

Title: Covered Calls: Make your shares pay you without selling them (yet)

Author: steelandquill

Created 2021-08-20 03:32:34 UTC

Permalink: /r/ratioatblessons/comments/p7u7lg/covered_calls_make_your_shares_pay_you_without/

Url: https://www.reddit.com/r/ratioatblessons/comments/p7u7lg/covered_calls_make_your_shares_pay_you_without/

Is_self: True

Body:

All right, Ratios. You asked for a quick demo on Covered Calls, so here's one for you.

If you don't know what a Covered Call is, or get lost with some terms, see [my FAQ](https://www.reddit.com/r/ratioatblessons/comments/o6tman/faq_options_101/)

For this demo, I bought 425 shares of \$NAK. If you've never heard of it, don't worry. This isn't meant to be a DD on NAK, and I'm overall ■ish on NAK anyways after they were caught lying about the scope of their project. (It's also how I incurred my biggest loss ever once upon a time, but another day, another flair.) I simply chose NAK since it's a cheap example and had strikes in \$0.50 increments.

Note: You'll notice \$0.06 differences in some prices. This is the commission fee per contract I pay to trade options.

STEP 1: Get approved for basic options.

Some brokers call it Level 0, others call it Level 1. Either way, it's the same permission: The ability to *sell* Covered Calls and Cash-Secured Puts. You're allowed to do this before being able to *buy* long calls and puts, due to the way the risk is assessed. I'll get to that later. Most brokers don't require any experience/trading history, but some might. All will require you to formally acknowledge the risks of options trading before approving you for the first tier of options. For more on options approval levels, [see here: WarriorTrading.](<https://www.warriortrading.com/options-trading-option-approval-levels/>) If you can't figure out how to get approved, I'm happy to help you find out, but *please* look it up first before asking.

STEP 2: Buy at least 100 shares

[Nothing special about the number](<https://preview.redd.it/c1ouow59bfi71.png?width=912&format;=png&auto;=webp&s;=a9cc1d40b128f131c35e8ed5ede0916fe46bb303>)

Why 100? Because you have to **cover** the sale of the call with 100 shares. Here, I went with 425 to show a specific point about multiple expiration dates, and to have 25 left over after tendering 400 *just in case* it blew up for some odd reason. (Don't hold your breath though.)

STEP 3: Consult the Option Chain

[Not a whole lot of demand for one of the biggest untapped gold deposits in the world. Wonder why.....](<https://preview.redd.it/r11onfq2cfi71.png?width=593&format;=png&auto;=webp&s;=f46c8061ba40f075aefaf10e6d290a25a4e3d40c>)

"Steel, what am I looking at?" On the left is the list of best bid/ask for each strike of calls, and on the right is the same for puts. Green is the bid price (what someone has offered to pay for the option contract), and red is the ask price (what a seller is *ask*ing for the contract they're selling) In this case, we're interested in the green numbers on the left - that's the going price for selling a call.

A thing to note - most exchanges require option prices to be incremented in \$0.05 if the price of the underlying security is trading under \$3. In the case of \$NAK, this is always the case.

Translation: It's next to impossible to sell a 20Aug21 call at any strike and have the system clear it since even the ask is below the minimum.

Besides - at a basis of \$0.4116/share, $\$0.94/\$41.16 = 2.28\%$ return. Not great. (Didn't follow the math? See step 4)

STEP 4: Select an expiration and strike, and write it.

Search through the chain and find the call strike & date you want to sell. Longer-term and nearer to the money will get you the highest prices, if that's solely what you're going for. Your picks will depend on what the underlying stock is doing at the moment. Let's look at NAK's chart to lay the ground for why I picked the options I did.

[Going down. Next stop: \$0.30](https://preview.redd.it/0j56n913ffi71.png?width=1066&format;=png&auto;=webp&s;=9293c8b09b41b2bd314b2178eba8526abb77c287)

Yeah. Like I said earlier, this isn't a DD on NAK, so the short version ■ is that I don't expect to see NAK above \$0.50 for any appreciable amount of time anytime in the next few years. So in this case, I chose to go as close to the money as I possibly could - \$0.50 strikes, and since I don't think it's going up anytime soon except in a reverse split, I don't anticipate being assigned to sell the shares at any date.

[Not a lot of demand for September options. So I moved out to November and January.](https://preview.redd.it/y5hhc2b8gfi71.png?width=609&format;=png&auto;=webp&s;=9638ba436422bc5e98eaa0c153308ab6c2064f6d)

Reminder: Note the "-1" is because when you sell a covered call, you're "short" the call. If you suddenly decide one day you like the stock and want to hodl it to the moon and not be forced to sell it, you can buy the call back and "cover your short."

[23, 18, 14, 12... that's more like it....](https://preview.redd.it/0etbhoxgygfi71.png?width=603&format;=png&auto;=webp&s;=da617b6f2190a54daa4b8304067c1f5500cf7a2c)

If you're keeping track, yes, that's 4 short calls. Here's a look at how those juicy 0.5c20Jan23's look in my position list:

[Juicy. \$23.94/\$41.16 = 58.16% instant return on investment per 100 shares.](https://preview.redd.it/dv53o024ifi71.png?width=870&format;=png&auto;=webp&s;=0385bf7752b59b37bc2baf18abde2dccdc147d63)

How to read this: the top line is the total "position," and the two lines below are the individual components of that position - the underlying shares and the short covered calls. Notice something weird about the new average price?

$\$0.4116 - \$0.2394 =$ a new cost basis of \$0.1722 per share (note it's rounded up to \$0.18 above). What's cool about that: in the unlikely event NAK went to at least \$0.75 and I got assigned on the 10Jan23's (\$0.50 strike + \$0.24 option cost + \$0.01 to be profitable), that's a gain of 190%. Not bad, don't you think?

STEP 5: Put your premiums to work.

You now have cash from the proceeds of the sale, and you didn't even have to sell a single share. Use it to buy more shares of the stock you're selling calls on to rinse and repeat, buy more \$GME, buy other stocks, whatever. You now have cash. Keep in mind though, if you want to sell those covering shares, you have to buy back the calls first to unlock them. (unless you're approved for L4 options. In that case, why are you even reading this?)

Important Note

Something that should be obvious but should be repeated - should you decide to use this strategy on a stock you like, say...\$GME, you're implicitly agreeing to sell your shares when you write a covered call. ****Don't write covered calls on stocks that you don't want to sell under any circumstances****. Only on the ones you wouldn't mind selling. Someone wants to pay me \$50 for 100 shares of a sketchy Alaskan mining project? Fine. The OCC can just go ahead and assign me now.

Enjoy! I'll be along now and then to answer any questions.

