -- but certainly a choice that, from time to time, investors can consider. And it's nice to have this one in your toolbox.

I do want to look at this strategy in one other slightly different way. Because this question comes up. What if it's not a stock, that you're trying to protect, and instead it's a portfolio and you just want to buy an option on, say, an index or an ETF, you don't want to go in and buy options on each of the stocks that you own? Let's look at an example of how that's done. Specifical-- how do you calculate how many options to buy? That's the most common question I get. Portfolio value here is $100,000. And the desired protection is 10 percent. In other words, the investor's willing to give up 10 percent before they purchase their protection.

If the underlying or ETF that you have determined is a close correlation in performance to your portfolio's trading at 250, you're willing to give up that first 10 percent, well, that helps you select your strike price, of 225. And now your time duration is going to be unique, again, to your market analysis. How much protection and how long are you looking to purchase for? Let's say three months' worth of protection. The 225 strike, 90 days out, trading for $3. Now you know which option you're going to buy to protect this portfolio. The question is how many do you buy? What's the correct number? And it's

rather simple math. The desired amount of protection, or $90,000, divided by the notional value or aggregate value of the strike price -- in this case, our strike was 225 -- times 100 -- that's $22,500 -- equals four put options. In more simple terms, if everything went to zero, if every index and stock went to zero, your portfolio would have lost $100,000. You wanted to protect $90,000 of that amount. If you own a strike price of 225 and that underlying went to zero, you would get paid $22,500, or the strike price times 100, for each one that you owned. That gets you your four put options. That's full protection! Four puts, to hedge $90,000 worth of risk. You can then evaluate the cost of doing so. That would cost $1,200 in premium. You can buy fewer, if you think that's too expensive. You can buy more, if you're expecting it to cost more. And again, of course, this assumes one-to-one correlation between portfolio and hedge.

Now, Andrew, we talked covered call. That's bullish. Protective put is bullish, a bit differently. You've got all that upside and you're paying to protect the downside. Again, current market environment, and what kind of conversations are you having with clients and what are you seeing with activity, with respect to this strategy?

Andrew Rakowski: Yeah. This question comes up a lot. And if we have time at the end, we'll kind of walk through a real-world example. And say, you know, the market's had a nice rebound. I'm worried about just kind of keeping what I was lucky enough to recoup in my portfolio. I'm worried about the election uncertainty in the market and politics, etc. How do I protect some of the downside? And it just -- that same example, saying, "Hey, what's the appropriate index for you, based on what you own, from a correlation standpoint?" There is no perfect hedge -- right? -- unless you own the underlying index. Right? So, the other alternative would be the married put, buying a protected put on each individual stock that you own in your portfolio, which is at times an incredibly onerous task to take, depending on how many you own. Sometimes I see clients that have done this strategy and they feel that they've wasted money, after the fact, because either the individual stock has increased substantially... And they say, "Oh, I didn't... you know what? I wasted three grand on those 10 puts that I bought" -- in the individual example. And I'll say, "Yeah, but take a step back, Ed. That $84 stock is now trading at 120. That $3,000 investment allowed you to stay in the trade." Like you said, you slept at night and you maintained that upside. So, my, kind of, suggestion would be don't be shortsighted about, you know, the overall return of the package.

Edward Modla: Yeah, absolutely. And the worst-case situation, if you do a protective put, is that the underlying or the stocks just sort of consolidate around their current level and the put option gradually just loses its value and you don't get the upside on the stock. Or maybe the stock drops a little bit, your portfolio loses a little bit of money, and the put's really never come into play. That's the worst case. But then what I would say to investors is, if that does happen, your market thesis was wrong. It wasn't the strategy that performed poorly. Remember, keep in mind, you're bullish here. If you weren't bullish, you would not do this strategy. The benefits, as Andrew said, are going to be reaped when the stock rallies. And, if so, that protection was there. And you didn't need it. And that's okay.

So now the last strategy, I'm just going to walk through quickly, really just merging what we just talked about, is a collar. It's now a little more complex. Because now there's three pieces. But most commonly, the bullish outlook, with the use of a collar, is when an investor has unrealized gains in a position and they're focused on the risk-management element, the downside protection of the long put, but is not quite ready to get rid of their shares, looking for a little bit more of upside participation. And this is going to involve three pieces, putting all of what we just discussed together, and merging protective put with the covered call. Three pieces, on this strategy, long 100

shares of stock at 75. And here's the focal point, the risk management. This is why you're doing this trade. You want downside protection. So, you go down to the 67-half strike and put $1.30 for the put option, to maximize your losses. But instead of paying for that premium, you reach up to the 82-half call and sell it. So now you're combining the covered call with the protective put, receiving premium. And you're generating income through the sale of the call but you're not net positive. This isn't a credit trade. Most often, it's done as a debit, least a small debit, where call offsets most -- hopefully all but at least most of the cost of the put. You're buying the protection to the downside, without paying too much for that protection. And for that benefit, you're giving up the upside potential, without a net credit. So that's just a quick look at what the option collar looks like, merging those two strategies of protective put and a covered call into one, and what that looks like.

