

# Writing Covered Calls



Learn the advanced concepts of building, evaluating and managing a covered call strategy



# AGENDA

1. What is a covered call strategy?
2. What should you consider when choosing a strike price?
3. What should you consider when choosing an expiration?
4. How can you manage the strategy?



# Before we get started...

- Options trading entails significant risk and is not appropriate for all investors. Certain complex options strategies carry additional risk. Before trading options, please read [Characteristics and Risks of Standardized Options](#). Supporting documentation for any claims, if applicable, will be furnished upon request.
- Examples in this presentation do not include transaction costs (commissions, margin interest, fees) or tax implications, but they should be considered prior to entering into any transactions.
- The information in this presentation, including examples using actual securities and price data, is strictly for illustrative and educational purposes only and is not to be construed as an endorsement or recommendation.

## What is a covered call strategy?

- The basics
- Goals of the strategy
- Risks of the strategy

# The basics: Covered call strategy

## Profit/Loss diagram and table: covered call

Long 100 shares at 98.00

Short 1 100 Call at 3.50

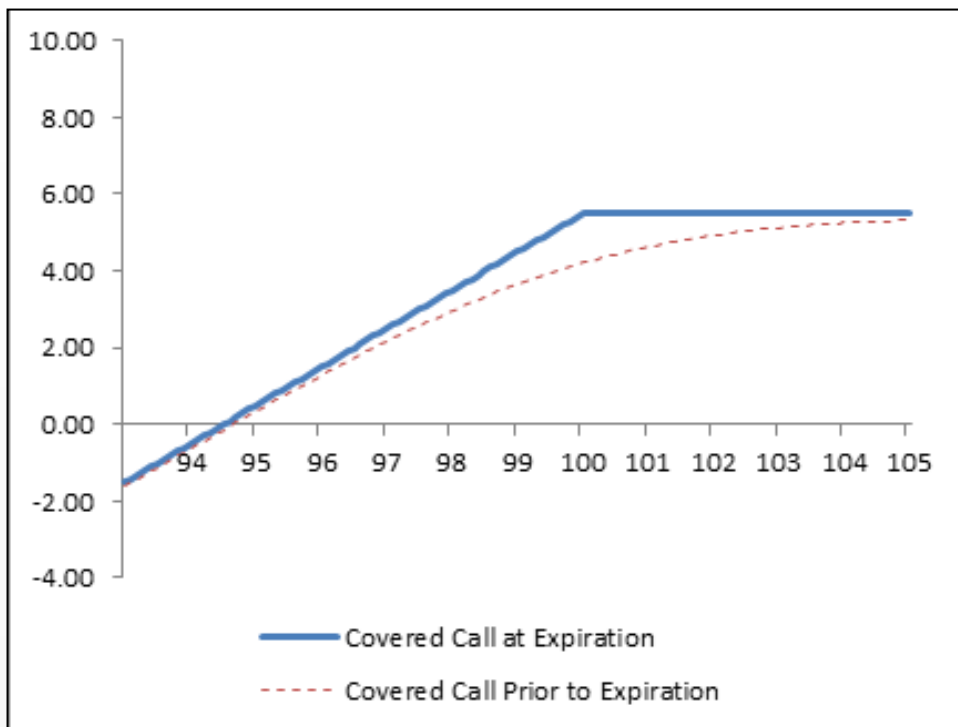


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## Outlook:

Bullish neutral

## Construction:

Buying (or owning) stock and selling call options on a share-for-share basis

## Max Gain:

(Strike Price + Call premium received)  
– Cost of the long shares

## Max Loss:

Cost of the long shares - call premium received

## Breakeven @ expiration:

Stock price - call premium received



Where can I learn more?

