Beginners Corner Information

Lesson 5

Calculations For Stock And Option Selection

Covered Call Writing

3 Basic Formulas

- ROO (initial return on option) for ATM and OTM strikes

- ROO for ITM strikes

- Breakeven

Calculating ATM AND OTM Strikes (Initial Returns)

- Option premiums are ALL time value or all profit

- Option premium x 100/ [price per share x 100]

- $1 x 100/ [$28 x 100] = 3.6%

- OTM strikes will offer upside potential

Calculating ITM Strikes (Initial Returns)

- ROO or profit = Option premium – intrinsic value (Buy @ $32 and sell $30 call @3; IV = $2 and TV = $1)
- Cost basis = Stock price – IV or the strike price ($32 - $2 = $30)
- % ROO = $100/$3000 = 3.3%
- ITM strikes offer downside protection of the option profit

Breakeven Of Total Position

Breakeven = Stock price – Option Premium

$32 - $3 = $29

Strike Price Selection

- OTM: ROO + Upside potential to strike

- ATM: Highest initial option return (ROO) but no upside potential or downside protection of ROO

- ITM: ROO + Downside protection of ROO

Ellman Calculator- Single Tab Check Option Chain

Ellman Calculator- Single Tab Enter Information

THIS OPTION PAGE WILL ALLOW YOU TO COMPARE THE RETURNS ON UP TO FOUR DIFFERENT OPTIONS CHOICES FOR ONE STOCK PURCHASE.

1) ENTER THE STOCK NAME, SYMBOL AND PRICE PER SHARE

Stock name >>	Hi-Tech
Stock symbol >>	HITK
Stock share price >>	$ 22.34

2) ENTER THE SYMBOL, STRIKE PRICE, EXPIRATION DATE AND OPTION PRICE PER SHARE

	Symbol	Strike Price	Exp Date	Price / share
Option choice #1 >>		20.00	03/19/10	3.10
Option choice #2 >>		22.50	03/19/10	1.70
Option choice #3 >>		25.00	03/19/10	0.80
Option choice #4 >>				

Ellman Calculator- Single Tab Calculation Results

Ellman Calculator- Multiple Tab Calculation Results

Stock Name or Symbol	Stock $/sh	Option $/sh	Strike $	Expires	Intrisic	Upside	ROO	Up Potential	Down Protect
nflx	$ 75.00	$ 4.70	$ 75.00	05/21/10	$ -	$ -	6.3%	0.0%	0.0%
nflx	$ 75.00	$ 2.60	$ 80.00	05/21/10	$ -	$ 5.00	3.5%	6.7%	0.0%
swks	$15.49	$ 1.15	$ 15.00	05/21/10	$ 0.49	$ -	4.4%	0.0%	3.2%
db	$ 59.11	$ 1.95	$ 60.00	05/21/10	$ -	$ 0.89	3.3%	1.5%	0.0%
nei	$ 29.40	$ 1.65	$ 30.00	05/21/10	$ -	$ 0.60	5.6%	2.0%	0.0%
ipx	$ 17.94	$ 1.20	$ 17.50	05/21/10	$ 0.44	$ -	4.3%	0.0%	2.5%
prgo	$ 59.08	$ 5.50	$ 55.00	05/21/10	$ 4.08	$ -	2.6%	0.0%	6.3%
prgo	$ 59.08	$ 2.40	$ 60.00	05/21/10	$ -	$ 0.92	4.1%	1.6%	0.0%
ctrp	$ 40.29	$ 4.00	$ 38.00	05/21/10	$ 2.29	$ -	4.5%	0.0%	5.7%
ctrp	$ 40.29	$ 2.90	$ 40.00	05/21/10	$ 0.29	$ -	6.5%	0.0%	0.7%
ctrp	$ 40.29	$ 2.00	$ 42.00	05/21/10	$ -	$ 1.71	5.0%	4.2%	0.0%
urtn	$ 37.84	$ 2.75	$ 36.00	05/21/10	$ 1.84	$ -	2.5%	0.0%	4.3%
urtn	$ 37.84	$ 1.60	$ 38.00	05/21/10	$ -	$ 0.16	4.2%	0.4%	0.0%
urtn	$ 37.84	$ 0.80	$ 40.00	05/21/10	$ -	$ 2.16	2.1%	5.7%	0.0%
swec	$ 48.96	$ 1.95	$ 50.00	05/21/10	$ -	$ 1.04	4.0%	2.1%	0.0%

For A FREE Copy OF The Basic Ellman Calculator

- alan@thebluecollarinvestor.com

- "Basic Ellman Calculator" in header

- Include your name

Summary

- Because ITM strikes have intrinsic value, the calculation formula is different than that of ATM and OTM strikes

- Breakeven relates to total cc position

- Downside protection relates to preservation of the time value of the option premium

- Each strike price category has its pros and cons

- In Lesson 6 we will discuss executing covered call trades