So now what we do want to do is, you know, look at some of the -- there's the math behind the covered call numbers -- is look at some bearish strategies. And most often, bearish strategies are not going to involve shorting stock. Most investors are not doing that. They're often left with possibly nothing at their disposal. When an investor's bearish and they're not using options, there's not a whole lot you can do. And for those of you in session number one, Sam had talked about where we are currently, in the markets today,

about eight percent off the highs, and the potential, at least in his view, that maybe we go further lower from there. If you are in agreement with that point of view and you think prices are going lower, you're just a stock trader, you're mostly left with either just doing nothing and waiting that out or reducing your market exposure and increasing your cash position. Options can actually get you into trades to the downside.

So, let's look at a few of those. This is buying puts to speculate. This is leverage. This is trying to take advantage of a downside move for profit, not to hedge a stock position or a portfolio but to profit. Stock's trading 72. And the investor goes out s-- "I think this stock's going to correct, and go down into the 60s, possibly the 50s." So, you could buy the 70-strike put, pay $4.50. And now, at expiration, here's where your profit-and-loss graph looks like, on a protective put. Stock would have to be all the way down here at 65-half. And we'll put the calculations up now. Break-even point is the strike price minus the premium paid -- this is at expiration, where the maximum loss is what you pay. You own this put option. You pay 4.50. That's $450 in total premium. Option's being quoted on a per-share basis. And delivering 100 shares gets you 450 total dollars. It can only go to zero. So, there's your maximum loss. But I'm stressing this graph is drawn at expiration. Undoubtedly, your intention is to not hold this option that long. Options positions are most

frequently closed before reaching expiration. There is a myth... I always like to mention this, especially for those new to options, that they hear most options expire worthless. Seventy, 80 perc-- and 85 percent of all options expire worthless. And that really isn't true. Most options -- in fact, about 70 percent of all options that are opened are closed before ever reaching expiration. Another 20 percent or so are held through expiration and expire worthless. And the remaining roughly 10 percent are exercised at some point. The myth really comes from ignoring all of the closing sales and focusing on the options held through expiration date, of which the vast majority expire worthless. But overall, that's really not the case. Options positions are frequently closed. In fact, in this case, that's exactly what you would be expecting or planning to do, if the stock dropped. You're anticipating selling this put option for something greater than 4.50, before ever reaching expiration. And that's speculating to the downside with puts.

And I'm just going to add one more piece to this, for our other bearish strategy, the bear put spread. This is going to take what we just did but just add a short put option to it, to reduce the cost. We're going to lower our cost and we're going to cap our gains. That's what we're going to give up. Stock's trading 92. We're bearish, we think the stock's running lower, buy the 90 put for 3.50. If that's all we did, our cost would be 3.50 and our break-even point

would be down at 86-half. If we add the sale of a put, for $1.80, now our cost has been reduced. Doing the calculations, our cost is now reduced to 1.70. That's our max loss. If the stock runs down to 85... Just think back to the beginning of the presentation. What does this mean? We own the 90 put. We have the right to sell shares at this level. We've sold the 85 put, taking on the obligation to buy them back, here. That's the best that can happen. And that would be capturing $5, from a 1.70 cost, maximizing profits at 3.30. And as Andrew had said earlier, in reference to flexibility of the product -- and that's what I want to highlight here, as well -- with various strategies, and this being on of them, the investor can choose their quantities. We're looking at this at the lowest denomination, of one-by-one. But if you bought five of these puts and wanted to offset that cost to a certain extent, you could sell two or three or four of these puts, reduce your cost, and have one or two puts that, you can capitalize on a huge move lower. And maybe a little more complex thought. But if you're following all of this and the four sides available to you, what this 85 put means is you're obligated to buy shares.

You might be short-term bearish. But if the stock goes down to here, you might be willing to pick up some shares. So maybe buy two of the 90 puts. You could sell more of the 85 puts than what you bought over here. And that could greatly reduce your initial cost. You could still profit on the 90 put, as it

sells off. And if you really got a sell-off, into the 80s, keep in mind your extra puts sold would result in being long shares of stock. You might be okay with that. The point is options are flexible -- all sorts of different things that you can do. And right before we get to the demo and we look at a few things on the platform... Andrew, I don't know. How often do these bearish strategies come up, with the investors that you work with who are using options?