**Research > Learning Center >**  
**[Options Strategy Guide](#)**

# Goals: Why do traders sell covered calls?



- **Generate income**
  - Take in premium on bullish neutral outlook
  - Enhance returns on a security that is not expected to move in the short-term
- **As a method of selling stock**
  - Can be used as an exit strategy for a long position
- **To help manage a long stock position**
  - Reduce cost basis / breakeven
  - Reduce delta exposure (share exposure)
  - Generate positive returns in a sideways market



Where can I learn more?

*Research > Learning Center > [Generating income with options](#)*

# Risks: Get to know the Greeks

## The Greeks (at time of trade)

- **Delta** - rate of change (+)
- **Gamma** - rate of change of delta (-)
- **Theta**- time decay (+)
- **Vega** - volatility (-)

## What are the risks?

- **The underlying price moves down**
- **Increase in realized volatility**
- **Not applicable**
- **Increase in implied volatility**



### Trader's View:

Understand the risks of early assignment to your personal situation – upcoming dividends and tax considerations are often mistakenly overlooked when writing covered calls.



### Where can I learn more?

**News & Insights > Viewpoints > [Get to know the Greeks](#)**

## What should you consider when choosing a strike price?

- Underlying security exposure
- Rate of return potential
- Key resistance levels
- Probability of assignment



# Underlying security exposure

97.72 1.46 (1.52%)		V 17,748,57			
Strike	Last	Bid	Ask	Delta	
▼ Nov 22 CALLS					
60	36.85	37.65	37.90	0.9959	
65	31.05	32.65	32.85	0.9953	
70	26.24	27.70	27.90	0.9865	
75	22.80	22.75	22.95	0.9759	
80	17.60	17.80	18.00	0.962	
85	12.00	12.95	13.15	0.9257	
87.5	10.45	10.60	10.80	0.8912	
90	8.55	8.40	8.55	0.8351	
92.5	6.45	6.40	6.50	0.7519	
95	4.75	4.60	4.75	0.6446	
97.5	3.20	3.15	3.25	0.5203	
100	2.08	2.05	2.08	0.392	
105	0.71	0.70	0.71	0.1775	
110	0.22	0.22	0.23	0.0677	
115	0.09	0.08	0.09	0.0274	
120	0.06	0.04	0.05	0.014	
125	0.03	0.01	0.04	0.008	
130	0.05	0.00	0.03	0.0046	
135	0.03	0.00	0.03	0.004	
140	0.01	0.00	0.01	0.0015	

Image is for illustrative purposes.

Evaluate how the short call will affect your exposure to the underlying security:

<b>ITM</b> <b>92.5 Call</b>	<ul style="list-style-type: none"> <li>Delta = 75</li> <li>Net Delta (1 lot) = <b>25 share exposure</b> (100-75)</li> </ul>
<b>ATM</b> <b>97.5 Call</b>	<ul style="list-style-type: none"> <li>Delta = 52</li> <li>Net Delta (1 lot) = <b>48 share exposure</b> (100 -52)</li> </ul>
<b>OTM</b> <b>105 Call</b>	<ul style="list-style-type: none"> <li>Delta = 18</li> <li>Net Delta (1 lot) = <b>82 share exposure</b> (100-18)</li> </ul>

# Evaluate rate of return (ROR) potential

Strike	Last	Bid
97.72 1.46 (1.52%)		
Nov 22 CALLS		
60	36.85	37.65
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105	0.71	0.70
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115	0.09	0.08
120	0.06	0.04
125	0.03	0.01
130	0.05	0.00
135	0.03	0.00
140	0.01	0.00

Image is for illustrative purposes.

Covered call contract	Bid	Break-Even	Static ROR	Profit if Assigned	Assigned ROR
ITM 92.5 Call	6.4	91.32	-	1.18	1.29%
ATM 97.5 Call	3.15	94.57	-	2.93	3.10%
OTM 105 Call	0.7	97.02	0.72%	7.98	8.23%

Example:

- Assumes cost basis of the long stock shares is the current price of \$97.72
- Assumes November contracts are being sold

**Don't forget that long stock position has an unlimited potential ROR!**



**Trader's View:**

Consider the purpose of the underlying position in your account before selling a covered call against it. Does it make sense to cap your potential gains on a security you own strictly for its growth potential?

