Introduction:

In the first article of this series we discussed portfolio insurance as the missing link to a sound financial investment program. Our second article dealt with a possible solution to the insurance concern by using the purchase of put options to minimize losses for a stock investment position. The third article applied put option insurance together with some management techniques for the Hewlett Packard (HPQ) stock to illustrate the theory of the first two articles. In this, the forth article we will demonstrate the tools available on the PowerOptions financial web site to aid in implementing the married put and collar strategies in a methodology which controls risk and extracts income profit from the married put option position.

Married Put Insurance:

If you currently own a stock position that is profitable, it is possible to create a married put position to guarantee some of that profit. Rather than take the risk of losing that gain to the vagaries of the market, it might be more prudent to lock in some of the gain and not give back those hard earned dollars. The first tool to be discussed uses put option insurance to lock in a defined profit. The position insurance tool on PowerOptions provides a means to assess the merits of different insurance positions using put options.

Navigation:
After logon from the home tab click the “Married Put” tab. If the married put tab is not present use the last tab “Other Strategies” to put up the married put tab. Click “Insurance” or “Position Insurance”

The following menu will appear to insert the data needed to calculate the put insurance:

Figure 1. Position Insurance Tool
As an example, HPQ will be used with the following parameters submitted as data for Figure 1:

- Stock Symbol for Hewlett Packard: HPQ
- Cost Basis / Share of: $39.00 (cost basis for a profitable stock)
- Buy Put Month of: January 2009 (insurance for 204 days)

Figure 2. Position Insurance example for HPQ

Figure 2. illustrates a matrix of results for the creation of a married put for the HPQ stock position having experienced a profit. The column labeled "Locked In Profit" shows how much of the current profit can be locked in using each put position considered. The resulting locked in profit is sorted from highest to lowest. Even though the $40 strike has the lowest put premium, it sacrifices several points from the $44.28 current price and actually result in a slight loss if the stock were to decline substantially from these levels.

Writing a covered call against the stock position can enhance the locked in profit as illustrated in Figure 2. In Figure 3 a covered call for the month of August has been added to each put insurance position and sorted by Locked In Profit. The use of a covered call with a protective put is called a Collar Strategy: Figure 3. Creating a Collar from a married put option position:
Adding a covered call can enhance returns. The Aug. 08 call options were used because they were within 2 months of expiration. Since the protective put will not expire until Jan. 09, there will be several more opportunities to write calls against this position if the position is not called away. It should be noted you are seeking insurance because the stock has performed well and you want to lock in some of those profits, therefore, you should give the stock some room to continue this trend and choose the a strike for the call OTM and higher than the put used for insurance. In Figure 3 these would be the last three candidates shown. The last three have the highest % if assigned, but have not guaranteed the highest locked in profit. They are anticipating follow through on the stock price up trend.

Married Put Search:

In the previous case we created a married put position to lock in profit from an already existing profitable equity position. However, if we have cash ready to invest, we need a tool to find the best married puts available to trade. For this case, we will examine a tool available to find a married put by searching the through the entire market using a set of search criteria. The goal of the search is to find a stock and a protective put that meet our requirements. First we need to establish the search criteria or conditions for our ideal married put purchase. An initial set of parameters were established under the named search “**Radioactive”:

Navigation:

- After logon from the home tab click the “Married Put” tab. If the married put tab is not present use the last tab “Other Strategies” to put up the married put tab.
- Click “Search” in the sub menu
- Select the Search Settings Saves As “**Radioactive”

The following settings are part of the “**Radioactive” search:

- Sorted by % Max Risk
- Put expirations between 150 to 700 days out in time
- Put up to 20% In The Money (ITM)
- % Risk between 2.5 and 9%
- Put open Interest greater than 0
- Stock price between 9 and 200
- Average stock volume greater than 300K
- In an up trend based on the Stock Price > 50 Day Moving Avg.
- Stocks chosen also appears on the IBD 100 or CANSLIM lists

Other criteria could have been used, but these criteria provide a good starting point for the married put search. The following sorted list illustrated in Figure 4 is the result of the above search parameters applied to the entire options market on 6/27/08.
The Married Put strategy can be used to set maximum risk the investor will tolerate before considering strategies to generate income or growth from the position. Since all of the stocks in this screen are members of the IBD100 or CANSLIM list, they are considered companies with good growth prospects. Using a married put we have established a safety net from which to operate using other income management techniques. In general the management process depends on the direction the stock price takes:

- If the stock price increases to the put strike price, we might write an ATM or OTM covered call
- Buy back and roll up and out any covered calls that go ITM by the amount of the initial premium
- If the stock goes down by 8% or more we might sell the put and move it down one strike price
- Continue the put roll down process in a declining market to establish the lower break-even for an eventual bounce back.
This process can be repeated as the stock fluctuates as shown in the HPQ example in Part 3. The “My Portfolio” section of the PowerOptions site helps apply these rules to the married put positions that are tracked in the portfolio. More details about using the “My Portfolio” tools for paper trading or tracking your real positions will be discussed at the end.

**Married Put with a covered call, the “Collar”**

Some investors would prefer to establish the collar immediately rather than create a married put and then wait for a movement in the stock as outlined above in the married put strategy. If the stock chosen immediately moves up, it is better to wait in creating the covered call, however if the stock immediately declines it would have been better to sell the covered call early. The collar search assumes that the stock, put, and covered call are all acquired at the same time.

