OCC - How Options Can Be Used to Generate Positive Cash Flow

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IBKRWebinars
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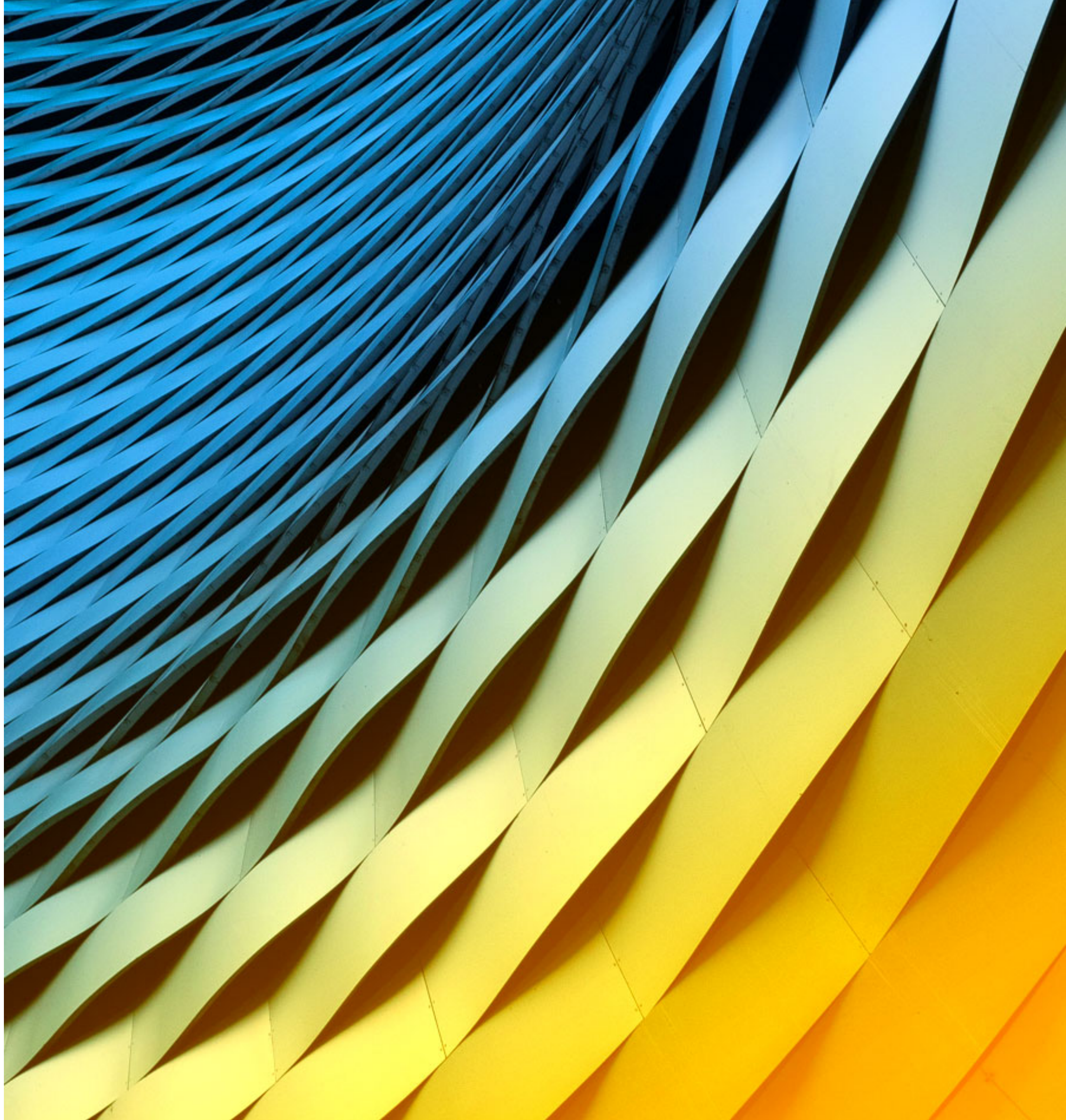

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How to Use Options to Generate Positive Cash Flow

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Disclaimer

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About OIC

- **FREE** unbiased and professional options education
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- Online courses, podcasts, videos, & webinars
- Contact Investor Education at *options@theocc.com*

