The Naked Call

February 24, 2024

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1 The Naked Call Write (AKA Sell or Short)

1.1 What

- It involves the sale of one Call option.
- It is a neutral to bearish strategy. You'll make money as long as the price of the Underlying does not move above the sold Call Option's strike price.
- We recommend the selling of the Option to be:

  OTM

  Around 1.5 SD away (with less than 20% probability of being ITM on expiration day)

  1.5 months to 1 week of life left on the Option.

1.2 Risk/Reward

- Maximum Profit: Limited to the premium recieved.
- Maximum Risk: Is unlimited as long as the price of the Underlying keeps going up. There is more theoretical risk with the Naked Call than there is with the Naked Put.
- Breakeven:

  Strike Price of the Call + Premium recieved

  The Underlying must be below this breakeven in order to make money.

1.2.1 Example: You sell the ORTY $40 Oct15 Call Option for $5

1. Scenario A
   - In October, ORTY trades at $35. Since $35 is lower than the Call's strike price the call you sold is OTM and so it expires worthless. You keep 100% of your profits (the $5 you received when you sold the Option).
2. Scenario B
   - In October, ORTY trades at $45. Since $45 is higher than the strike price, the Option is $5 ITM (45-40). This is your loss, however, since you received $5 from the sale of the Option, you lose nothing, and make nothing. This is your breakeven scenario.
3. Scenario C

- In October ORTY trades at $50. Since $50 is higher than the strike price, the Option is $10 ITM. This is your loss, however, since you recieved $5 from the sale of the Option, your loss is only $5 (10-5). You still lose money on this trade though.

1.3 When

- As with Naked Puts, look for Underlyings with high IV Ranks (75 or above).
- This strategy attempts to profit from people's excessive greed. So Call selling is especially attractive in Underlyings that have experienced large price increases and investors look to buy calls because they think the ride will last forever. When greed-driven, investors will by junk calls that have very high probability of expiring OTM. You sell this junk to them and you pocket the money when they expire worthless.
- You believe that the rise in price of the underlying is an overreaction, and that the stock will soon return to its normal levels, or at least its price will not continue to increase as drastically.

1.4 Pros

- It is a straightforward, simple strategy:

  Low commission costs

  Easy to monitor

  Easier for your order to get filled
- You can make money if the Underlying falls, doesn't move, or even if it moves up slightly.
- You make money on time decay every day that goes by.
- If you follow our recommendations, you are very likely to be successful, as the odds are in your favor.

1.5 Cons

- If the Underlying continues to increase in price significantly, you can be exposed to huge losses.
- Brokerage firms will require significant cash or margin reserves before they let you sell a call option naked.
- While your maximum profit is defined prior to entering the trade, your maximum risk is (theoretically) infinite.

1.6 The Greeks of The Naked Call

- Δ: Negative

  You make money when the price of the Underlying decreases.
- Θ: Positive

  You make money as time passes.
- Vega: Negative

  You lose money if volatility expands.