

BULLCHARTS MELB
USER GROUP.. *23rd Mar 11*

Covered Calls - Simplified

Important Notice — No Advice!

- This presentation does not include any advice.
- For proper advice, your personal financial situation needs to be considered.
- This presentation is pure education, only for your general awareness.
- There are no recommendations to take any action, or to invest any money in any way.
- Always consult a properly licensed advisor before making investment decisions.



Will cover the following :

- Basic understanding of call options
- Writing a covered call against stock
 - > For BHP US using my trading platform (TOS)
 - > Using “real time” trading
- How this applies to the Australian Market
- CSE Charting package.
- How I trade, (if time permits)

Why I trade options US..

- ◉ Cash flow not capital gains.
- ◉ Options for leverage
- ◉ US market – largest and best system
 - > Platforms – free
 - > Entry/Exit
 - > Opportunities
- ◉ Trade early, lifestyle
- ◉ Why I come to Bullcharts?

Cashflow & Compound Int

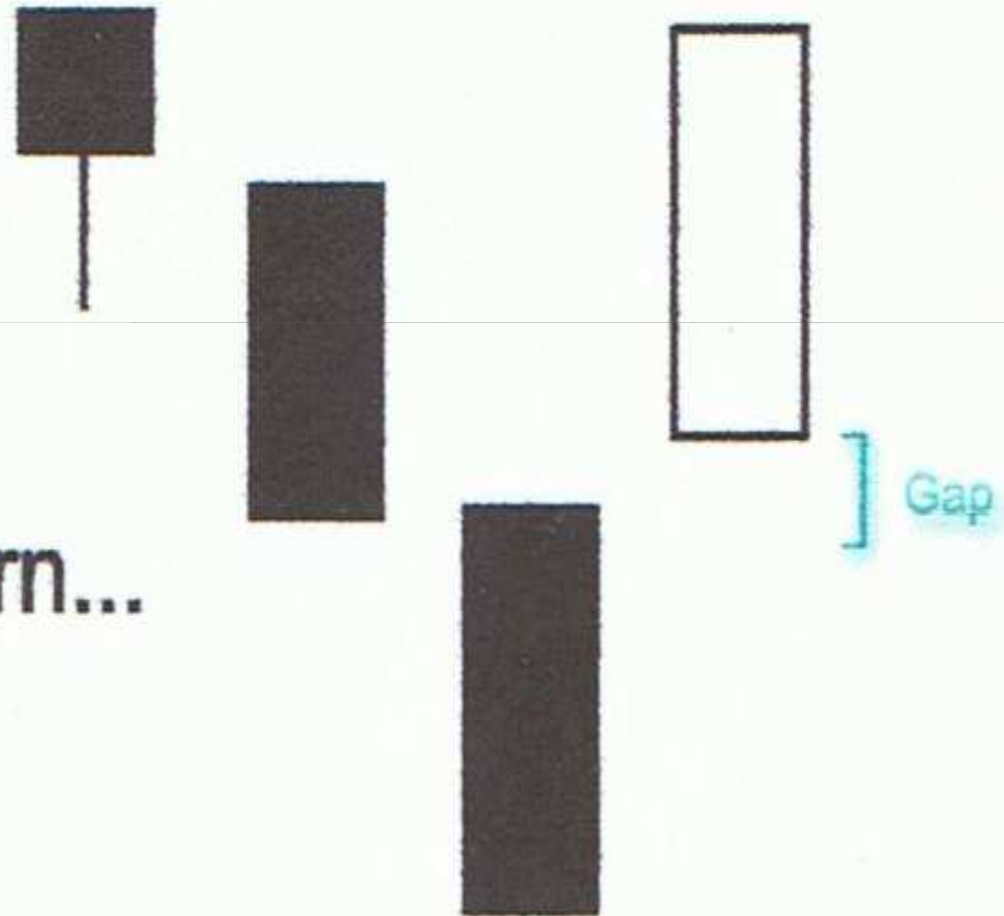
Time	Simple @5%pa	Compound @5%pa	Compound @4%pm
Start	\$10,000	\$10,000	\$10,000
Year1	10,500	10,500	16,010
2	11,000	11,025	25,663
3	11,500	11,576	41,039
4	12,000	12,155	65,705
5	12,500	12,763	105,196
6	13,000	13,401	168,423
7	13,500	14,071	269,650
8	14,000	14,775	431,718
9	14,500	15,513	691,195
10	15,000	16,289	1.106,626

Let me tell you a story



Bullish Kicking

Last month,
Ilia Bermous
described the
Bullish Kicking
candlestick pattern...



