Volume 36, Number 5

# THE VALUE LINE

## Daily Options Survey

*On Line at the Opening Bell, Every Trading Day*

Pages 1-2

## *The Weekly Option Strategist*

February 2, 2004

# Our Educational Option Strategy Reprints

### In This Issue:



We now post a series of option strategy reports in our *Interactive Options Study Guide.* These reports, which previously appeared in *The Weekly Option Strategist*, are also posted elsewhere on the web to educate the investing public about options and about *The Value Line Daily Options Survey.* We have grouped these reports in one menu (complete with a short description of each) and have presented them in easy-to-read HTML web format (with online graphics). These reports should prove to be a relatively painless refresher course on options for our existing subscribers.

### General Introduction

As we have often noted, when you buy an option, you buy insurance against uncertainty – more specifically- against making the wrong financial decision. Two examples of wrong financial decisions might be (1) failing to get out of a stock when you should or, (2) failing to be invested in a stock when it rises. As these reports will show, you can tailor your insurance to your assessment of the risk. You can also be a seller of insurance when this insurance is sufficiently overpriced. Covered call writing is an example of this type of insurance selling.

### Our Index Page at www.valueline.com/edu_options/

The link to this page can be found online in our Interactive Options Study Guide. (See Figure 1 on page 2).
Welcome to the Educational Reprints from *The Value Line Option Strategist*. We have posted these reprints to help you use options as an investment tool and to introduce you to *The Value Line Daily Options Survey*.

1. *Buying Naked Calls*. This report shows you how buying calls is really insurance against (1) losing money if the stock falls and (2) missing out if the stock rises. According to our models (and our track record), this insurance is a bargain a lot more often than people think.

2. *Buying Naked Puts*. This report shows you how you can diversify your investments by buying "naked" puts. These puts can be in-, at- or out-of-the-money. Our recommended puts are based on stocks that Value Line expects to under perform the market. They are also under priced, according to our model. Our track record shows that even a small allocation to naked put buying can greatly improve your returns over time.

3. *Covered Calls: Doing the Math.* You write covered calls when the call is overpriced compared to how much you expect the stock to move. In this report, we show you some very useful calculations to help you make your covered call selections.

4. *Naked Puts:* an Alternative to Covered Call Writing. This report shows how put writes and covered calls have very similar gains and losses and how, in many instances, fully collateralized put writes can be preferable.

5. *Option Spreads I: Basic Bull* and *Bear Spreads*. Knowing a few basics can save you a lot of time in figuring out spreads. This report gives you the tools to trade spreads with confidence.

6. *Option Spreads II: Credit Spreads* as *"Naked" Write Alternatives*. Writing "naked" options can be very profitable, but is also very risky. Did you know that often a credit spread based on a certain option can require less margin and give you better returns than a "naked" write. Here are examples of how to look for these opportunities.

7. *A Primer on Put/Call Parity.* If you know one rule and can remember your high school algebra, you know all the rules. Put/Call parity will often tell you which strategy is best at a given time.

You can find these reports online at the following web address

www.valueline.com/edu_options/

Alternatively, you can find them under *Strategy Reprints* in our *Interactive Study Guide.*

## Additional Reprints

We also plan to add the following strategy reports to this series.

*8. Hedging with Married Puts.* This strategy incorporates owning the stock and buying a put to protect it. Often market conditions make married put buying a very viable course of action. Stocks with long-standing bullish trends often offer surprisingly cheap out-of-the-money put insurance, while even very volatile stocks can often be hedged with under-priced, in-the-money puts (Ot020702.Pdf).

*9. Hedging with Collars:* You can greatly reduce the cost of your put hedges by selling off some of your insurance when you hedge with what is known as a collar. You can even sell your insurance in such a way that you actually take in time premium (Ot031103.Pdf).

*10. Hedging with a Bear Spread:* You can also hedge your stock with a bear put spread or a bear call spread. These spreads can offer you the opportunity of taking advantage of overpriced insurance in making your hedges more efficient (OT031103.Pdf).

*11. Option Spreads III – Calendar Spreads:* A typical calendar spread is the sale of a shorter-term option and the purchase of a longer-term one. These spreads often offer the average investor the chance to sell overpriced premium with relatively little risk.