# Key resistance levels

Other factors to consider when choosing a strike price are key resistance levels...

- Identifying price points where the security has had trouble breaking through
- Using slow moving averages (more periods included) as a resistance level

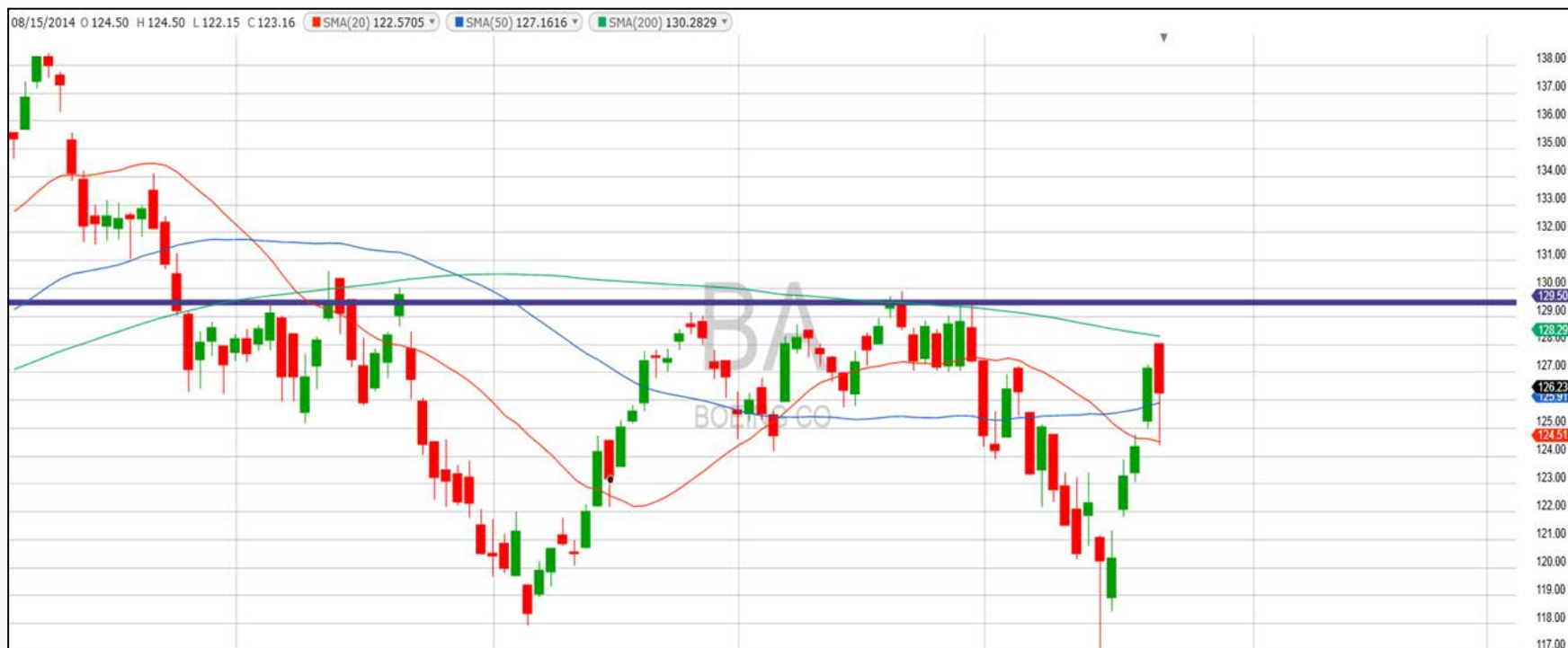
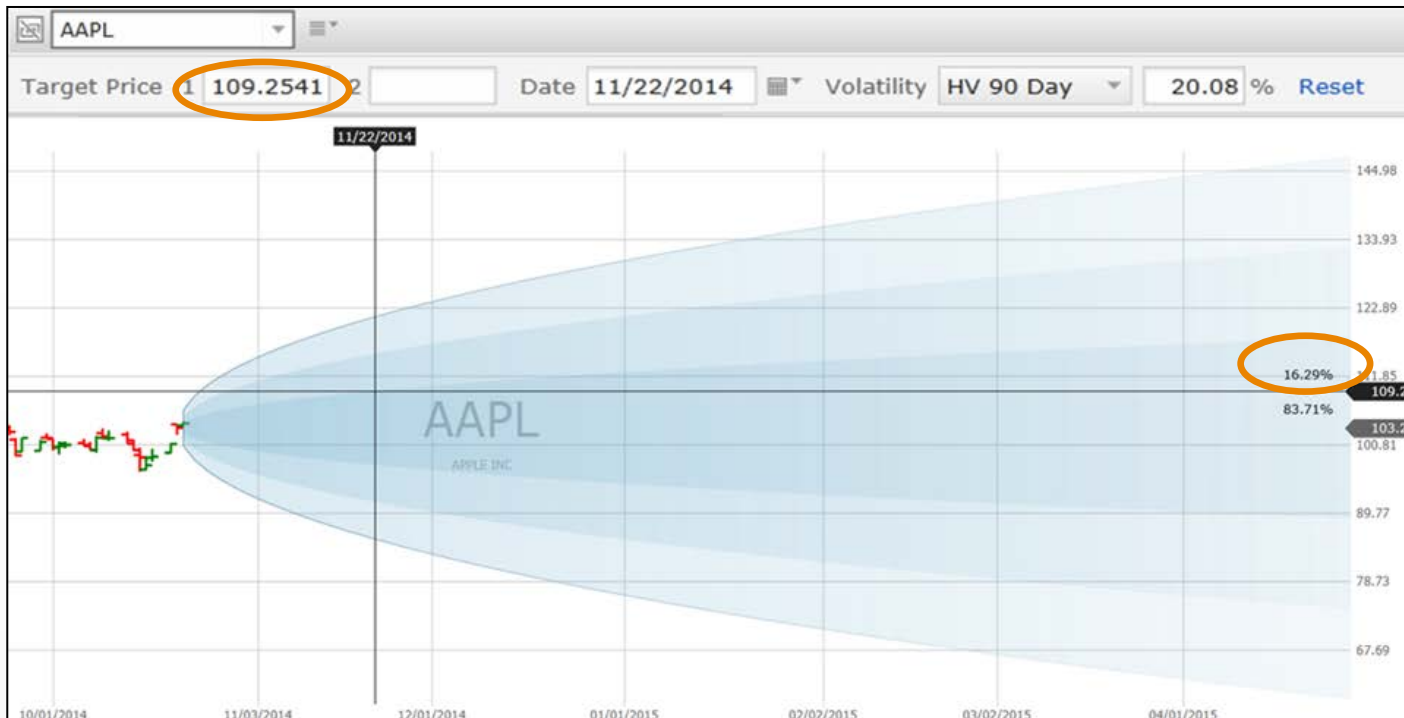


