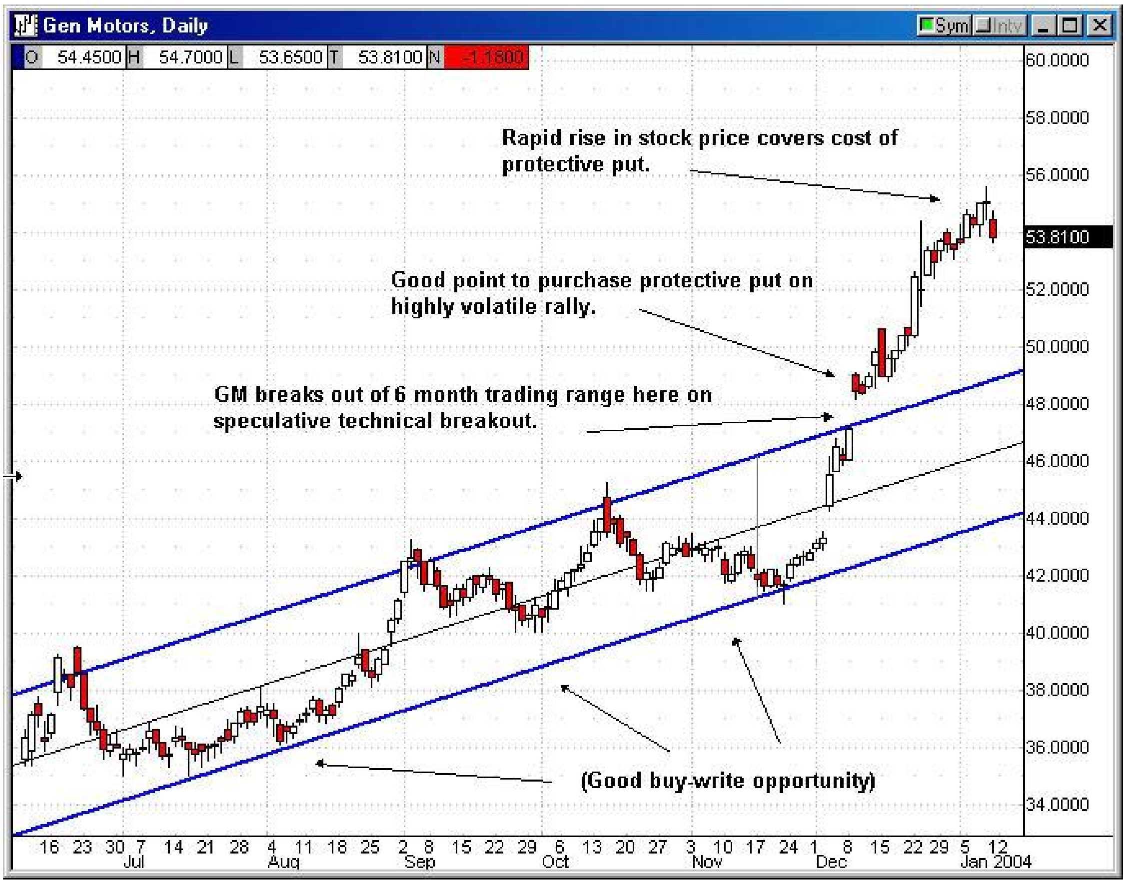
GM Chart – Protective Put Example #4



GM General Motors
Protective Put

1. After trading in a tight range for a considerable period of time with low volatility, GM's volatility spiked in early December 2003 and the stock gapped open considerably higher, followed by another breakout gap opening several days later.

2. This second gap opening forced the stock up through a previous resistance level, as the stock broke out and began a new, higher trading range.

3. The stock then advanced five of the next seven trading days with bigger intraday ranges than average during the previous 12 months, indicating increasing volatility.

4. The initial GM breakout, when it traded through $44.00 and quickly proceeded to trade up to the $54.00 range in less than one month, represented a 25% return in a very short period of time.

Conclusion: GM is a perfect example of an opportunity to use the protective put strategy to provide protection against a false break-out when buying a stock on a technical breakout.

In this case, GM had been trading in a lower volatility pattern for several months, which would have kept option premiums down. This would have allowed the investor to purchase the put at an advantageous price.

With the protective put in place, and at a relatively inexpensive price, the investor could ride the break-out with patience and confidence, with limited loss and controlled risk.

Even though this stock was in a rapid uptrend after breaking out of its previous trading range, and the protective puts purchased would have expired worthless, it still would have been a good idea to put on this protection in case the stock pulled in.

Gap openings tend to get filled at some point before proceeding higher, and in the case of a rapid sustained rally, there is usually some type of pullback when the stock is overbought.

In this case, the puts would not have been profitable, but would have provided the necessary protection in case the rally failed, or temporarily retraced.

We wanted to show this example where the puts would not have been profitable, because you never know where the stock is going to go. But even though the puts would have expired worthless, the rise in stock price would have clearly offset the cost of these puts.

So again, the protective put strategy here would have provided a cost effective insurance policy against the stock's pulling back or a failed rally.

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