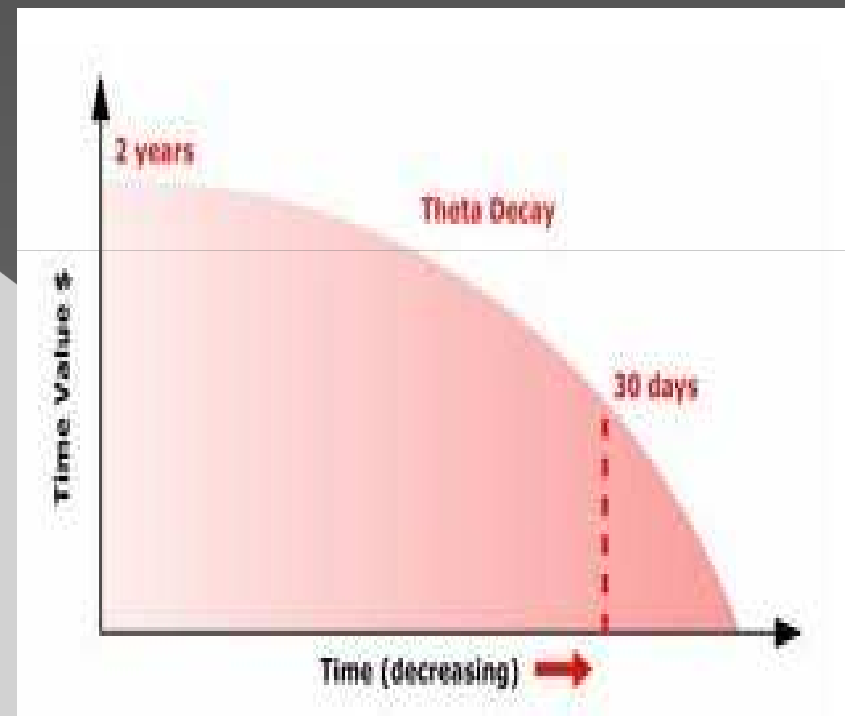


The Arrangement.

- Buyer, (Robert) and a seller (Neighbour).
- Current value \$1,000,000
- Exercise price \$1,100,000, (\$1.3 Mill)
- Agreed on an amount \$5,000 (premium)
 - > Hold house and arrangement for period
- Agreed on a time 12 months
- Rob can exercise (close) any time up to 12 months (American style).
- Rob can on sell if wishes, at any time.

Premium based on

- Factors include:
- Current house price
- Exercise price
- Time to expiration
 - > Less time to move up in price.



Outcomes ..

- ◎ The only possible outcomes are:
 - > Robert exercises the agreement because :
 - The house value has risen $> \$1.1$ mil.
 - He has arranged funds, so ..
 - > Robert pays \$1,100,000 for the house and the seller keeps the premium of \$5,000.
 - > Or
 - > Value $< \$1.1$ mil Rob chooses not to exercise, and the Seller keeps the premium of \$5,000.

Rob's Agreement

- ◉ Rob has bought a call option....
- ◉ Where you buy an option to purchase an asset at an agreed price for an agreed period, because you believe that the asset will appreciate in value.

BHP on the TOS trade page
in the US Market ...

March 11 Call Options



	Last X	Net Chng	Bid X	Ask X	Size
	95.64 N	+1.92	94.49 P	96.04 P	2 x 1

▶ TRADE GRID

▼ OPTIONS

CALLS							Strikes:	ALL ▼
	Impl Vol ▲	Prob. Exp ▲	Delta ▲	Bid X	Ask X	Exp	Strike	
▶ FEB 11 (3) 100								
▼ MAR 11 (31) 100								
	82.06%	92.82%	.92	28.75 X	32.60 X	MAR 11	65	
	--	100.00%	1.00	24.25 X	26.25 X	MAR 11	70	
	50.00%	94.05%	.93	20.60 C	20.80 X	MAR 11	75	
	38.30%	93.39%	.94	15.65 X	15.85 C	MAR 11	80	
	30.95%	88.99%	.91	10.85 X	11.00 C	MAR 11	85	
	27.91%	75.08%	.78	6.50 C	6.65 C	MAR 11	90	
	25.91%	51.22%	.54	3.15 X	3.20 C	MAR 11	95	
	25.25%	25.69%	.28	1.18 C	1.22 A	MAR 11	100	
	25.46%	9.76%	.11	.36 C	.39 C	MAR 11	105	
	25.51%	2.81%	.03	.06 C	.12 C	MAR 11	110	
▶ MAY 11 (94) 100								
▶ AUG 11 (185) 100								
▶ JAN 12 (339) 100								
▶ JAN 13 (703) 100								

