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THE VALUE LINE
Daily Options Survey
On Line at the Opening Bell, Every Trading Day

The Weekly Option Strategist

July 23, 2007

Selling your Option before Expiration

In This Issue:

Most introductory option texts show only the possible gains and losses of an option at its expiration. However, if you have bought an option, there is no reason why you cannot sell it before it expires. In fact, most of the time, you should sell your option before expiration - either to maximize your profit or to minimize your loss.

The Life of an Option

First, it helps to review the dynamics of option premiums. As is well known, an option's premium consists of *tangible value* and *time value*.

Tangible value is what the option is worth if you chose to exercise it. For a call, tangible value is the stock price minus the strike price as long as the stock price is greater than the strike price. If the stock price is less than the strike price, you would not choose to exercise it. Therefore, it has zero tangible value. For a put, tangible value is the strike price minus the stock price as long as the strike price is greater than the stock price. If the strike price is less than the stock price, then the tangible value of the put is zero, because the owner of the put would not exercise it.

Time value is the insurance component of an option's premium. This premium both insures you against loss if the stock moves in the wrong direction and against missing out if the stock moves to where you want. Basically, time premium is a function of (1) how close the stock is to the strike price, (2) how volatile the stock is expected to be, and (3) how much time is left before the option expires.

Tangible value is strictly determined by the relationship between the stock and the strike price, regardless of time. If time passes and the stock stands still, tangible value will remain the same.

Time value, on the other hand, is affected by the passage of time. If the stock stands still and time passes, then (if volatility expectations remain unchanged) the option's time value will decline. (See "Understanding Time Decay," Ot060306.Pdf in our *Reports Archive* for an explanation of why option time premiums lose value the way they do.)

A Call Buying Example

Suppose we bought one January 2009 $55 strike Leap call on NCR for $8.65 on July 16th with the stock at $55. In Figure 1 below, we show what we expect the premiums to be at different stock prices on three different dates for this call;

1) July 16, 2007, the day we bought the option,

2) October 15, 2007, 91 days after having bought the option, and

3) January 17, 2009, the call's expiration date.

Notice that at its expiration, the option is worth only its tangible value. Notice also that at dates before its expiration, the option has time value in addition to tangible value and that for any given stock price, the time value gets progressively lower as you approach expiration.

Figure 1 - Expected Premiums of one January 2009 $55 Strike Call on July 16, 2007: Beginning Stock Price $55, Beginning Premium $8.65

	Stock Prices								
	$ 35	$ 40	$ 45	$ 50	$ 55	$ 60	$ 65	$ 70	$ 75
7/16/2007	$ 0.70	$ 1.70	$ 3.35	$ 5.65	$ 8.65	$ 12.20	$ 16.15	$ 20.40	$ 24.95
10/15/2007	$ 0.45	$ 1.25	$ 2.70	$ 4.90	$ 7.75	$ 11.25	$ 15.25	$ 19.55	$ 24.10
1/17/2009	$ -	$ -	$ -	$ -	$ -	$ 5.00	$ 10.00	$ 15.00	$ 20.00

In Figure 2 below, we show the expected profit and loss of this option purchase. (We do this by calculating what the option is worth on various dates at various stock prices and subtracting from this the $865 we initially paid.)

Now let us suppose that on October 15, 2007, the stock has risen to $70. The call would then be worth $2,040 ($20.40 x 100). Thus, if we sell this call, we reap a $1,175 profit ($2,040 minus $865). In this example, if we don't expect the stock to rise further, then it makes sense to take our profit and sell the call for $2,040 rather than wait until expiration, at which time the call would only be worth its tangible value of $1,500 and our profit would be only $635.

Suppose that instead of rising, the stock has declined to $45 on October 15. 2007 and the premium has declined to $3.35. If we do not expect the stock to recover, then it makes sense to sell our call. Here our loss would be $530 ($865 minus $335). While nobody likes to lose money, this loss is a lot less than the $865 loss we would incur if we waited until expiration and let the call expire worthless.

