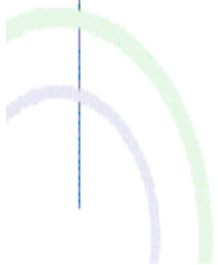




Covered Option Writing
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4th Annual Client Conference





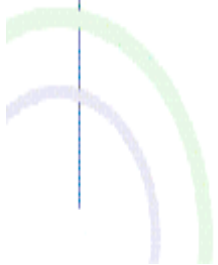
What is an option?

- An option gives the holder the right to buy or sell an asset at a specific price (“**strike price**”) until a pre-set date (**maturity**).
- A **call option** gives the holder the **right to buy** an asset.
- A **put option** gives the holder the **right to sell** an asset.
- An investor must pay an up-front fee or **price** in order to purchase an options contract.
- Every option has a **time value**. As its maturity approaches, the option’s **time value** goes down.
- Every option is either ***in the money***, ***at the money*** or ***out of the money***.



Important Characteristics

- **Intrinsic Value** is the difference between the option's *strike price* and its *spot price* (current market value).
- **Premium Income (Cost) = Intrinsic Value + Time Value.**

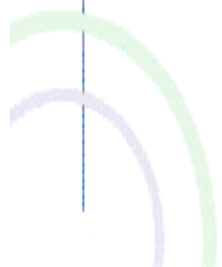




Important Characteristics

- For puts and calls there are buyers and sellers (*“writers”*).
- If the **market** is expected to go **up**, either you buy a call or write a put.
- If the **market** is expected to go **down**, either you buy a put or write a call.

Today, we’ll talk about *calls*...



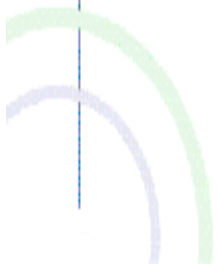


Why use Options?

- To generate **income**
- To **hedge** a security or an entire portfolio

Who uses options?

- Banks
- Insurance companies
- Pension Funds
- Endowments & Foundations
- Individuals



How are Options Used?

An Example:

- Investor holds Ten-year Treasury note.
- Variation in ***strike prices*** yields different ***premiums***:

<u>Price</u>	<u>Strike Prices: 3 month option</u>		
112.17	112	111	110
	1 $\frac{26}{64}$	2 $\frac{5}{64}$	2 $\frac{55}{64}$

Premium



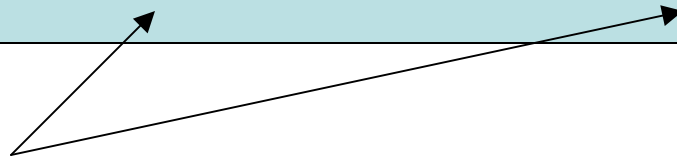
How are Options Used?

An Example:

- Investor holds Ten-year Treasury note.
- Variation in ***time*** also yields different ***premiums:***

<u>Price</u>	<u>Strike Price:</u>	
112.17	115.16	115.16
	1 ¼ (6 months)	2.02 (One Year)

Premium





Conclusions

- Options are contracts to buy or sell.
- They can be executed, or they can be an investment.
- They can serve as an alternative to hedging mechanisms where the client can know the actual cost of the hedge.
- The downside is if markets go up, the client foregoes profits.