Andrew Rakowski: Every now and then, I would say -- I mean, not nearly as popular, I would say, as bullish strategies, just because, in general, retail investors are, traditionally, bullish. But, you know, a lot of times, it's more the Street speculative put buyer, not really talking too much about put spreads and verticals and calendars and that sort of thing. But it does come up, every now and then. I mean, one thing I would kind of touch on that you brought up is that, you know, both of these strategies allow clients to express that bearish opinion, where they otherwise may not have the ability to do so. Because the only other way that you can, quote, unquote, bet against a stock or express a bearish opinion would be to short the stock. And that would require a margin agreement. It can only be done in a taxable account. So, if I want to place my option trades in an IRA and I do want to kind of make a contrarian trade, I won't be able to short a stock. And that's where looking at either one of those

strategies, depending upon kind of what my outlook is for the downside, would make sense.

Edward Modla: Yeah. And, you know, we did cover a number of strategies here today. And I want to emphasize, for those new to options, certainly you're not going to understand these strategies in their entirety. As long as you get a sense for why options are used and how they can benefit your portfolio. And, Andrew, you're right. You have these somewhat complex strategies, when you have a couple of different pieces lining up together and with strategies that will require some form of position management, especially if they work out for you, you know, in this case, if the stock does run lower. These are generally not set it and forget it type of investments.

You're going to have to take some action here, and proactively close out the positions, take your profits off. If you have a stock that's sitting in between the strike prices, you are definitely going to have to take some action to avoid that exercise and assignment activity that could leave you with a position in shares that you don't want to have. So, certainly -- you know, again, Andrew, we're going to the platform here, in just a second -- you know, there's a lot to know with options. But I'm always a believer that it's not too complex. Anybody

really can understand this. It's just a matter of time and dedication to learn the product and then use it wisely and responsibly.

Andrew Rakowski: I would agree. On that note... So, I'm going to go ahead and share my screen here, to kind of just walk through just some of those examples. Hopefully... I wrote down five of the strategies, when you were talking. Not sure if we'll get to each one. But just kind of talk through some things. To Ed's point, to learn more, News & Research, Learning Center, there's an incredible amount of content here, about options trading, Options Strategy Guide. There's archived webinars. Which, I believe there's some of Ed's webinars, some other professionals, from different partnerships, from the Cboe, the OIC, etc., a lot of content for you to get up to speed as an investor, or, quite honestly, just to learn more. So, keep your braining work and it'll never grow old.

Covered call. Right. So, News & Research, Options. I'm just going to go to the options starting page. Blank page. I haven't plugged in a symbol yet that I'm interested in. I'm actually going to skip over that part and go to the Market Overview. Because I just want to highlight a few things. This is a great place to start. What's going on in the market? Where are some implied volatilities? Where are things trading? Market Scanner.

But I want to bring your attention to the left-hand rail. And that's the Covered Call-- on the Argus Focus List. If I click on See More, will take me to the next page, to this particular strategies home page and ability to search by different attributes. So, these reports are provided by Argus Research. It's a third-party research firm, that puts together potential top-returning covered call strategies. And they will suggest different strike prices, expirations, etc. I already know -- hypothetically... Let's say I'm long ExxonMobil. And I've been long for 10 years. I've underperformed the market. I'm not exactly sure that there's an incredible amount of upside, at this point. But I want to kind of get paid for my equity risk, generate some additional income, through the premium. This is where I could get into that covered call strategy, I could open in the PDF. I'm not going to go there. Because really -- like this is a real-world example of what Ed went through. The suggested covered call's the October 36.5, October 9. All right? So that's about a week and a half, I guess, maybe a little longer. Downside Protection. So, this premium, from the covered call, is going to give me 3.24 percent downside protection. So that's that break-even point, that Ed just talked about. It's going to move my breakeven over to the left. My assigned rate of return. So, this is if the stock is above the strike price and it gets taken away from me. In that timeframe, I'm going to realize 3.55 percent, from when I put the trade on. So, this is pretty important, when you

kind of run through the numbers. Do you think there's more than 3.55 percent in the stock, in the timeframe? If so, then maybe you want to revisit a different strategy, move a strike higher, etc. This is where it gets powerful. If I could do this trade every 18 days... Right? And this is kind of -- Ed touched on the idea of rolling. And that's just the idea of buying this option back, selling it. That is going to generate an annual return of 72 percent. Right? Highly unlikely we could do the exact same trade every 18 days. But to put it in context of "Hey, what is this 3.55 percent -- what does it represent on an annual basis?" in this case, 72 percent return -- right? -- again, if we could do that every 18 days. So that's just one kind of tool, where -- a report... We could search for ideas, you know, based on... Like I said, we could add some attributes, assigned rate of return, annualized return, etc., etc.