Of course, in all instances, whether or not you sell your option depends on your expectations. If the stock has risen and you expect it to rise further but want to take some profit in the meantime, then maybe you should consider selling the $55 strike call and buying a higher strike call instead. This "rolling" transaction has the effect of reducing your risk. (A popular strategy, usually used with shorter-term options, is to roll your option, once your profits have equaled your initial premium.)

Graphing It

On page 3, we show a graphical presentation of the expected P/L of our January 2007 $50 call at different stock prices and on three different dates. This type of graph is also used in our template, Whatifi3.Xls, which allows you the flexibility of viewing three additional (option or stock) positions on the same underlying. We always recommend that you use this template when forming your option strategies.

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Figure 2 - Expected Profit and Loss on One Option Contact
(Current Premium - Beginning Premium) x 100

	Stock Prices								
	$ 35	**$ 40**	**$ 45**	**$ 50**	**$ 55**	**$ 60**	**$ 65**	**$ 70**	**$ 75**
7/16/2007	$ (795)	$ (695)	$ (530)	$ (300)	$ -	$ 355	$ 750	$ 1,175	$ 1,630
10/15/2007	$ (820)	$ (740)	$ (595)	$ (375)	$ (90)	$ 260	$ 660	$ 1,090	$ 1,545
1/17/2009	$ (865)	$ (865)	$ (865)	$ (865)	$ (865)	$ (365)	$ 135	$ 635	$ 1,135

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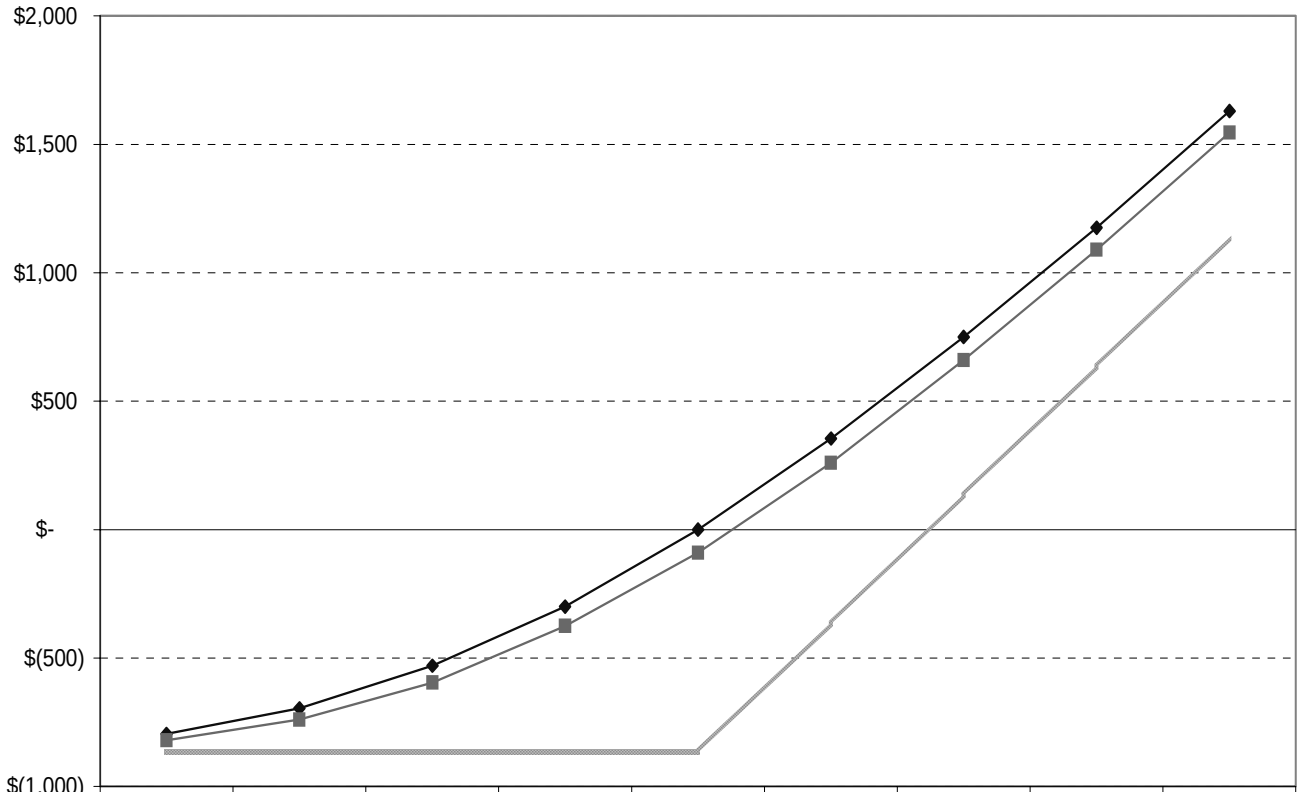
Graph 1 - Gains and Losses at Different Stock Prices on Different Days:
January 2009 $55 Call bought at $8.65



