

Beginners Corner Information

Lesson 1

What is Selling Cash-Secured Puts

Introduction and preview example

Selling Cash-Secured Puts- Definition

- Investment strategy that combines selling put options while simultaneously placing enough cash in the brokerage account to buy the stock if “put” to us
- A stock is a unit of ownership in a corporation
- A put option is a contract that gives the right to the holder to sell shares of stock to the option seller (that’s us)

Selling Cash-Secured Puts- 4 Words

- **Selling-** We are writing or initiating the option contract and receiving a cash premium for undertaking the option obligation
- **Cash-secured:** Placing an appropriate amount of cash in our brokerage account to pay for a possible future stock transaction
- **Put-** The type of option we are selling...the right, but not the obligation, to sell shares of stock to us

Preview Example

- BCI Corp. currently trading at \$32 per share
- Sell a put option: Agree to buy the stock @ \$30 during the next month
- Capture a premium of \$1 per share or \$100
- “Secure” the put sale by placing \$3000 (less the put premium of \$100 or \$2900) into our cash brokerage account
- This is a 3.4%, 1-month initial return ($\$100/\2900)...return if unexercised

Two Possible Outcomes

- Stock price remains above \$30
- Stock price moves below \$30

Stock Price Remains Above \$30

- Option buyer (holder) will not exercise
- Why sell for \$30 when it can be sold for more?
- The option expires worthless and we keep the 3.4% 1-month return
- Cash is freed up to secure another put position the next month

Stock Price Moves Below \$30

- Option buyer will exercise right to sell @ \$30
- We buy the shares at a cost basis of the strike price – put premium $(\$30 - \$1) = \$29$
- Some call this buying “at a discount”
- Discount = $(\$32 - \$29)/\$32 = 9.4\%$

Is There Risk?

- The risk is in the stock dropping below the breakeven (\$29)
- Money can be lost if share price declines more than premium collected + the amount the strike is lower than current price
- $\$30 - \$1 = \$29$ is breakeven
- Stock selection, option selection and management is critical

Summary

- Selling cash-secured puts is a conservative, cash-generating strategy
- It combines stock selection, cash deposits and option SELLING
- Stock selection, option selection and position management are 3 skills that must be mastered
- In Lesson 2 we will discuss Option Basics