Presentation Outline

<u>Income generators</u>

- Covered calls
- Cash-secured puts
- Covered combo

Covered Calls

Covered Calls

- Covered call: investor simultaneously
  - Writes (sells) one or more equity call contracts
  - Buys equivalent number of underlying shares
  - One short call for each 100 long shares
- Primary goal – increase returns
  - Call premium received and kept (assigned or not)
  - Generate additional income (over any dividends)
- Investor's forecast
  - Neutral to bullish on the underlying stock
  - Within a small price range over strategy's lifetime

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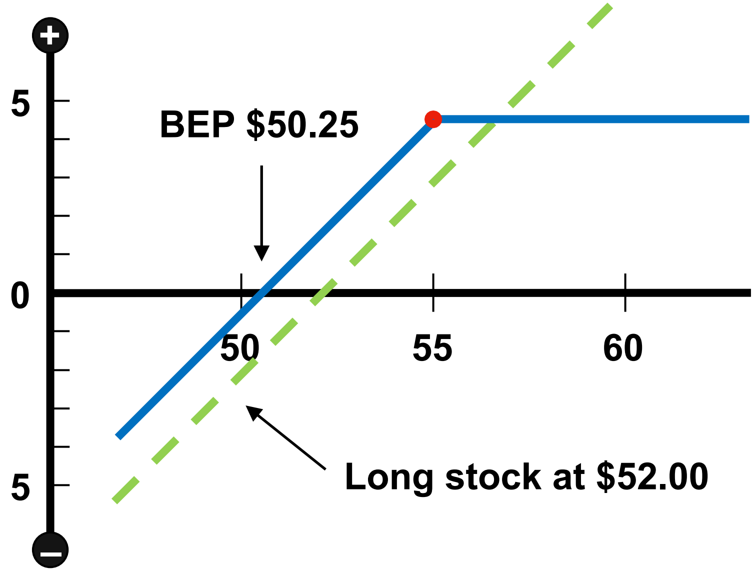
Covered Call Writer's Obligations?

- Like any call writer (short call position)
  - Has the obligation to sell underlying shares
  - At strike price
  - If assigned
- Assignment (your potential obligation)
  - Possible at any time before expiration
  - Equity options are American-style
- In return for this obligation
  - Call writer receives and keeps option premium

Covered Call Example

Own 100 shares XYZ at $52.00

Sell 1 XYZ 55 call at $1.75



Not including commissions

Maximum Profit if Assigned:

Effective Stock Sale Price – Stock Price Paid

($55.00 + $1.75) – $52.00 = $4.75

$475.00 Total

Break-even at Expiration:

Stock Price Paid – Call Premium Received

$52.00 – $1.75 = **$50.25**

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Cash Secured Put Writing

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Characteristics of Cash Secured Puts

- Typically involves selling ATM or OTM options
- **Assignment** is potentially welcome and desirable
- May be possible to buy shares below current market price with funds set aside
- If assigned, investor now has risk of owning the stock or ETF
- Can potentially earn additional interest income on funds set aside