	$35	$40	$45	$50	$55	$60	$65	$70	$75
7/16/2007	$(795)	$(695)	$(530)	$(300)	$-	$355	$750	$1,175	$1,630
10/15/2007	$(820)	$(740)	$(595)	$(375)	$(90)	$260	$660	$1,090	$1,545
1/17/2009	$(865)	$(865)	$(865)	$(865)	$(865)	$(365)	$135	$635	$1,135

Call and Put Buying Rank Averages Last Updated: 07/17/07

	Number of Options	% of Total	Common Rank	Implied Volatility Ask Price	Adjusted Volatility Forecast	Under/ Over Priced Ask Price	Days to Exp.	% in-or out-of-the-money	Rel. Vol Option	Time Decay as % Common Price
Call Buying Ranks										
Rank 1	3010	5%	1.31	38%	56%	-29%	301	-4%	658	-0.017%
Rank 2	10393	17%	2.09	38%	49%	-19%	278	-7%	680	-0.018%
Rank 3	47690	78%	3.15	48%	43%	12%	218	-6%	523	-0.021%
	61093	100%	2.88	46%	45%	5%	232	-6%	556	-0.021%
Put Buying Ranks										
Rank 1	2113	3%	4.49	46%	61%	-21%	239	-4%	728	-0.011%
Rank 2	8360	14%	3.71	44%	52%	-13%	256	-2%	621	-0.012%
Rank 3	51084	83%	2.67	50%	43%	16%	229	6%	524	-0.014%
	61557	100%	2.87	49%	45%	11%	233	5%	544	-0.014%

Call and Put Writing Rank Averages

	Number of Options	% of Total	Common Rank	Implied Volatility Bid Price	Adjusted Volatility Forecast	Under/ Over Priced Bid Price	Days to Exp.	% in-or out-of-the-money	Rel. Vol Option	Time Decay as % Common Price
Call Writing Ranks										
Rank 3	32635	74%	2.57	30%	41%	-22%	276	-5%	570	-0.024%
Rank 4	8467	19%	3.56	31%	32%	2%	246	-3%	421	-0.028%
Rank 5	3188	7%	4.11	41%	33%	26%	217	0%	357	-0.037%
	44290	100%	2.87	31%	39%	-14%	266	-4%	526	-0.026%
Put Writing Ranks										
Rank 3	32148	68%	3.19	36%	44%	-15%	259	3%	515	-0.017%
Rank 4	11200	24%	2.28	37%	35%	7%	257	7%	456	-0.018%
Rank 5	3881	8%	1.76	56%	40%	32%	263	50%	315	-0.027%
	47229	100%	2.86	38%	42%	-6%	259	7%	484	-0.018%

