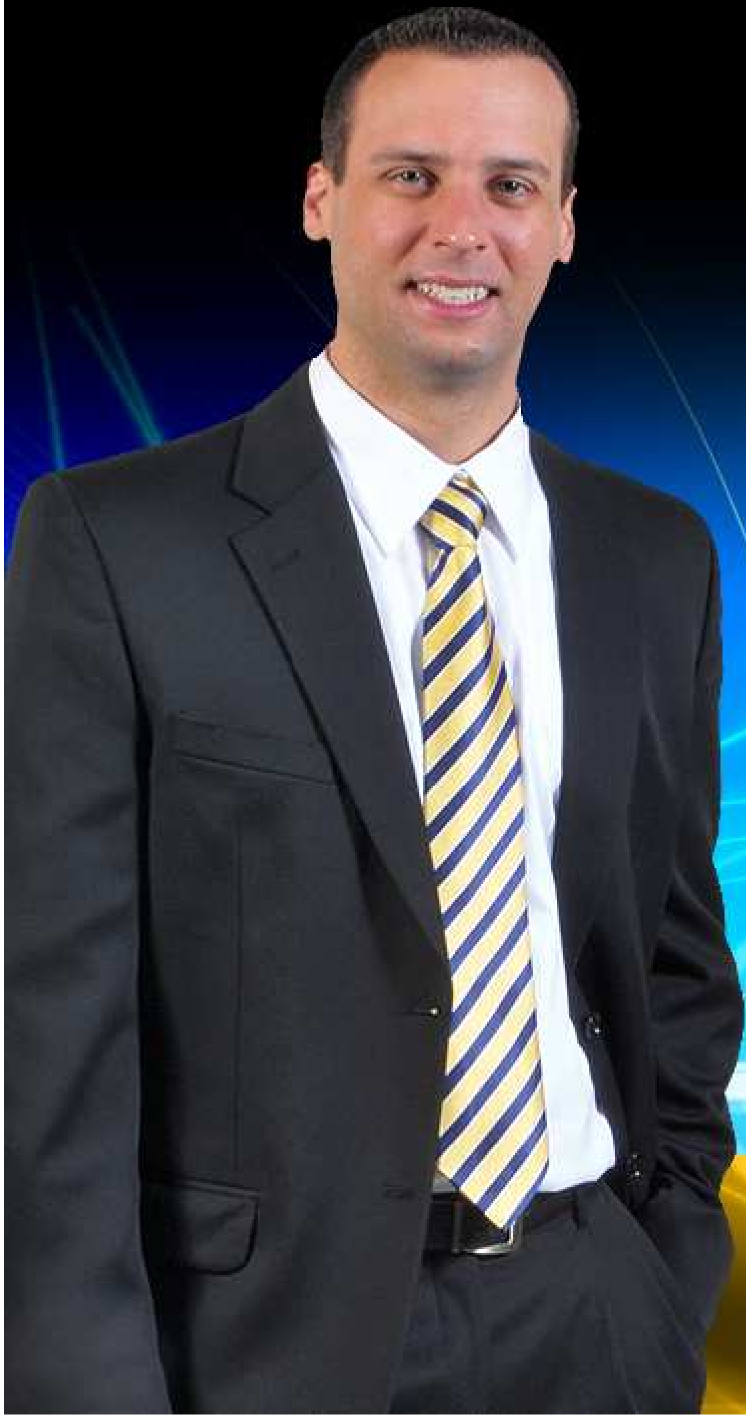
# Rolling Up Your Collar

By John White



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# What Is a Collar?

- Long stock position insured by an OTM or ATM put option.
- Put premium is partially or totally covered by sale of OTM or ATM call option.

# What To Look For

- Bullish/Bearish Candidates
- Stocks, ETFs, indexes, etc., already in up/down trends or just bouncing off support/resistance.
- Affordable stocks
- $1.00 Strike Increments
- Deep ITM call can be used as stock replacement.

# Hedging Downside with Puts

- Buy put that is closest to ATM
- Insurance should kick in as soon as possible

# Hedging Downside with Puts

- Stock at $30.27

- PUT OPTIONS

  33 put $3.05 ($.32 time value)

  32 put $2.30 ($.57 time value)

  31 put $1.50 ($.77 time value)

  **30 put $1.05 ($1.05 time value)**

  29 put $.75 ($.75 time value)
- **Total risk of hedge is $1.32 (1.05 + .27)**

# Hedging With Synthetic Strikes

- Stock at $30.48 - Long 1000 shares
- Need 10 contracts of puts

31 put $1.20

30 put $.95

Create 30.50 strike by buying 5 cts

of 31 strike and 5 cts of 30 strike for average of $1.28 ($1.20 + $.95 = $2.15 / 2 = $1.08

# How Does Hedge Work?

Long 1000 shares $30.27

Long 10 contracts 30 put $1.05

Long put will protect the position from $30.00 to $0

# How Does Hedge Work?

Long 30 put $1.05

(now worth at least $10.00)

Stock has declined from $30.27 to $20.00

(Stock has lost $10.27 in value)

# Selling Call Premium

- Sell strike OTM that gives at least enough premium to pay for hedge over course of trade.
- If put hedge (plus downside risk) costs \$1.60 with four weeks until expiration, choose call that brings in at least \$.40 per week (\$.40 x 4 = \$1.60)

# USO closed at $39.22

Wk 42 call $.09

Wk 41 call $.15

**Wk 40 call $.35**

USO @ $39.22

Feb 12 39 put $1.71

- Downside risk is $1.93, so $1.93 / 6 weeks= $.32

# USO at $39.22

Sell 10 cts Jan Wk 2 40 call $.35

Long 1000 shares USO @ $39.22

Buy 10 cts Feb 12 39 put $1.71

- Total initial cost is $40.58 (39.22 + 1.71 - .35)
- If called out at $40.00, the sale of remaining premium of 39 put should be more than $.58.