Cash Secured Put Example

XYZ @ $50 60 Days to Expiration

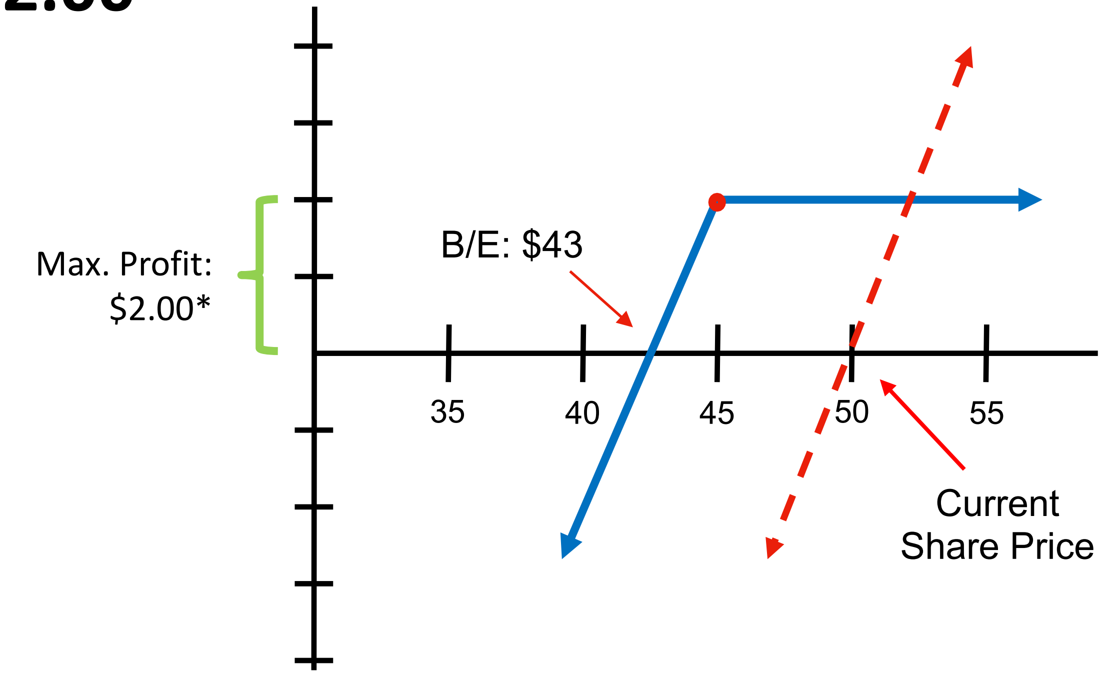
- Sell 1 60-day 45 Put at $2.00
- Set aside $4,300 to buy stock if assignment occurs (preferably in an interest bearing security)

Cash Secured Put Example

Sell 1 XYZ 60-day 45 put at $2.00

Breakeven = strike - premium

** Max profit of $2.00 does not take into account resulting long stock position should assignment occur*



Not including commissions

Covered Combo

Characteristics of the Covered Combo

An understanding of Covered Calls and Cash Secured Puts is imperative

- Assignment is generally seen to be favorable
- Theta (time decay) is your friend
- Limited (but substantial) reward
- Risk is in long stock

Covered Combo Example

XYZ @ $65.00 45 Days to Expiration

Sell 1 45-day **70** Call $ 1.50

Sell 1 45-day **60** Put $ 1.75

+ Long 100 shares XYZ at $65

Maximum Gain:

Call Strike (70) – Stock ($65) + net premium ($3.25)

$70 - $65 + $3.25 = $8.25 or <u>$825.00</u>

Gains limited from stock and premiums (effect of short call)

Excludes transaction costs

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Covered Combo Example

XYZ @ $65.00 45 Days to Expiration

Sell 1 45-day **70** Call $ 1.50

Sell 1 45-day **60** Put $ 1.75

+ Long 100 shares XYZ at $65

Maximum Risk:

- Stock ($65) + put strike (60) – net premium ($3.25)
- $65 + 60 - $3.25 = $121.75 or <u>$12,175.00</u>
- Only occurs should XYZ = $0 at expiration
- Losses can occur on both stock and short put

