

Title: To LEAP or Not Too LEAP

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Created 2021-05-15 15:52:46 UTC

Permalink: /r/ratioatblessons/comments/nd1ww1/to_leap_or_not_too_leap/

Url: /r/options/comments/ncya8d/deep_itm_leaps_seems_to_provide_high_upside_for/

Is_self: False

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Body:

I was looking into buying some ITM LEAPS to increase my potential leverage given the recent drop in the NASDAQ and SPY. However, upon delving into option chains pricing, I noticed a trend in the limited upside for Sellers of deep ITM LEAPS while Buyers arguably are stand to benefit greatly from the synthetic shares at a lower price ratio. This led me to become really curious on the potential upside of Sellers of deep ITM leaps.

I will try to make a cases using the following examples of deep ITM LEAPS for popular stocks. Examples are sourced by using deep ITM LEAPS that were last transacted on Friday (14 May). Prices are based on Ask Price to take into account low liquidity:

1. MSFT 110C 1/20/23 - Ask Price: \$141. Current MSFT Price: \$248

- * Seller only restricts their potential gain from MSFT to \$3/share (or 1.2%) for 1.5 year period

- * Buyer is able to benefit from MSFT gains from synthetic shares at 57% price ratio. Downside is similar to owning shares, and only increases if MSFT drops below \$110

2. AAPL 65C 1/20/23 - Ask Price: \$64. Current AAPL Price: \$127.5

- * Seller restricts their potential gain from AAPL to \$1.5/share (or 1.2%) for 1.5 year period

- * Buyer is able to benefit from AAPL gains from synthetic shares at 50% price ratio. Downside is similar to owning shares, and only increases if AAPL drops below \$64

Could anyone explain the rationale of the sellers of deep ITM leaps and if it is a bearish stance? Given the low returns (1.2%) for the Sellers of deep ITM LEAPS (and assuming that the Sellers are bearish on the long term outlook) why wouldnt the seller just sell the shares right now?

The only argument i can make is that the sellers stand to benefit if the price stays within the strike price and the breakeven price which hence allows them to benefit from the premiums earned (reducing their cost per share by the further 1.2%). Hence, the Sellers are adopting a bearish stance and hoping that they can achieve a guaranteed return of 1.2% for 1.5 years while generating upfront cashflow.

Separately, is there also an argument that everyone should own deep ITM LEAPS to replace stocks if it is deemed impossible for the share price to be lower than the strike price? I cant forsee many scenarios where AAPL would be below \$64 or if MSFT would be below \$141 in Jan 2023. While the price benefits for increasing leverage using synthetic shares from deep ITM LEAPS would increase the potential of gains significantly.

I would be delighted if there is anyone that can help enlighten me or to correct my understanding of the benefits/cons of Sellers and Buyers of deep ITM LEAPs. Looking forward to everyone's advice :).