*12. Option Spreads IV – Long Diagonal Spreads*: These spreads consist of a longer-term option purchase (often a Leap) and a nearer-term option sale. These spreads can be very attractive alternatives to covered calls.

*13. Option Spreads V – The Backspread*: This spread, which can often be established with little or no outlay of cash, and can offer you a way to participate in a rapidly rising stock with little downside risk.

*14. Option Spreads VI – The Diagonal Backspread*: Often, when markets are panicked, lower strike short-term premiums are overpriced, while longer-term higher strike premiums are relatively cheap. The diagonal backspread offers you a way to take advantage of such a situation if you think that the stocks are likely to recover.

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## Figure 1 – Our Interactive Options Study Guide

**How to Use *The Value Line Daily Options Survey***

*I: GETTING STARTED ONLINE*

*Accessing Our New Interactive Options*

*Accessing Selected Options*

*Guide to the Daily Spreadsheet Files*

- *Guide to Daily Spreadsheet Files (PDF File*)*
- *Guide to Portnew4.Xls (PDF File*)*
- *Guide to Trackrec.Xls (PDF File*)*
- *Guide to Whatifi2.Xls (PDF File*)*

*II: USING THE OPTIONS ARCHIVE*

*Recent Additions to the Archive*

*III: Educational Strategy Reprints (HTML File*)*

*IV: GLOSSARY (HTML File*)*

*V: Value Line Guide: How to Invest with Options*

**Market Review - Week Ending 01/27/04**

| Market Indexes | Close | % Change | Volatility Indexes* | % Change |
|---|---|---|---|---|
| Dow Jones Industrial | 10,609.92 | 0.77% | | |
| Nasdaq 100 | 1,519.23 | -2.17% | 23.03 | 12.40% |
| S&P 500 | 1144.05 | 0.46% | 15.35 | 0.92% |

**Performance Tables**

| Common Ranks | % Change | Count | Percent |
|---|---|---|---|
| Rank 1 | -0.18% | 7805 | 7.86% |
| Rank 2 | 0.12% | 20877 | 21.02% |
| Rank 3 | 0.02% | 52971 | 53.33% |
| Rank 4 | 0.28% | 13855 | 13.95% |
| Rank 5 | 1.22% | 3825 | 3.85% |
| **Call Buyer's Ranks** | | | |
| Rank 1 | 3.66% | 4344 | 8.76% |
| Rank 2 | 5.21% | 10245 | 20.65% |
| Rank 3 | 3.69% | 35023 | 70.59% |
| **Call Writer's Ranks** | | | |
| Rank 5 | -1.87% | 1984 | 5.74% |
| Rank 4 | -0.83% | 5078 | 14.68% |
| Rank 3 | 0.20% | 27531 | 79.59% |
| **Covered Call Ranks** | | | |
| Rank 1 | 1.66% | 2129 | 6.15% |
| Rank 2 | 0.05% | 5004 | 14.47% |
| Rank 3 | 0.14% | 16590 | 47.96% |
| Rank 4 | 0.14% | 7314 | 21.14% |
| Rank 5 | 0.20% | 3556 | 10.28% |
| **Put Buying Ranks** | | | |
| Rank 1 | -0.74% | 6119 | 12.29% |
| Rank 2 | -1.50% | 10357 | 20.81% |
| Rank 3 | -3.40% | 33305 | 66.90% |
| **Put Writer's Ranks** | | | |
| Rank 5 | 4.54% | 2076 | 5.55% |
| Rank 4 | 1.89% | 5272 | 14.10% |
| Rank 3 | 0.76% | 30055 | 80.35% |
| **Married Put Ranks** | | | |
| Rank 1 | -0.21% | 4407 | 8.85% |
| Rank 2 | -0.13% | 10550 | 21.19% |
| Rank 3 | -0.07% | 24036 | 48.28% |
| Rank 4 | 0.00% | 7179 | 14.42% |
| Rank 5 | 0.10% | 3609 | 7.25% |

* - VIX for the S&P 100 and VXN for the Nasdaq 100