Beginners Corner Information

Lesson 7

Exit Strategies: Monitoring Your Stock and Option Positions

Selling Cash-Secured Puts

First Step in Exit Strategy Execution

ALWAYS BUY BACK THE OPTION FIRST

Events Leading To Exit Strategy Opportunities In the 1st Half Of The Contract

- Stock price falls below the strike of the put by > 3%
- Stock price declines dramatically
- Stock price rises significantly

Example When Stock Price Falls > 3% Below The Strike Price

- Stock price = $51
- Sell the $50 put for $1.50
- Cash to secure the position is $5,000 ($150 of which is from the put sale)
- Initial return is $150/$4850 = 3.1%
- In the first half of the contract the share price is $48 or 4% below the strike
- Net one-month unrealized return = $150 - $200/$4,850 = (-)1%
- A reasonable premium to buy back the put would be $2.50 ($2 intrinsic value + $0.50 in time value)
- Net loss = $2.50 - $1.50 = $1 = $100 per contract or 2.1%
- Use the freed up cash from closing the position to secure another put to help mitigate all or part of the $100 loss

Events Leading To Exit Strategy Opportunities On Or Near Expiration Friday

- The strike price of the put option we sell is in-the-money on or near expiration Friday, and no earnings report due out the following month
- The strike price of the put option sold is in-the-money **on or near expiration Friday,** and an earnings report is scheduled in the following month
- The strike price of the put option sold is out-of-the-money on or near expiration Friday (option expires worthless)

Example When The Strike Price Is In-The-Money On Or Near Expiration Friday, With No Earnings Report Due The Following Month: Rolling The Option

- Stock price = $51
- Sell the $50 put for $1.50
- Cash to secure the position is $4,850 (plus the $150 put premium)
- Initial return is $150/$5,000 = 3.1%
- On expiration Friday, the stock price is $49.75 (leaving the strike price in-the-money) with no upcoming earnings report the next month
- Cost to buy back the $50 put is $0.50, or $50 per contract
- Selling the next month $50 put generates $2.50, or $250 per contract
- Net option credit is $250 - $50 = $200 per contract
- Cash required to secure the $50 put is $4,800 per contract ($5,000 - $200 option credit)
- Initial one-month return for rolling this option = $200/$4,800 = 4.2%

Summary

- All exit strategies begin with buying back the put originally sold
- Relationship between stock price and strike price will be 1 factor in identifying ES opportunities
- Time to expiration is another factor
- Keep an eye out for earnings reports dates
- Mastering position management will maximize returns

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