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# Probability of assignment

...or targeting an option with a specific statistical probability of assignment.



Tells you that there is a 16.29% statistical probability that AAPL will be above \$109.25 on 11/22/14 – the probability of assignment

Image is for illustrative purposes.

- 1 standard deviation captures ~68% of occurrences
- 2 standard deviation captures ~95% of occurrences
- 3 standard deviation captures ~99% of occurrences



## Trader's View:

Because the risk of assignment is to the upside, by selling a 16% probability option, a trader is expecting less than a 1 standard deviation move in the underlying.

# Use Delta to evaluate probability of assignment

97.72 1.46 (1.52%)		V 17,748,57		
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135	0.03	0.00	0.03	0.004
140	0.01	0.00	0.01	0.0015

Image is for illustrative purposes.

Use Delta to evaluate your probability of being assigned:

**ITM**  
**92.5 Call**

- Probability of being ITM at expiration is approximately **75%**
- Bid: 6.40

**ATM**  
**97.5 Call**

- Probability of being ITM at expiration is approximately **52%**
- Bid: 3.15

**OTM**  
**105 Call**

- Probability of being ITM at expiration is approximately **18%**
- Bid: 0.70

# Consider your goals and objective for the trade

<b>In-the-Money (ITM)</b>	<ul style="list-style-type: none"><li>• Method of selling the stock</li><li>• Higher premium received</li><li>• More conservative (less bullish)</li><li>• Offers the most downside protection</li><li>• Higher probability of being assigned</li></ul>
<b>At-the-Money (ATM)</b>	<ul style="list-style-type: none"><li>• Offers the most exposure to time decay</li><li>• ATM options have the most time value</li><li>• Highest gamma risk</li><li>• Probability of being assigned, approximately 50%</li></ul>
<b>Out-of-the-Money (OTM)</b>	<ul style="list-style-type: none"><li>• Income generation with upside potential</li><li>• Lower premium received</li><li>• Lower up front downside protection</li><li>• Lower probability of being assigned</li><li>• More aggressive (more bullish)</li><li>• Offers the highest potential return</li></ul>

## What should you consider when choosing an expiration?

- Time decay
- Rolling vs. selling
- Shorter vs. longer-term expirations

# Consider time decay in option prices

Strike	Last	Bid	Ask	Theta
▼ Nov 22 CALLS				
85	13.40	13.45	13.65	-0.0198
87.5	11.25	11.10	11.30	-0.0258
90	9.00	8.90	9.05	-0.0336
92.5	6.95	6.85	7.00	-0.0413
95	5.10	5.05	5.20	-0.0473
97.5	3.55	3.55	3.60	-0.0491
100	2.35	2.35	2.38	-0.0468
105	0.85	0.84	0.86	-0.0317
110	0.30	0.29	0.30	-0.0176
115	0.12	0.12	0.13	-0.0099
▼ Apr 17 CALLS				
95.71	8.50	8.45	8.60	-0.0204
96.43	8.15	8.05	8.20	-0.0204
97.14	7.95	7.70	7.85	-0.0205
97.5	7.63	7.50	7.65	-0.0204
97.86	7.45	7.35	7.50	-0.0205
98.57	7.10	7.00	7.15	-0.0205
99.29	6.66	6.65	6.80	-0.0204
100	6.45	6.35	6.45	-0.0204
100.71	6.10	6.05	6.20	-0.0204
101.43	5.70	5.75	5.90	-0.0203

Time decay typically accelerates as expiration comes closer, meaning shorter-term options have the highest time decay.

