OptionsUniversity©

Options Trading Strategies

Lean:

Professional traders use the term "lean" to refer to one's perception about the directional strength of the stock. When you own a stock and intend to hold it for a period of time, you are aware that you will probably be holding it while it goes up and while it goes down.

This means that at any given moment in time, you might have a different opinion of the potential movement of that stock. Knowing this, there is a way to address your present level of confidence or "lean." You do this by your choice of which option you sell.

While it is true that the at-the-money option has the most amount of extrinsic value, it might not always be the ideal option to sell in every situation.

For instance, if you feel that the stock itself has a very high chance of producing capital appreciation above the potential amount of premium you could receive from
selling an at-the-money call, then sell an out-of-the-money-call so you can allow yourself a little more room to the upside on the stock.

For example, let's say the stock is trading at $27.00. Normally, you would sell the 27.5 calls at say $1.00. If the stock were to rise quickly and eclipse the $28.50 mark, then with the buy-write strategy, your position would have maxed out at $28.50, and you would have a $1.50 one month gain. Not bad, but if the stock went to $29.50 then you would have missed out on another $1.00 profit. However, if we had sold the 30 calls for $.30 then we would have another outcome. You bought the stock at $27.00 and sold the 30 calls for $.30 and the stock goes to $29.50.

You would have made $2.50 in capital appreciation and $.30 in option premium for a total of a $2.80 return.

So, if you feel the stock has a real good shot at taking a run up, you can lean your position long by selling an out-of-the-money call.

If you have a more neutral view on your stock you would sell an at-the-money-call in order to receive a bigger premium which allows for greater

© Copyright 2004 OptionsUniversity.

downside protection if the stock trades down and higher potential profit if the stock becomes stagnant.

This strategy also works on the downside. If, by chance, you feel that the stock may trade down a bit during the life of the option, then you can sell an in-the-money-call. The effect of this would be to provide you with a little extra premium to cover more downside risk.

Remember when you sell an option you seek to capture extrinsic value. An in-the-money option not only has extrinsic value but also some intrinsic value.

When you feel that you want to lean your covered call strategy (buy-write) a little short, choose to sell an in-the-money call so you can also have some intrinsic value to cover your downside.

As an example, say your stock is trading at $29.00 and you feel that your stock may trade down a little but still remain in an uptrend cycle. You don't want to get rid of the stock but you also don't want to lose any money so you sell the 27.5 call at $2.00.

The stock starts to trade down and finishes at $26.00. If you had owned the stock naked, then you would have lost three dollars since you owned the stock at $29.00 and it closed at $26.00 on expiration.

However, because you sold the 27.5 calls at $2.00, you would only realize a $1.00 loss in the stock. The premium received will offset the loss due to the fact that you identified and adjusted for a likely move.

As you can see, the buy-write strategy can be altered to fit any directional view you have on your selected stock.

Finally, if you intend to use the buy-write strategy successfully, you generally need to sell the calls against your stock on a consistent, recurring interval, over a period of time.

This means that you will have to be prepared to "roll" your calls out to the next month come expiration. Sometimes, all you'll need to do is to sell the next month out call.

For more Information about option trading, please click here:
www.options-university.com

© Copyright 2004 OptionsUniversity.