The PowerOptions collar search enables one to select the put conditions separate from the short-term call conditions. In some cases it is possible to find a “Conversion” where the put assures only a 0.60 % max. loss and a 3.3% profit if assigned:

**Navigation:**

- After logon from the home tab click the “Collar” tab. If the collar tab is not present use the last tab “Other Strategies” to put up the collar tab.
- Click “Search”
- Select the Search Settings Saves As “Different Months - Put ITM Collars”

These setting can be used to get you started, but they can be modified to meet your personal investment conditions. The selection parameters used for the saved search called “Different Months - Put ITM Collars” are:

- Sorted by % Max. Risk
- Put expirations between 150 to 700 days out in time
- Put up to 20% In The Money (ITM)
- % Max Risk on the position less than 10%
- Call open Interest greater than 0
- Stock price between 15 and 150
- In an up trend based on the Stock Price > 50 Day Moving Avg.
- Call bid price greater than $.30
- No List selected

Using these settings resulted in finding 115 selections, as illustrated in Figure 5, which met the above parameter search conditions. It is generally best to make the search restrictive enough to limit the number of selections to 20 or less. The PowerOptions default searches will often result in more selections, but additional restrictions can be easily applied and then the new more restrictive search parameters can be saved under a new name for future access. The last three columns in Figure 5 are the risk reward columns. In general the % if Assigned returns are favorable with only one covered call write against the stock position and most selections are close to break-even if the stock price is unchanged.
Figure 5. PowerOptions: Collar Search

Portfolio Management:

Any of the opportunities found in doing a married put or a collar search can be inserted into the “My Portfolio” and the Profit / Loss application, which is shown in Figure 6. Just click the blue “More Info” button on the left of the selection and point to “Add to Portfolio”. Just follow the instructions by choosing a portfolio and entering the remaining information i.e. number of shares, contracts, and commissions.

Once your position is established in the Profit / Loss Portfolio program it will be available to monitor the value of the position. Also by clicking on the “Edit More Info” key in the Profit / Loss Portfolio a number of management tools are available:

Navigation:
- After logon from the home tab click the “My Portfolio” tab
- Click “Profit / Loss Portfolio”
Click “Edit More Info” next to the position to analyze
Then cursor to “Position Actions” and then “Position Analysis”

Figure 6. PowerOptions: My Portfolio – Profit/Loss Portfolios – Position Analysis
Married Put Profit/Loss Graph for Green Mountain Coffee Roasters Inc.

Current Stock Price: $35.96 (0.61)
Break Even: $50.36
Current Option Bid: $10.60
# Days To Expiration: 162
Max Risk: $5.46
% Max Risk: 10.3%

Profit/Loss for GMCR ($35.98)

Original Position Value
This is the total cost to enter the position. The cost of stock, long put, and commissions done at a time where there was 177 days to expiration.
Original Position Value = $10,112.50

Current Liquidation Value
The Liquidation Value is the amount you can expect to receive if you closed out both the Stock position and the near term put (sell to close). Subtracting the Original Position Value from the Liquidation Value will give you your Liquidation Profit/Loss for the position.
Current Liquidation Value = $9,298.50
Current Liquidation Profit/Loss = $-814.00
Current Liquidation % Return = -8.0% after 15 days

Future Expiration Value
This is the total value of profit or loss that can be expected at expiration date. Since your option is ITM, you could sell shares of stock at the written strike price.
Future Expiration Value = $8,992.00
Future Expiration Profit/Loss = $-1,120.50
Future Expiration % Return = -11.1%

Roll Out Opportunities...
Your stock has fallen by 12.6%, you may want to consider selling your put and buying a lower strike put. You could sell to close the GGXI (08 DEC 45.00) for $10.60 and buy to open one of the below puts...
In Figure 6. above, the Married Put position can be analyzed during the holding period to evaluate the:

- Original position value
- Current liquidation value (using present prices)
- Future expiration value (using present prices)
- Roll out management opportunities (list not shown)
- History (past transactions, not shown)

The original, current liquidation, and future values help the investor to monitor the position, while the roll out opportunities provides ideas on generating income from the position. Roll out opportunities are found by applying the rules suggested earlier, which depend on the stock movement up or down from the original purchase. The roll out opportunities act as alerts to suggest actions that could provide income generation alternatives.

This suite of tools will enable an investor to find, analyze, compare, manage, and make money with option related strategies.

**Summary of PowerOptions Tools available to support the married put investment strategy:**

- **Married Put Insurance** – Used when a stock position is already profitable and you want to lock in profits using a Put for insurance.
- **Married Put Search** – Used to create a new position, by purchasing a stock and put protection at the same time, based on parameters that screen the entire options market
- **Married Put Search by Symbol** – Used to create put insurance on an existing position that is not profitable or view several other put insurance alternatives.
- **Collar Search** – Used to create a new covered call plus protective put position based on screening the entire options market
- **Collar Search by Symbol** – Used when you have a stock of choice for a covered call and protective put.
- **My Portfolio** – a management tool for different option positions. Tools to monitor the position, to suggest roll out candidates, and to archive historical transactions.
- **SmartHistoryXL** – this tool was not reviewed in this article, but is available to help test your choice of screening parameters against past stock and option data. This approach is much faster and more effective than paper trading.