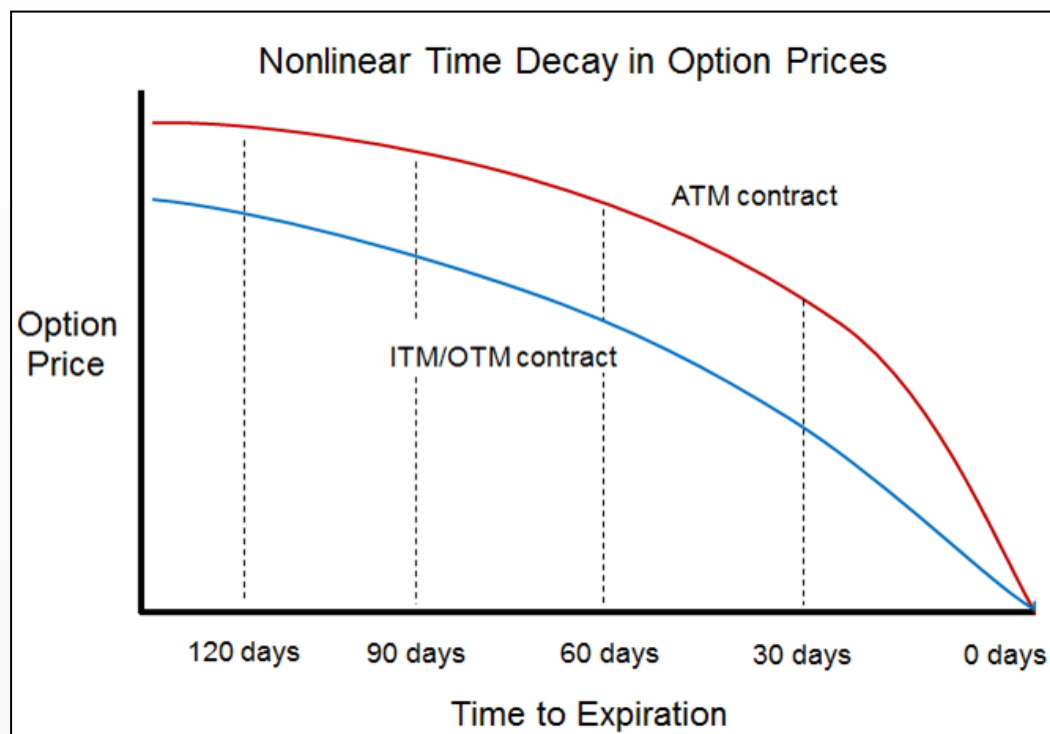


Image is for illustrative purposes.

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# Rolling versus Selling

Rolling shorter-term contracts vs. selling one long-term contract

Strike	Bid	Ask	Theta
▼ Dec 12 CALLS			
51.5	2.65	2.90	-0.0187
52	2.29	2.52	-0.0199
52.5	1.96	2.17	-0.0209
53	1.64	1.86	-0.0215
53.5	1.40	1.54	-0.0219
54	1.12	1.31	-0.0217
54.5	0.91	1.08	-0.0211
55	0.78	0.88	-0.0206
55.5	0.59	0.74	-0.0193
56	0.46	0.61	-0.0179
▼ Apr 17 CALLS			
45	9.15	11.25	-0.0107
46	6.95	10.25	-0.0071
47	6.25	9.35	-0.0079
48	6.80	7.20	-0.0084
49	6.15	6.40	-0.0091
50	5.50	5.70	-0.0098
52.5	3.90	4.15	-0.0106
55	2.69	2.89	-0.0106
57.5	1.77	1.94	-0.0098
60	1.11	1.30	-0.0085

Over a 6 month period...

Write a 30 day option 6 times?

$\$1.00 \times 6 = \$6.00$

OR...

Write a 180 day option 1 time?

$\$2.75 \times 1 = \$2.75$



# Shorter-term versus longer-term expiration

So why would anyone sell a longer-term covered call?

## Shorter-Term Expiration

- Offer the most exposure to time decay
- **Have the highest gamma risk**
- Allow for the higher return by continually rolling (all else equal)
- **Higher probability of early assignment**
- **More commissions incurred**
- More aggressive (more bullish)

## Longer-Term Expiration

- Offer more upfront premium
- Provide more downside protection
- **Low exposure to time decay**
- Lower gamma risk
- **Higher probability of being ITM at expiry**
- Less aggressive (less bullish)

...consider the trade in light of the outlook/objective.



## How can you manage the strategy?

- 3 ways to manage any strategy
- Use Fidelity's tools

# 3 ways to manage any strategy

## 1. Leave the strategy alone

- Let the covered call(s) expire
- Allow assignment

## 2. Close the strategy

- Unwind – sell the shares, buy to close the covered call(s)