Covered Call Rank Averages

	Number of Options	% of Total	Common Rank	Implied Volatility Bid Price	Adjusted Volatility Forecast	Under/ Over Priced Bid Price	Days to Exp.	% in-or out-of-the-money	Rel. Vol Option	Time Decay as % Common Price
Rank 1	2619	6%	1.60	40%	33%	23%	216	-2%	392	-0.042%
Rank 2	8491	21%	2.14	32%	33%	0%	246	-1%	429	-0.030%
Rank 3	22323	55%	2.93	31%	39%	-17%	264	-7%	569	-0.026%
Rank 4	5474	13%	3.76	32%	50%	-32%	291	-17%	708	-0.024%
Rank 5	1744	4%	4.53	31%	53%	-41%	300	-20%	759	-0.021%
	40651	100%	2.86	32%	39%	-14%	262	-7%	555	-0.027%

Married Put Buying Rank Averages

	Number of Options	% of Total	Common Rank	Implied Volatility Ask Price	Adjusted Volatility Forecast	Under/ Over Priced Ask Price	Days to Exp.	% in-or out-of-the-money	Rel. Vol Option	Time Decay as % Common Price
Rank 1	2743	4%	1.22	43%	60%	-24%	272	-18%	868	-0.009%
Rank 2	8504	14%	1.94	42%	50%	-13%	260	-10%	659	-0.012%
Rank 3	32592	53%	2.84	43%	42%	3%	237	-2%	546	-0.013%
Rank 4	13813	22%	3.60	53%	41%	29%	207	11%	463	-0.015%
Rank 5	3905	6%	3.82	111%	58%	88%	199	82%	340	-0.021%
	61557	100%	2.87	49%	45%	11%	233	5%	544	-0.014%

Market Review - Week Ending 07/17/07

Market Indexes	Close	% Change	Volatility Indexes*	% Change
Dow Jones Industrial	13,971.55	3.48%	14.52	-10.70%
Nasdaq 100	2,041.78	3.54%	16.95	-8.92%
S&P 500	1,549.37	2.60%	15.63	-11.04%

Performance Tables

Common Ranks	Count		Percent
Rank 1	2.88%	12246	8.82%
Rank 2	1.75%	27951	20.13%
Rank 3	1.64%	69921	50.36%
Rank 4	1.26%	20761	14.95%
Rank 5	0.83%	7960	5.73%
Call Buyer's Ranks			
Rank 1	30.26%	2861	4.15%
Rank 2	20.94%	9883	14.33%
Rank 3	17.03%	56220	81.52%
Call Writer's Ranks			
Rank 5	-4.41%	2935	6.63%
Rank 4	-5.89%	8490	19.17%
Rank 3	-7.53%	32872	74.21%
Covered Call Ranks			
Rank 1	1.14%	2463	5.99%
Rank 2	0.89%	8392	20.41%
Rank 3	0.89%	22775	55.40%
Rank 4	0.80%	5659	13.76%
Rank 5	0.80%	1823	4.43%
Put Buying Ranks			
Rank 1	-1.51%	2142	3.10%
Rank 2	-5.29%	8454	12.23%
Rank 3	-8.67%	58532	84.67%
Put Writer's Ranks			
Rank 5	4.45%	3478	7.56%
Rank 4	3.16%	10512	22.86%
Rank 3	3.15%	31999	69.58%
Married Put Ranks			
Rank 1	2.51%	2728	3.95%
Rank 2	1.44%	8596	12.43%
Rank 3	1.28%	32921	47.62%
Rank 4	0.96%	17265	24.98%
Rank 5	0.52%	7618	11.02%

Market Neutral Hedges	
Long/Long Hedge (Buy Rank 1 Calls and Puts)	13.27%
Short/Short Hedge (Write Rank 5 Calls and Puts)	-0.08%
Long/Short Call Hedge (Buy Rank 1 Calls/Write Rank 5 Calls)	11.59%
Long/Short Put Hedge (Buy Rank 1 Puts/Write Rank 5 Puts)	1.42%
Combined Hedges (Buy Rank 1 Calls and Puts/ Write Rank 5 Calls and Puts)	6.38%

* - VIX for the S&P 500, VXN for the Nasdaq 100 & VXD for Dow