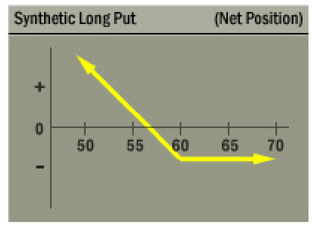
Synthetic Long Put

Description

By combining a **long call** option and a **short stock** position, the investor simulates a **long put** position. The object is to see the combined position gain value as the result of a predicted decline in the underlying stock's price.

It is not particularly popular, because it entails a short stock position. A synthetic long put is often established as an adjustment to what was originally simply a short stock position.

There is one possible advantage over a long put: in the event of an extended trading halt, the synthetic long put strategy does not require any action since the stock was sold when the strategy was implemented. However, as with any short sale, there is always a risk of being forced to return the stock.



Net Position (at expiration)

EXAMPLE
Short 100 shares XYZ stock
Long 1 XYZ 60 call

MAXIMUM GAIN
Short sale price - premium paid

MAXIMUM LOSS
Strike price - short sale price premium paid

Outlook

Looking for a sharp decline in the stock's value during the life of the option.

Summary

This strategy combines a long call and a short stock position. Its payoff profile is equivalent to a long put's characteristics. The strategy profits if the stock price moves lower. The faster and sharper the move lower, the better. The time horizon is limited to the life of the option.

Motivation

The only motive is to profit from a fall in stock's price.

Variations

N/A

Max Loss

for the stock price to be above the ition can be closed out by ice of the stock (where it was sold

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Synthetic Short Stock

Breakeven = initial short sale price - premium paid

Volatility

An increase in volatility would have a positive impact on this strategy, all other things equal. For one thing, it would tend to boost the long call option's resale value.

Time Decay

The passage of time will have a negative impact on this strategy, all other things being equal. As expiration approaches, the call's resale value tends to converge on its intrinsic value, which for out-of-the-money options is zero. Also, the sooner the call expires, the sooner it ceases to offer protection for the short stock position in the event of an unexpected rally.

Assignment Risk

None. The investor is in control.

Expiration Risk

There should be none. Presumably, if this position is held into expiration and the option is sufficiently in-the-money to be exercised, the investor will want to exercise the option to close out the short stock position.

Comments

N/A

Related Position

Comparable Position: **Long Put**

Opposite Position: **Covered Call**

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