

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
- $\text{Option premium} \times 100 / [\text{price per share} \times 100]$
- $\$1 \times 100 / [\$28 \times 100] = 3.6\%$
- 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

Hi-Tech Pharmaceutical Co., Inc. (NASDAQ:  HTH) Optionable						
Last: 22.34	Chg: +1.48 (+7.07%)	Open: 20.68	Avg Vol: 367,139	Volume:		
Bid: 22.35	Ask: 23.23	High: 22.41	Low: 20.68	W%Chg:		
After Hours Data Last: 22.35 Chg: +0.02 %Chg: +0.07% Volume: 6,458						
Option Tools:		Covered Calls Calculator			Selling Pu	
View: All Months						
Calls						Feb 10
Last	Intrinsic Value	Bid	Ask	Vol	Open Interest	Strike
7.30	7.34	7.00	7.60	0	0	15.00
4.85	4.84	4.70	5.00	0	22	17.50
2.42	2.35	2.30	2.55	97	285	20.00
0.50	0.00	0.45	0.55	55	402	22.50
0.05	0.00	0.05	0.05	0	460	25.00
0.05	0.00	0.05	0.05	3	726	30.00
0.05	0.00	N/A	0.05	0	560	35.00
0.10	0.00	N/A	0.10	0	0	40.00
Spreads for Fri Feb 19 21:00:00 PST 2010 Options: Bull Call Spreads Bull F						
Calls						Mar 10
Last	Intrinsic Value	Bid	Ask	Vol	Open Interest	Strike
7.45	7.34	7.30	7.60	0	0	15.00
5.15	4.84	5.00	5.30	0	17	17.50
3.25	2.35	3.10	3.40	1	115	20.00
1.77	0.00	1.70	1.85	22	217	22.50
0.88	0.00	0.80	0.95	8	123	25.00
0.17	0.00	0.10	0.25	0	119	30.00
0.10	0.00	0.05	0.15	0	20	35.00

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 >>	HITC			
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

Option selected	HITK MAR 16.00	HITK MAR 22.50	HITK MAR 25.00
Today's date	02/16/10	02/16/10	02/16/10
Days to expiration	31	31	31
Cost for 100 shares of stock	\$ 2,234.00	\$ 2,234.00	\$ 2,234.00
Proceeds from one contract	\$ 310.00	\$ 170.00	\$ 80.00
IN / OUT OF THE MONEY	IN	OUT	OUT
INTRINSIC VALUE	\$ 2.34	\$ -	\$ -
UPSIDE AMOUNT	\$ -	\$ 16.00	\$ 266.00
UPSIDE POTENTIAL	0.0%	0.7%	11.5%
DOWNSIDE AMOUNT	\$ 234.00	\$ -	\$ -
DOWNSIDE PROTECTION	0.5%	0.0%	0.0%
RETURN ON VARIOUS OUTCOMES			
Proceeds from option sale	\$ 310.00	\$ 170.00	\$ 80.00
Amount of buy-down	\$ 234.00	\$ -	\$ -
Actual option profit	\$ 76.00	\$ 170.00	\$ 80.00
Option profit	\$ 76.00	\$ 170.00	\$ 80.00
Upside profit	\$ -	\$ 16.00	\$ 266.00
Total profit	\$ 76.00	\$ 186.00	\$ 346.00
Cost of shares	\$ 2,000.00	\$ 2,234.00	\$ 2,234.00
Return On Option (ROO)	3.8%	7.6%	3.6%
Return on Upside	0.0%	0.7%	11.5%
Total return	3.8%	8.3%	15.1%
Annualized return	11.7%	97.7%	182.5%

Ellman Calculator- Multiple Tab

Calculation Results

Stock Name or Symbol	Stock \$/sh	Option \$/sh	Strike \$	Expires	Intrinsic	Upside	ROU	Up Potential	Down Protect
rftc	\$ 75.00	\$ 4.70	\$ 75.00	05/21/10	\$ -	\$ -	6.3%	0.0%	0.0%
rftc	\$ 75.00	\$ 7.60	\$ 80.00	05/21/10	\$ -	\$ 5.00	3.5%	6.7%	0.0%
snks	\$15.49	\$ 1.15	\$ 15.00	05/21/10	\$ 0.49	\$ -	4.4%	0.0%	3.2%
dlb	\$ 59.11	\$ 1.95	\$ 60.00	05/21/10	\$ -	\$ 0.89	3.3%	1.5%	0.0%
neil	\$ 29.40	\$ 1.05	\$ 30.00	05/21/10	\$ -	\$ 0.60	5.0%	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%
clrp	\$ 40.29	\$ 4.00	\$ 33.00	05/21/10	\$ 2.29	\$ -	4.5%	0.0%	5.7%
clrp	\$ 40.29	\$ 2.90	\$ 40.00	05/21/10	\$ 0.29	\$ -	6.5%	0.0%	0.7%
clrp	\$ 40.29	\$ 2.00	\$ 42.00	05/21/10	\$ -	\$ 1.71	5.0%	4.2%	0.0%
urtn	\$ 37.84	\$ 2.75	\$ 38.00	05/21/10	\$ 1.84	\$ -	2.5%	0.0%	4.3%
urtn	\$ 37.84	\$ 1.60	\$ 33.00	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%
snvc	\$ 48.06	\$ 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