## 3. Adjust the strategy

- Close the calls, keep the long shares
- Rollout – same strike, up or down

Option Trading Account		Options by Strategy							
Total Account Value \$1,151,762.43		Tdy G/L -\$622.34 (-0.45%)		G/L \$28,705.50 (18.97%)		Options Margin Req \$5			
Strategies	Last	Chg	% Chg	Bid	Ask	Volume			
Covered Call									
Oct 21 2016 115				114.93	114.98				
100 Long Shares	117.07	-0.05	-0.04	117.06	117.07	11,663,538			
-1 Oct 21 2016 115 Call	2.12	-0.10	-4.50	2.09	2.13	6,489			
Nov 18 2016 47.5									
1000 Long Shares				47.05	47.09				
-10 Nov 18 2016 47.5 Call				0.42	49.68	7,829,087			
				5.24	2.60	2,884			
Covered Put									
Oct 21 2016 29				31.48	31.59				
-100 Short Shares									
-1 Oct 21 2016 29 Put									
Credit Spread									
Jan 20 2017/Dec 21 2018 2150/2100									
-2 Jan 20 2017 2150 Put									
2 Dec 21 2018 2100 Put									
Dec 16 2016/Jan 20 2017 60/50 Put									
-5 Dec 16 2016 60 Put									
5 Jan 20 2017 50 Put									
Debit Spread									
Oct 21 2016 105/115 Call				9.87	10.01				

- Buy to Open
- Buy to Close
- Sell to Open
- Sell to Close
- Roll
- Trade Strategy
- Find Position in All Accounts
- Quote
- Chart
- Option Chain
- Option Analytics
- News

- Nov 18 2016 \$110.00 Call (\$5.71cr)
- Nov 18 2016 \$115.00 Call (\$2.06cr)
- Nov 18 2016 \$120.00 Call (-\$0.25dr)
- Dec 16 2016 \$110.00 Call (\$6.21cr)
- Dec 16 2016 \$115.00 Call (\$2.86cr)
- Dec 16 2016 \$120.00 Call (\$0.53cr)
- Create Custom Roll

Image is for illustrative purposes.

- Take advantage of a single-click Roll experience in Active Trader Pro®
- Access from Positions or Option Summary

Where can I learn more?

Research > Learning Center > [Position Management](#)



# Find trading ideas with Fidelity's tools

There are a number of resources available to help find covered call ideas:

- S&P Best 10 – Covered Calls
- S&P Intra-Day Trade Ideas
- Strategy Ideas – Covered Call
- Market Scanner

**S&P Best 10**  
 PROVIDED BY S&P CAPITAL IQ  
 10/03/2016 4:00:00PM  
 Top covered calls and calendar spreads, daily from S&P.

[Covered Calls](#) [Calendar Spreads](#)

Stock Symbol	Annualized Return Rate*
GOLD	35.47%
RRC	34.65%
CRM	33.07%
SAVE	32.67%
DISH	31.86%
BIIB	31.48%
UAL	30.38%
MLNX	29.58%
LULU	28.89%
DAL	28.77%

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 Bullish  Neutral  Bearish

**Profit Potential**  
 Limited  Substantial  Unlimited

**Risk Potential**  
 Limited  Substantial  Unlimited

**Available Strategies**  
 Click on a strategy to see its definition and run a market scan.

<a href="#">Bearish OTM Put</a>	<a href="#">Bullish OTM Call</a>	<a href="#">Call Time Spread</a>
<a href="#">Put Time Spread</a>	<a href="#">Collar</a>	<a href="#">Covered Call</a>
<a href="#">Double Diagonal</a>	<a href="#">Iron Condor</a>	<a href="#">Long Call Butterfly</a>
<a href="#">Cash Covered Puts</a>	<a href="#">Long Put Butterfly</a>	<a href="#">Long Straddle</a>
<a href="#">Short Straddle</a>	<a href="#">Long Vertical Call Spread</a>	<a href="#">Long Vertical Put Spread</a>
<a href="#">Short Vertical Put Spread</a>	<a href="#">Short Vertical Call Spread</a>	