Next thing that I wanted to get into... And then, Ed, you know, while I'm talking through this, please add any commentary to kind of that Exxon trade. But... I liked what Ed said -- was kind of the idea of a correlation. Right? Portfolio hedge. Let's say, hypothetically, that I own a portfolio of large-cap technology stocks. I chose the QQQ, the Nasdaq-100, the ETF that tracks the Nasdaq-100, as my underlying index or ETF for which to trade the option. In this case, we'd want to be looking at what the downside... Again, we can use Ed's numbers. Because, 270, that's going to put us roughly around 243, 244,

with what that 10 percent downside is. So, let's go, from a Custom Range, from 240 to 250. And I'm going to choose November as my expiration. I've customized, under Settings, what comes up when I look at the option chain on fidelity.com. Because I like to just focus in on the month that I'm interested in. If I click Apply... And if we did our math correctly... Right? Two-seventy minus 27. Two forty-three is roughly that down-10-percent threshold. Right? Again, we're making an assumption that our large-cap technology portfolio is going to act in line with the Qs. Here's that cost of establishing that floor. It's going to be about $6.30. To Ed's point, we've done the math. We know what the notional value is. We know how many contracts we would need to buy to hedge out our notional value. It would be as simple as buy to open. Again, we're establishing a new position. It would be an opening trade. The one thing I would add, too, is just that $6.30 is going to add kind of about 2.5 percent to that 10 percent threshold. So, if we are very strict with that 10 percent number, we may want to look a little higher in strike to get to that equivalent 243. Right? It's going to cost us a little more for the premium. Because now we're moving that floor a little higher, the example being, if we looked at the 250s, minus roughly $8, it's going to put that floor in place at 242. Right? So just got to... Y-- there's all different ways, kind of, to get to your 10 percent number or what you feel comfortable with.

Edward Modla: Yeah, really good stuff there. And I'll just kind of, really quickly...

What jumped off the screen -- a few things. First of all, during the analytics that you've showed, that annualized rate of return is really powerful. Because it does help investors choose from one trade to the other, comparing apples to apples. What is the annualized rate of return versus two different trades, that might have different expiration dates? It gives you a good idea of what trade is offering the higher annualized rate of return. But be careful. If you're getting higher annualized rates of return, that could very well be because the stock itself is more volatile. The lower rate of return might be the better trade, if it's a low-volatile, slower moving stock.

And just with respect to the demo you just gave, it's really helpful to see this example with the Qs. And then you can further evaluate, if you're looking at this trade, "Am I comfortable with that premium amount?" If you are, you can go ahead and execute, as Andrew was showing. If not, then maybe this is not the trade you would take. Or you could start to look further down the line and see... Maybe there's something down lower, maybe under 240, that's trading for a premium level that I'm willing to sell, because I'm not concerned about the market going that far. And then you can reduce your cost that way. Just some observations, and different things you can do.

Andrew Rakowski: Yeah. You have a lot of different options. Pun intended. Right?

Edward Modla: Yeah.

Andrew Rakowski: So, I do want to get into like that idea of a collar. Because that is a question that comes up pretty often, with the recent run-up in the market or rebound in the market and some individual stocks that have done fairly well. And to do so, I'm actually going to change my share to the Active Trader platform.

And so, here's real-world example. We're long 1,000 shares of Apple, which we were fortunate enough to purchase at $75. With Apple trading right now at 109.50, we have an unrealized gain of $34,530. For a number of reasons, we may not want to exit that trade right at this time. It could be tax implications. It could be that we still think that there's some upside. But being that we're in a fortuitous situation, we can look at the idea of a collar, to say, "Hey, I want to limit some of the downside. I'm worried about the market, in general, specific..." Let's stay on that election theme. I added simulated position. I'm going to go to Collar. In this case, it's 1,000 shares. And I'm going to do all 1,000 shares, on the protection side. So, I know my expiration is November. And let's just do rough math, down $20, up $20. One-ten, that'll

put me at 90. So, I'd be looking at buying the 90 puts. If I just bought them outright, it's $2 trade. So that would be the cost of that married put. I may not want to spend that much money, you know, depending on kind of what my outlook is. If I did want to sell some upside call... And this is a pretty wide, kind of, collar. Maybe $10 would have been a better example. But we're already into it. So, let's stay with the $20 spread. In this case... Right? And this is pretty interesting, where we could actually enter this trade for a credit. We could purchase the downside put at 2.08. We could sell that upside call at $2.85. We could generate a 75-- excuse me -- a 77-cent credit. I'm going to add... I'm going to click Apply. And that is going to add into my profit-and-loss calculator. Now I'm going to look at everything as a whole. And essentially, here, you could see my upside, the maximum I'm going to make, is 55,770. My downside is 15,770. So that's what the collar has done. You know, it's minimized my downside. I'm giving away some upside to pay for it.

END OF AUDIO FILE

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.

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