EBAY Chart – Collar Example #2

NOTES ON EBAY (EBAY)
Collar

1. Ebay traded in a very wide range during July 2003. It started the month around $51.50 and traded up to $57.50 before trading down to $54.40. Within a week it traded to a high of $59.00. The week after that, the end of the month, the stock was down to $52.50.

2. August, was another volatile month. The stock had a high of $57.25 and a low of $50.00.

3. The stock started the month of September trading at $56.50. It traded down to $50.50 then back up to $57.00.

4. Volatility continued in October. The stock had quite a range with a high of $61.50 and a low of $53.50. Moreover, the stock had no less than 5 gap openings. The gap openings were almost evenly divided between "ups" and "downs".

5. The pattern continued in November 2003. The stock started the month by quickly putting in a high around $58.50. It then traded down, reaching a low around $50.75, before rallying and trading back up to $57.00 before the month's end.

6. December began with the stock trading around $57.00. It then moved down quietly to $55.00 by the middle of the month. By the end of the month, Ebay was trading at $64.00, up an astounding $9.00 in a little more than two weeks.

Conclusion: A stock this volatile needs a hedging strategy that provides maximum protection. A covered call strategy will provide some protection but not enough for a stock with the month in and month out volatility that Ebay exhibits.

The protective put strategy would work in terms of maximum downside protection, but at what cost? With volatility this high, the puts will be very expensive, maybe too expensive. This situation is perfect for employing the collar.

The sale of a call against the purchase of the put will at least partially offset the expense of the put, making the downside maximum protection affordable, while still leaving room for capital appreciation.

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