Financial Education

BLOG

Options 101 Continued - Let's Talk "PUTS"

The last time I wrote an article on this subject (link to old article) we discussed how options strategies could reduce your risk and augment your returns.

Today we are going to learn about strategies that can augment your returns, reduce your risk and buy stocks at cheaper prices. As the saying goes, if you liked Apple at $180 you should like it more at $145!

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A put option is the right to sell a stock (100 shares) at a specific price lower than today's price at some specific date (expiration) usually in the next 12 months.

Over 12 months an option is called a Leap. As stated, the buyer of a put can buy a put (pay a premium) for the right to sell 100 shares of Apple (AAPL) for say $135, and in this case, wanted to limit your downside in a specific stock or index. This is called buying protection, but what about selling puts?

Selling puts can be a great strategy, especially in a volatile market, to buy stocks at a lower price than it is trading today. I will use Apple (AAPL) company stock to illustrate:

Say you are interested in AAPL after this move down from its highs at $182.13 today trading at $145.49. If you just buy it the reality is that you have a 50-50% chance of it going up or down in the very short term. **In a market downturn you may want to see if you might be able to get a better price . . . but wait, you are telling me I can get paid for buying AAPL at a lower price?! Well yes.**

Let’s look at the following example:

- • AAPL gets to $135/share. You would buy it or want to buy it.
- • You could sell a $135 Put in AAPL, this would give the buyer the right but not the obligation to sell you their AAPL 100 shares for $135 per share by a certain date.
- • In exchange you would be paid money for making this promise (obligation) to make this purchase.
- Today AAPL last traded 145.49/ share. You are looking to buy 100 shares of AAPL for $135, remember?
- You could sell an August 19th, 2022, 135 Put for $3.05, since it is always 100 shares you would receive $305 to take the obligation of purchasing 100 shares of AAPL at $135 each.
- That is 7.2% lower than today’s price or effectively with the premium received would be 9.3% lower than today’s price. What a bargain you say…if you liked AAPL at $135 you are going to like it even more at $131.95.

So, what is your risk?

- If AAPL goes out of business, you in this case would lose $13,195. Remember you were interested in AAPL at today's price if AAPL went out of business after purchasing 100 shares you would have lost $14,549 or 10.26% more than if you just sold the put.

- If by August 19th AAPL is above $135 you keep the $305 and your obligation to buy is gone. You also made an annualized return of 22.8% on your $13,195 obligation for 37 days (actual return 2.31%). This strategy has lowered your risk of buying today, augmented, or given you a great return on idle capital and gave you the opportunity to buy a stock that you like at a discount of 9.3% from today's price or a discount of 27.55% from the highs.

- Your other risk here is opportunity risk if AAPL goes higher you keep the premium but don't own the stock that you were interested in buying.

Although Options may seem complex, they provide you with strategies to mitigate risk and provide alternative to your investment strategies. If this is something you would like to explore further, please give me a call and we can see if this is a good fit for you.

Let's talk to see if this is a good strategy for you!

Jim Jones, CFP®, CCO, Principal Member, spent 10 years working at the Chicago Board of Trade where he worked as a broker and market maker. Jim also served as an advisor to several large Commodity Trading Advisor (CTA) hedge fund clients. He has over 20 years of expertise in helping clients "de-risk" their portfolios by augmenting returns utilizing options. Reach out today to find out if Trading Options might be a good fit for you.

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