

- You think that Big 'n' Oily Malted Balls candy (symbol BOMB) is going to be the next big thing. The stock is currently selling for \$29. You purchase a call options contract to buy 100 shares at \$30. The price of the option was \$2. Answer the following questions: market price = \$29 strike price = \$30 \$1 out-of-the-money

 - Is your option: a) "in-the-money" b) "at-the-money" c) "out-of-the-money"
 - What is the break-even point for your option? option price \$2 + strike price \$30 = \$32 break-even point
 - Ignoring commissions, if the stock price rose to \$36, what would be your profit?

$$\begin{matrix} \$36 \\ \text{stock} \\ \text{price} \end{matrix} - \begin{matrix} \$32 \\ \text{break-even} \\ \text{point} \end{matrix} = \$4 \text{ profit} * 100 \text{ shares} = \underline{\$400 \text{ profit}} \text{ for one contract}$$
- You are sure that the price of Opie's Obedient Pet Service (symbol OOPS) is far too high. You think investors have bid up the price to an outrageous amount. About a month ago, you purchased a put options contract to sell 100 shares at \$90. The price of the option was \$3. The stock is currently selling for \$88. Answer the following questions: strike price \$90 market price \$88

 - Is your option: a) "in-the-money" b) "at-the-money" c) "out-of-the-money" \$2 in-the-money
 - What is the break-even point for your option? Strike price \$90 - option price \$3 = \$87 break-even price
 - Ignoring commissions, if the stock price fell to \$82, what would be your profit?

$$\begin{matrix} \$87 \\ \text{break-even} \\ \text{price} \end{matrix} - \begin{matrix} \$82 \\ \text{stock} \\ \text{price} \end{matrix} = \$5 \text{ profit} * 100 \text{ shares} = \underline{\$500 \text{ profit}} \text{ for one contract}$$
- Your broker calls you and says, "Ya' know, straddles are a great way for you to generate commissions, uh, I mean make money. This stock, Young's Underwater Crab Hatchery (symbol YUCH), is extremely volatile. It's currently selling for \$33. I suggest you purchase a call option to buy at \$35 and a put option to sell at \$35. The price of the call option is \$2 and the price of the put option is \$5." Even though you're not quite sure whether or not this is a good idea, you go ahead with the offer from your broker. Answer the following questions: \$2 call + \$5 put = total price \$7 * 100 shares = \$700

 - What's the total price of your options (excluding commissions)? \$2 call + \$5 put = total price \$7 * 100 shares = \$700
 - How far does the stock price have to swing from \$35 in either direction before your straddle is "in-the-money?" (i.e. What's the break-even point?)
must swing \$7 in either direction above \$42 or below \$28
- You purchased 100 shares of Pretzel's Unlimited (symbol PU) some time ago when the price was \$10. The current price is around \$72. You are thinking of selling but you aren't sure. Instead, you sell (write) a single call options contract at the strike price of \$75. The option price was \$1. Answer the following questions: \$1 * 100 = \$100 option premium

 - How much money did you receive when you sold (wrote) the call options contract? strike price = \$75
 - If the option is exercised, what price will you receive for your 100 shares of PU stock? strike price = \$75
 - What is the total amount you will receive? What are the disadvantages of this strategy?

$$\begin{matrix} \$75 \\ \text{Strike} \\ \text{price} \end{matrix} + \begin{matrix} \$1 \\ \text{option} \\ \text{price} \end{matrix} = \begin{matrix} \$76 \\ \text{per} \\ \text{share} \end{matrix} * 100 \text{ shares} = \underline{\$7600} \text{ received for one contract}$$

If the price were to rise very high, you would lose the opportunity to sell the stock at the very high price
- Fire Abatement Technology (symbol FAT) is currently selling for \$15. You are thinking of purchasing 100 shares but you're not quite sure. Instead, you sell (write) a single put options contract with a strike price of \$15. The put option sells for \$2. Answer the following questions: \$2 option price * 100 shares = \$200 received

 - How much money did you receive when you sold (wrote) the put options contract? strike price \$15
 - If the option is exercised, what price will you pay for the 100 shares of PU stock? \$15 - \$2 = \$13 effective price
 - What's the effective price per share that you paid for PU (assuming the option is exercised)? \$15 - \$2 = \$13 effective price
 - Is this an effective strategy? What are the advantages and disadvantages?
It may be an effective strategy -- as long as you have the cash (covered put option)
advantage - cheaper price than what you would have paid
disadvantages - price could fall very low and you still have to buy the stock at \$15
- might not get the stock if price goes up