Covered Call

What's the difference between a covered call and a naked short call position?

In a sentence: a covered call writer owns the underlying asset, and a naked short call writer does not.

In Lyra's system, to sell a call you must collateralize it with the underlying asset. This turns every call sale into what's known as a **covered call**. A covered call differs from a '**naked short**' call, where the option is partially collateralized by cash (and **not** the underlying asset). To write a covered call the writer must first purchase the underlying asset, which means they are **long** the asset itself. The accompanying short call position offsets this somewhat, but unless the call is 100 delta, the option seller remains net long the underlying asset (whereas they would be net short with a short call position).

Covered Call

Why trade it? You think an asset is going up, is going to trend sideways, or take a small dip in price.

Optimal conditions: Lower realized volatility than IV, small bullish to sideways stock

Example: Long 1 ETH for $2000 against short a 2500 strike call for $300 with 30 days to expiration.

Cost: Share of asset, less premium received for call ($2000 - $300 = $1700).

Theoretical Max Profit: The maximum profit occurs when the price of the asset rises to the strike price on expiration, so the call you sold is worthless and your asset appreciates in value. In this example, if ETH rose from $2000 to $2500 on expiration the profit would be $800 ($2500 - $2000 + $300).

Theoretical Max Loss: If the price of the asset goes to 0, you lose the amount you paid for the asset less the call premium. In this example it would be $1700 ($2000 - $300).

Breakeven At Expiration: The asset price minus the premium collected ($2000 - $300 = $1700).