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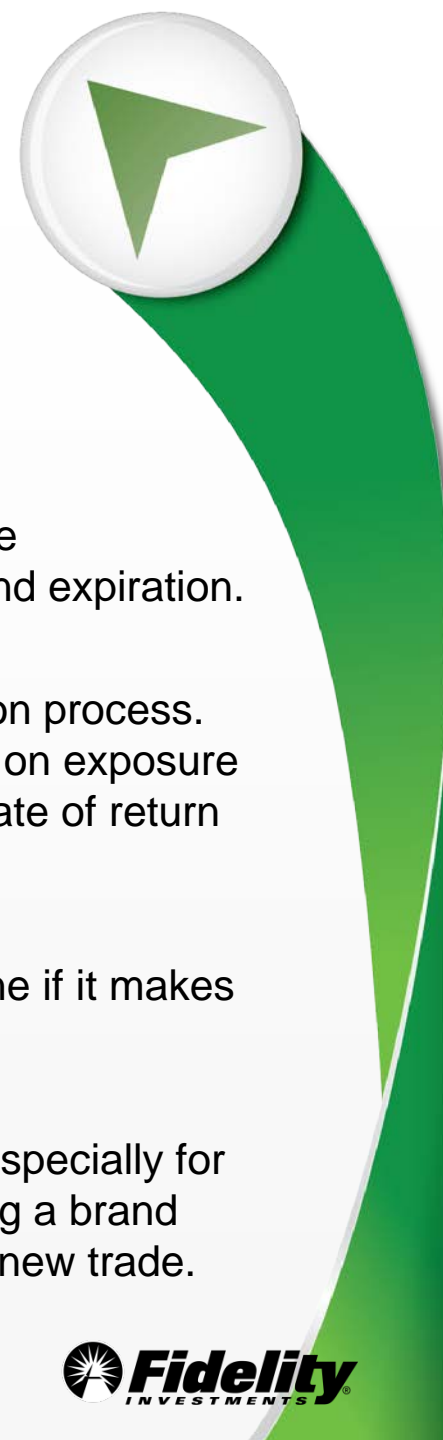


Where can I learn more?

**Research > Learning Center > [Find, analyze & execute options strategies on Fidelity.com](#)**

# Key Takeaways

- Covered call strategies can be put on for different reasons:
  - Generate income
  - Method of selling a long stock position
  - Manage a long stock position
- Properly identify what you're looking to accomplish with the trade before implementing it will, this helps to easily choose the appropriate strike and expiration.
- Tradeoffs should be considered during the strike and expiration selection process. Consider the premium being received vs. the risks being taken (impact on exposure to price movements, probability of being assigned, gamma exposure, rate of return potential, opportunity costs, etc).
- Properly manage risk management and look at the strategy to determine if it makes sense today and going forward – don't get distracted by the past.
- Do not blindly roll strategies without considering why you are doing it, especially for covered call strategies. Rolling is simply closing one trade, and opening a brand new one. Go through the same thought process you would for a brand new trade.



# Use the Fidelity Learning Center at home to...



## Get more information

Visit Fidelity.com - select **Research > Learning Center** and obtain even more information and insight about options

**Example:** [5 steps to develop an options trading plan](#)



## Take a course

Complete a course online to learn more about the basic concepts of covered calls

**Example:** [Generating income with covered calls](#)



## Watch videos

Learn how to navigate and leverage Fidelity's option research and trading tools.

**Example:** [Creating market scans; Monitor and manage your option portfolio with Option Summary](#)



## Attend seminars/webinars

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**Example:** [Get a Plan! How an options trading plan can help avoid large losses](#)

# Important Information

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.

Charts, screenshots, company stock symbols and examples contained in this module are for illustrative purposes only.

Options trading entails significant risk and is not appropriate for all investors. Certain complex options strategies carry additional risk. Before trading options, contact Fidelity Investments by calling 800-544-5115 to receive a copy of *Characteristics and Risks of Standardized Options*. Supporting documentation for any claims, if applicable, will be furnished upon request.

Greeks are mathematical calculations used to determine the effect of various factors on options.

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