THE VALUE LINE

Daily Options Survey

***The Weekly Option Strategist,* June 24, 2021**

A Dictionary of Option Strategies

Many subscribers are intimidated by not having a clear understanding of all the option strategies that we mention in our publication. This week, we try to rectify this by presenting a *Dictionary of Option Strategies*. We also provide references to *Weekly Strategist Reports* on these strategies.

Which Strategy is Best?

As for which strategy is best, perhaps the most specific answer we can give you is that "it depends." First of all, it depends on the expected behavior of the underlying stock (or index). Hindsight is 20/20. As we often stress in these reports, over the long haul, the best results come from a combination of bullish and bearish, and long and short premium options.

Also, it depends on you, the investor: your objectives, your tolerance for risk, your level of experience, your time horizon, your other investments, and finally, the amount of capital you can devote to options. So, without further ado, we invite you to view our list of strategies, taking a closer look at those strategies that many of you appear to find most intriguing.

Basic Strategies

These basic strategies are all described in our How to Guide, (How to Invest Using Options), which you can find in the *Resources* section of our Website in the Educational and "How-to-Guides" section.

Call Buying is a bullish premium buying strategy in which you pay a premium for the right, but not the obligation, to buy a stock at the strike price within a specified time period. The most you can lose is the premium you pay, while on the upside, your gains are potentially unlimited. During a bull market, buying our recommended calls has been easily our most profitable strategy. See "Buying Naked Calls OT210429.

Covered Call Writing is a moderately bullish premium selling strategy in which you own the stock and sell a call against it. The premium you collect gives you added income and a hedge if the stock goes down, but it also limits your profits if the stock ends up above the call's strike price. You might want to look at the Value Line Covered Call Guide on pages 25 to 27 (How to Invest Using Options) in the reports archive. Other weekly reports are "10 Covered Call Myths (or Myth Conceptions" OT210211 "Using Your Screener to Create Covered Calls on LEAPS" (Ot140424.pdf), and "Writing Covered Calls on Volatile Stocks" (Ot120308.pdf).

"Naked" Call Writing is a bearish premium selling strategy in which you collect the premium in return for the obligation to sell the stock at the strike price. Your best outcome occurs when the call expires completely worthless (i.e. the stock ends up below the strike price). However, with a "naked" call write, you can also profit as long as you are able to buy the call back for a lower premium than you initially collected. Look at pages 23 to 24 in (How to Invest Using Options). "Naked" call writing was a very profitable strategy from 1980-1990, and intermittently since then. Still, we use "naked call writing" as part of our recommended long/short call hedges. See also "Spotlight on Uncovered or "Naked" Option Writing" OT210121.

Put Buying is a bearish premium buying strategy. You pay a premium for the right, but not the obligation, to sell the stock at the strike price. Investors often buy puts as insurance. See "Protecting Your Assets with Options" OT200910.

"Naked" Put Writing is a bullish premium selling strategy in which you collect premium in return for the obligation to buy the stock at the strike price if the underlying stock falls below a certain level (the exercise price + the premium the buyer paid for the put option=their breakeven). If the stock ends up above the strike price, you get to keep the entire amount collected. See "Spotlight on Uncovered or "Naked" Option Writing" (OT200806).

Leaps: An acronym for Longer-term Equity Anticipation Security. Leaps trade on about 750 underlying stocks with expiration dates nine to 33 months into the future. We now rank Leaps from 1 to 5 for call and put buying and writing. See "Using Your Screener to Create Covered Calls on LEAPS" (Ot140424.pdf) and "What are LEAPS?" (Ot120412.pdf).

Hedges or Combination Strategies

Our hedges usually consist of combinations of different options on different underlying stocks.

Long/Short Hedge consists of equal weights of premium bought and premium sold. A long/short call hedge consists of recommended long calls and recommended "naked" call writes, while a long/short put hedge consists of recommended put purchases and recommended "naked' put writes.

Long/Long Hedge consists of buying equal amounts of recommended calls and puts. This strategy is fairly market neutral and has been highly successful over the past five years. However, it is vulnerable to periods when the market is flat. This strategy is a good way for new users of options to get comfortable using options. See "Building a Long/Long Hedge" (Ot110602.pdf).

Short/Short Hedge involves writing both recommended "naked" puts and calls on different underlying stocks. At one time, this was a very profitable strategy, but over the past nine years, due to changes in the dynamics of the options market, it has performed very poorly.

Spread Strategies

Spreads are combinations of different options on the same stock. We recommend that you test out likely spreads with our template Whatif.Xls. See "Our Whatifi Template" (WHATIFI4.xls).

Bull Spread: Created when the investor buys the lower strike call (or put) and sells the higher strike call (or put), with both options having the same expiration date. See "Screening for Out-of-the-Money Bull Put Spreads" (Ot140313a.pdf).

Bear Spread: The investor sells the lower strike call (or put) and buys the higher strike call (or put) on options of the same maturity. See "Consider the Bear Spread Hedge" (Ot110317.pdf)

Backspreads: A strategy with many different variations, all involving buying options at a particular strike price and writing a lesser number of options that are more deeply in-the-money. Call backspreads are generally bullish and put backspreads are generally bearish. See "Backspreads in Today's Market" (Ot110901.pdf).

Diagonal Backspread: Buying longer term options calls (puts) and selling a lesser number of nearer-term calls (puts) that are more in-the-money. See "The Diagonal Backspread" (Ot110908.pdf).

Collar: A long stock + long put +short call combination, sometimes referred to as a "fence". Usually collars involve buying lower strike out-of-the money puts on underlying stocks and then writing at-the-money or close-to at-the-money calls on the stock as well. You can also construct costless collars by buying a put and selling a call with equal premium amounts. See "Hedging Your Stocks with Collars" (Ot110224.pdf).

Credit Spreads: A credit spread is a 1-to-1 combination of calls and puts (but not both in the same spread) on the same underlying stock, with different strike prices, but with the same maturity, in which the investor writes the higher premium option, and buys the lower premium one.

Calendar Spread: A position created by writing a shorter term at-the-money (or near-the-money) call (put) and buying a longer term call (put) with the same strike price. See "Long Calendar Spreads" (Ot100513.pdf).

Prepared by the Options Strategist Team

© 2021, Value Line Publishing LLC. All rights reserved. Factual material is obtained from sources believed to be reliable and is provided without warranties of any kind. THE PUBLISHER IS NOT RESPONSIBLE FOR ANY ERRORS OR OMISSIONS HEREIN OR ANY DAMAGES OR LOSSES ARISING FROM ANY USE OF THE INFORMATION CONTAINED HEREIN. This publication is strictly for subscriber's own, noncommercial, internal use. No part of it may be reproduced, stored or transmitted in any printed, electronic or other form, or used for generating or marketing any printed or electronic publication, service or product. Officers, directors, or employees of Value Line, Inc. and its affiliates and subsidiaries, and EULAV Asset Management, may own stocks that are featured in this publication. Nothing herein should be construed as an offer to buy or sell securities or to give individual investment advice. Value Line, the Value Line logo, The Value Line Investment Survey, Value Line Select, Timeliness and Safety are trademarks or registered trademarks of Value Line Inc. and/or its affiliates in the United States and other countries. All other trademarks are the property of their respective owners. Value Line Geometric and Arithmetic Indices calculated by Thomson Reuters. Information supplied by Thomson Reuters. Value Line Geometric and Arithmetic Indices calculated by Thomson Reuters. Information supplied by Thomson Reuters.