# USO Advances to $41.10

USO now at $41.10 (call is $1.10 ITM)

Short Jan Wk 2 40 call

USO began at $39.22

Long Feb 12 39 put

# Rolling up Call

Sell Jan Wk 3 42 call $.35

USO $41.10

Short Jan Wk 2 40 call (BTC $1.10)

Long Feb 12 39 put

# Rolling Up Put

Short Jan Wk 3 42 call

USO $41.10

Long Feb 12 41 put

Long Feb 12 39 put

# Rolling Up Put Guidelines

- Roll up put if it’s possible to do so for approximately 30% of the strike prices moved.
- If rolling up put from 39 to 41($2.00), should be about to do so for about $.60.

# USO Declines

Short Jan Wk 2 40 call

Long Feb 12 39 put
USO declines to $38.00

Keep 39 put hedge in place and sell next week’s call for approximately $.35 – likely the 39 call

# USO Doesn't Move Much

Short Jan Wk 2 40 call

USO finishes week at $39.89

Long Feb 12 39 put

Keep put in place and sell next week's call for approximately $.35 – likely the 40 or 41 call or possibly 40.50 synthetic strike call.

# Creating Synthetic Call Strike

- 43 call $.04
- 42 call $.15
- 41 call $.25
- 40 call $.45

- To create 10 cts of 40.50 strike sell 5 cts of 41 call and 5 cts of 40 call for avg price of $.35 ($.25 + $.45 = $.70 / 2 = $.35)

# Replacing Stock With ITM Call

- Deep ITM call can be used to replace any optional stock.
- Choose time frame appropriate for trade (usually no more than 2 months out)
- Delta of at least .80
- Must factor in time value of call in amount of premium to be sold to overcome time risk and insurance premium.

# Replacing Stock With ITM Call

- USO at $39.22 call options

| STRIKE | DELTA | PRICE | TIME |
|---|---|---|---|
| 39 | .55 | 1.88 | 1.66 |
| 38 | .63 | 2.47 | 1.25 |
| 37 | .71 | 3.15 | .93 |
| 36 | .78 | 3.90 | .68 |
| **35** | **.84** | **4.70** | **.48** |
| **34** | **.89** | **5.55** | **.33** |
| **33** | **.92** | **6.35** | **.13** |

# Replacing Stock With ITM Call

- USO at $39.22

| Strike | Delta | Price | Time |
|---|---|---|---|
| 35 | .84 | 4.70 | .48 |
| 34 | .89 | 5.55 | .33 |
| 33 | .92 | 6.35 | .13 |

- If the 35, 34 or 33 strike were used, the above time value would be taken into consideration to determine how much premium needs to be sold.

# Call Option Replacement Using 34 call (delta .89)

USO at $39.22

Sell 10 cts Jan Wk 2 40 calls $.35

Buy 10 cts Feb12 34 call $5.55 ($.33 time)

Buy 10 cts Feb12 39 puts $1.71

$2.04($1.71 + $.33) in premium needs to be collected to pay for hedge.

# Stock Closes Above Short Call

Sell 10 cts Jan Wk 2 40 calls $.35

Buy 10 cts Feb12 34 call $5.55 ($.33 time)

Buy 10 cts Feb12 39 puts $1.71

- Since stock is not owned you wouldn't let yourself get called out.
- Sell ITM call for gain, buy back ITM short call for intrinsic value only and sell put for remaining amount.

# Bearish Position SLV $27.91

Buy 10 cts Feb12 28 call $1.35

Short 1000 shares $27.91

Sell 10 cts Jan Wk 2 27 put $.27

- If SLV declined below $27.00 the stock would make $.91 plus the $.27 for total income of $1.18.
- $.27 x 6 weeks = $1.62

# Bearish Position SLV

- If stock closes below short 27 put on weekly expiration, the trader would be put the stock at $27.00.
- Since the trader is short at $27.91 and forced to buy (buy back) the stock at $27.00, a $.91 gain would be realized.
- This $.91 gain is in addition to the $.27 premium received from the sale of the 27 weekly put.

# Bearish Position SLV

- Depending on the opinion of the trader, he/she may allow short 27 put to be exercised or may instead decide to roll the options.
- Rolling options guidelines
- An ITM put can be used as stock replacement using same criteria as used for ITM calls.

# Bearish Position SLV

Long Feb12 28 call

Short 1000 shares $27.91

Short Jan Wk 2 27 put

Buy Feb12 27 call

SLV declines to $26.88

Sell Jan Wk 3 26 put

# Next Class: Advanced Hedging

- Using put spreads and butterflies rather than a straight put.
- Provide downside protection while reducing the cost of insurance

# Advanced Hedging Preview

Stock at \$39.08 (34 call \$5.40 .89 delta)

Buy 39 put \$1.68

Sell 34 put \$.35

Cost of hedge is \$1.33 vs \$1.68

# Advanced Hedging Preview

Stock at $39.08(34 call $5.40)

Buy 39 put $1.68

Sell 34 put $.35 x 2

Buy 29 put $.06

Cost of hedge is $1.04 vs $1.68 -38% savings

Register now for

# Advanced Hedging

## Wednesday, Feb. 1, 8-10 p.m.

Learn how to use put spreads and butterflies rather than a straight put.

## Regular price: $149.95

## Special price tonight: $99

You must register online

to receive the special price.

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