Excludes transaction costs

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Covered Combo Example

XYZ @ $65.00 45 Days to Expiration

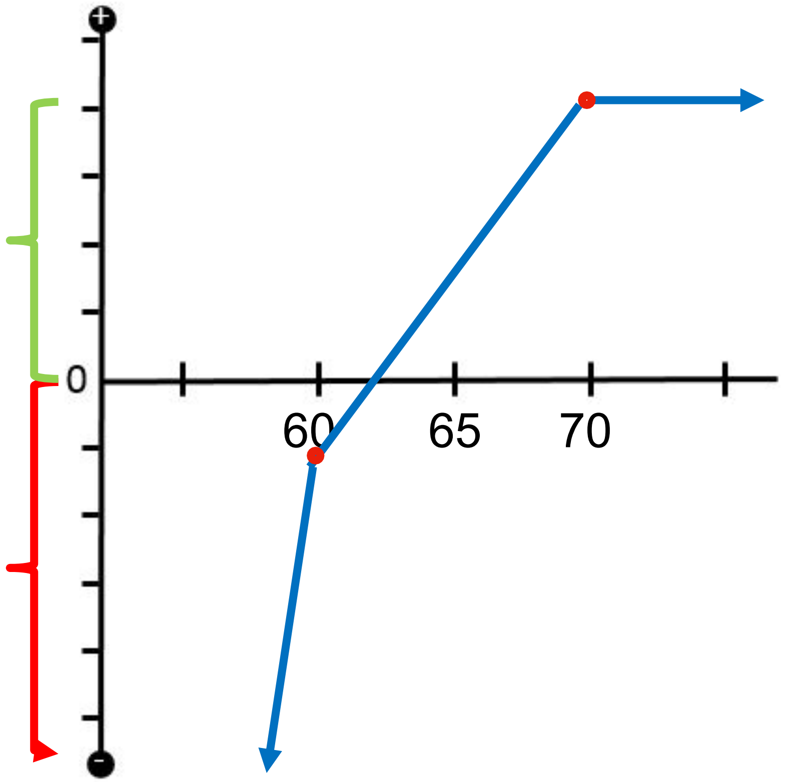
Sell 1 45-day **70** Call $ 1.50

Sell 1 45-day **60** Put $ 1.75

+ Long 100 shares XYZ at $65

Upside profit potential capped by short call

*Downside loss potential compounded by short put **AND** long stock*



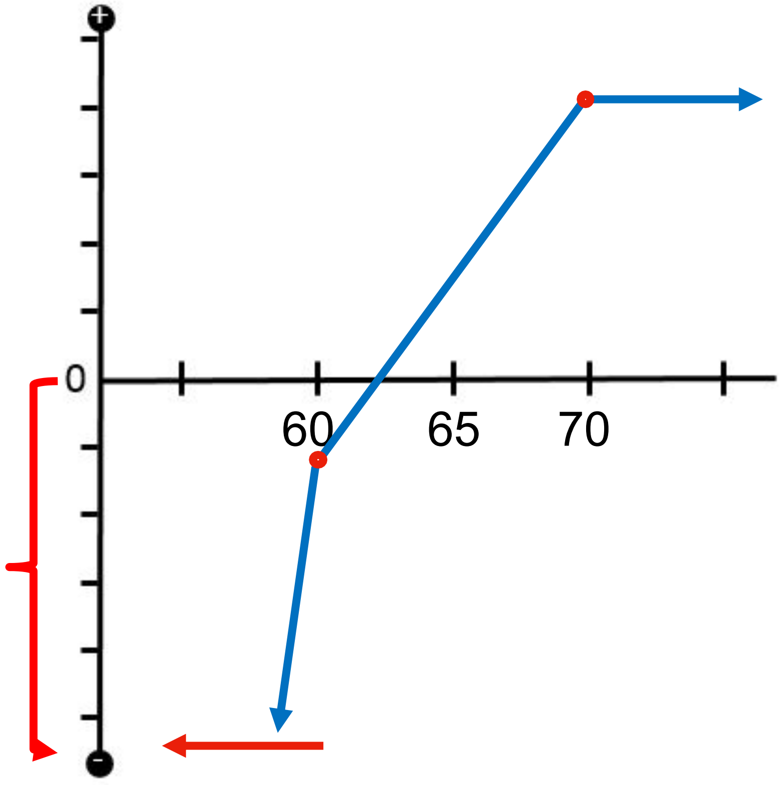
Excludes transaction costs

What Happens at Expiration?

Stock is < $60.00

Sell 1 45-day **70** Call $ 1.50
Sell 1 45-day **60** Put $ 1.75

+ Long 100 shares XYZ at $65



- *Short call expires worthless*
- *Short put gets assigned and investor purchases **ADDITIONAL** shares for $60 w/cash on hand*
- *New Risk/Reward results from long 200 shares XYZ*