Compare R. Brain & BHP

	ROBERT	BHP
Trading Price	\$1,000,000	\$95.64
Strike Price	\$1,100,000	\$100
Premium	\$5,000	\$1.20
Term	12 months	1 Month
Style of Option	American	American
Delta		.28
Can Close Trade	Yes	Yes

What is an Option?

- ◉ Financial instrument and contract.
- ◉ Value derived from stocks, indexes, futures and commodities.
- ◉ “Right ...not obligation”
 - > Don't have to exercise if not favourable.
- ◉ Two types of options:
 - > Call Option
 - > Put Option

Call Option

- ◉ Right ... not obligation to:
 - > Buy a stock at a certain price up to a certain date.
- ◉ Speculators expect increase in price of stock.
- ◉ Seller of stock expects price to fall and keep premium.
- ◉ Roberts case ...

Put Option

- ⦿ Right ...not obligation to:
 - > Sell a stock at a certain price up to a certain date.
- ⦿ Speculators expect decrease in price of the stock.
 - > Own 1000 shares of BHP @ \$40, and price falls to \$35, option seller has to buy at \$40.
- ⦿ Option seller expects price to rise and keep premium.

Leverage?

- \$10,000
- Stock at \$30, increases to \$32 ..expiry
 - > Buy shares return 6.7%
 - > Use options return 80%
- Stock at \$30, decrease to \$28 .. expiry
 - > Buy shares loss 6.7%
 - > Use options loss of most if not all of \$10,000
 - > Ways of getting out of position

Leverage Continued

- Calculated return of Call Option

- > \$10,000

- > Stock at \$30

- > Buys \$30 call option at \$1.00 per share

- > Contract size 100

- > Can buy 100 contracts $\{\$10,000/(\$1.00 \times 100)\}$

- > Stock \wedge to \$32, option value approx \$1.80.

- > Return is \$.80 per share x 100 shares

- > $.80/1.00 = 80\%$

Two pieces of Information

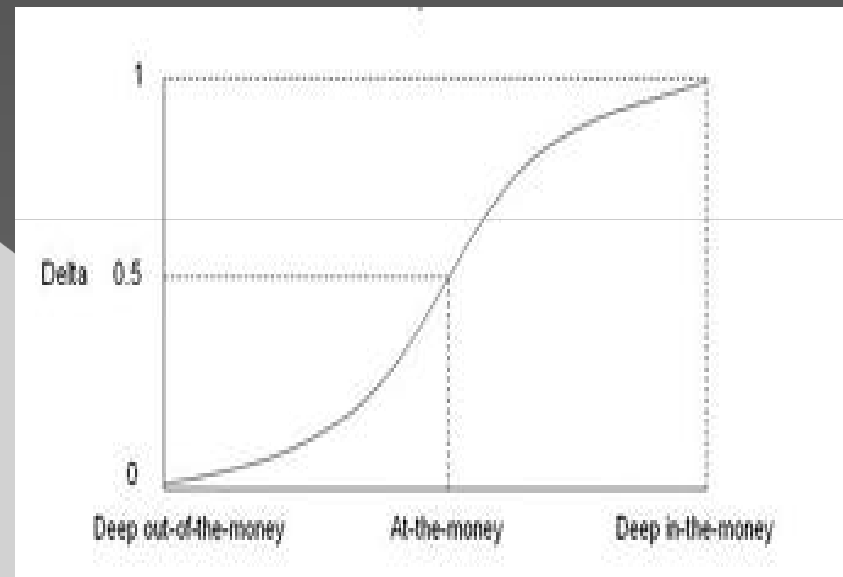
- ◉ The most successful trading system was the Turtle System, and they were correct 30% of the time ... Chris Tate ATAA
 - > Why speculate?
- ◉ Buyers of options lose approx 85% of the time ... Aaron Zalewski (CSE)
 - > Why buy options?

