

AMGN Chart – Protective Put Example #2



NOTES ON AMGEN (AMGN) Protective Put

1. With the use of Technical Analysis, Amgen is identified to be poised to break down through a technical support as determined by a line drawn through three bottoms points, occurring in January 2002.
2. Then, in May 2002, the stock breaks down below the support line indicating an upcoming drop to a new, lower trading range.
3. The stock begins to consolidate at around \$46.00, and attempts to rebound. A protective put can be used here with the purchase of the stock in case the stock has a false bottom.

4. Indeed, this level is a false bottom as the rally fails, and the stock heads lower before the next consolidation level at point around \$41.00. Again, stock may be purchased here with a protective put.
5. The rally fails again and the stock falls to around \$32.00, before putting a final bottom & reversing. Again, a protective put can be purchased here to guard against further downside. At this level, the stock begins its real rally and rises quickly from this point to provide an outstanding return from \$32.00 to a high of \$72.00 in one year.
4. In September 2002 at a stock price around \$41.00, you could also buy a protective put as the stock pauses in its uptrend before continuing higher. At this level, the stock could be gathering up strength for the next leg of the rally (which it does) or it can become tired and begin to trade down again.

CONCLUSION: The protective put allows the investor the room to be wrong by limiting the total loss. Because the loss is limited, the protective put investor has a staying power not afforded to naked stock buyers who would feel the full brunt of the loss.

This ability to play again increases the protective put buyer's chance of being right and therefore more profitable than the naked stock buyer would be. The Amgen chart is a textbook example of a stock in position for the use of the protective put strategy.

Obviously, this was a risky trade, but one that could, and in this case did, provide an outstanding return. This is the perfect time to use the protective put. The protective put provides maximum protection in risky situations while allowing you to have almost the maximum available upside.

So, if you did buy the wrong bottom, the put would have bailed you out by limiting your downside and saving you enough money to try again. As you see from the chart, within 12 months of the July 2002 low of around \$32.00, the stock traded to a high of over \$72.00. This profit is more than enough to have covered the purchase of a few puts.

As stated earlier, this is a textbook case and one that should be studied for its value of properly showing why and when to use the protective put.

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