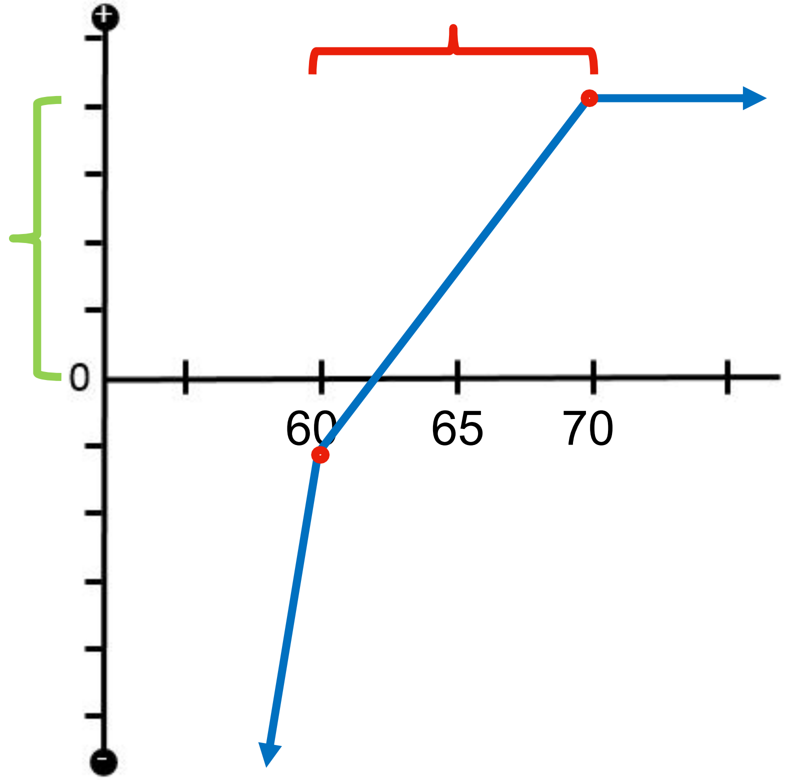
Excludes transaction costs

What Happens at Expiration?

Stock is > $60.00 and < $70

Sell 1 45-day **70** Call $ 1.50
Sell 1 45-day **60** Put $ 1.75
+ Long 100 shares XYZ at $65

- *Both call and put options expire worthless*
- *Long stock position remains 100 shares*
- *$3.25 premium added/subtracted to net profit/loss from long stock*



Excludes transaction costs

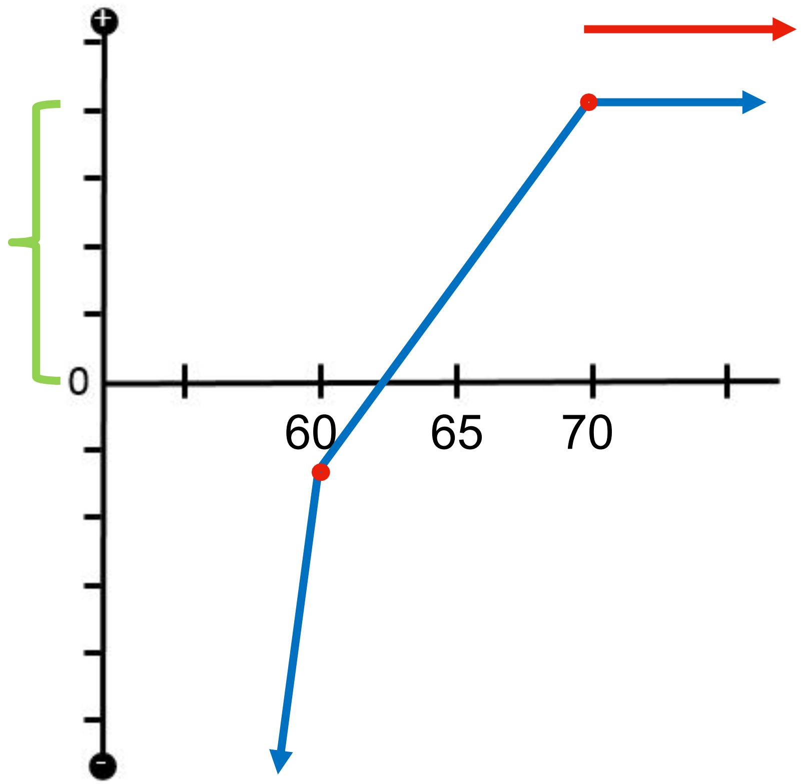
What Happens at Expiration?

Stock is > $70.00

Sell 1 45-day **70** Call $ 1.50
Sell 1 45-day **60** Put $ 1.75

\+ Long 100 shares XYZ at $65

- *Short put expires worthless and short call gets assigned*
- *Investor sells long shares at $70 (no remaining stock position)*
- *Resulting profit is call strike – long stock price + net premium received*
- *70 call - $65 stock + $3.25 premium = $8.25 max profit*



Excludes transaction costs

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