Covered Call

- ◉ Simplest : Own stock & sell call
- ◉ Need know:
 - > Strike Price, (exercise price)
 - > Expiry date & what happens on expiry
 - Exercised or not exercised.
 - > Premium paid by buyer to seller, (writer)
 - > Style of options (American or European)
 - > At/in/Out of the money
 - > Contract Size (100 US, 1000Aust)
 - > Delta

Delta

- ◉ Delta is increase in option value for every rise or fall in stock value.
- ◉ Stock delta is 1
- ◉ Delta is .5 when strike value = stock value.
 - > + \$1.00 stock
 - =
 - > + \$.50 option.





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Example : Using TOS

- ◉ BHP (US)
- ◉ Covered call
 - > Own stock
 - > Sell Call against that stock
- ◉ Example:
 - > BHP (US) trading at \$72.77
 - > Buy 1000 shares = \$72,770, (100 contracts)
 - > Look to sell call option, and not exercised ie keep premium and hold stock.

Jan 10 BHP – (1000 shares)

BHP	Exp	Date	Stock	Strike \$	Premium \$	Credit	Price @ Expiry
Jan 10	15 Jan	21 Dec	\$72.77	85	.05	\$50	\$79.18



Feb 10 - BHP

BHP Feb 10

BHP	Exp	Date	Stock	Strike \$	Premium \$	Credit	Price @ Expiry
Jan 10	15 Jan	21 Dec	\$72.77	85	.05	\$50	\$79.18
Feb 10	19 Feb	19 Jan	\$80.92	90	.30	\$300	\$74.92



March 10 - BHP

BHP March 10

BHP	Exp	Date	Stock	Strike \$	Premium \$	Credit	Price @ Expiry
Jan 10	15 Jan	21 Dec	\$72.77	85	.05	\$50	\$79.18
Feb 10	19 Feb	19 Jan	\$80.92	90	.30	\$300	\$74.92
Mar 10	19 Mar	22 Feb	\$75.14	85	.10	\$100	\$77.62

BHP April 10 at Open



BHP April 10 at Close



BHP May 10



BHP June 10



BHP July 10



BHP Aug 10



?? 6th August

○ Alternatives:

- > Will I be exercised , not likely.
 - If exercised buy back shares at current market value.
- > Buy back the call :
 - BHP @ \$75.51, value of \$75 call option \$2.04
 - Gain to date BHP $\$75.51 - \$72.77 = \$2.74$
 - Would be giving up part of the gain
 - Could sell the \$80 call for additional premium
- > Wait, set trigger at mid point between strikes.

BHP September 10



BHP Oct-Dec 10



BHP Jan – Dec 10

BHP	Exp	Date	Stock	Strike \$	Premium \$	Credit	Price @ Expiry
Jan 10	15 Jan	21 Dec	\$72.77	85	.05	\$50	\$79.18
Feb 10	19 Feb	19 Jan	\$80.92	90	.30	\$300	\$74.92
Mar 10	19 Mar	22 Feb	\$75.14	85	.10	\$100	\$77.62
Apr 10	16 Apr	22 Mar	\$78.72	85	.35	\$350	\$79.32
May 10	21 May	19 Apr	\$78.32	85	.55	\$550	\$58.43
Jun 10	18 Jun	24 May	\$61.48	72.50	.26	\$260	\$67.83
Jul 10	16 Jul	21 Jun	\$69.41	80	.12	\$120	\$65.33
Aug 10	20 Aug	19 Jul	\$66.03	75	.28	\$280	\$67.44
Sep 10	17 Sep	20 Sep	\$67.13	75	.21	\$210	\$72.53
Oct 10	15 Oct	18 Oct	\$73.93	85	.05	\$50	\$82.41
Nov 10	19 Nov	22 Nov	\$82.26	90	.44	\$440	\$86.49
Dec 10	17 Dec		\$86.59	95	.42	\$420	\$89.13

Summary BHP Jan – Dec 10

● Total Credits \$3130
> Less com @ \$12.66 pm 152
> Net \$2,978 = 4.1%

● Annual Div BHP
> @ \$1.74ps \$1740 = 2.4%

● Total return with C/Calls = \$6.5%

CSE CHARTING



L1 – Mom MA Prices L2 – Mom close to Hi/Lo L3 – Mom gains/losses L4 – Volume
 L5 - O'bought/sold L6 - Filtered Oscillator L7 – L6 filtered L8 – MACD format

Thank You ..

