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Protect your downside using protective puts

David Grant
CEO – optionsXpress Singapore

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Content

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Options – defined

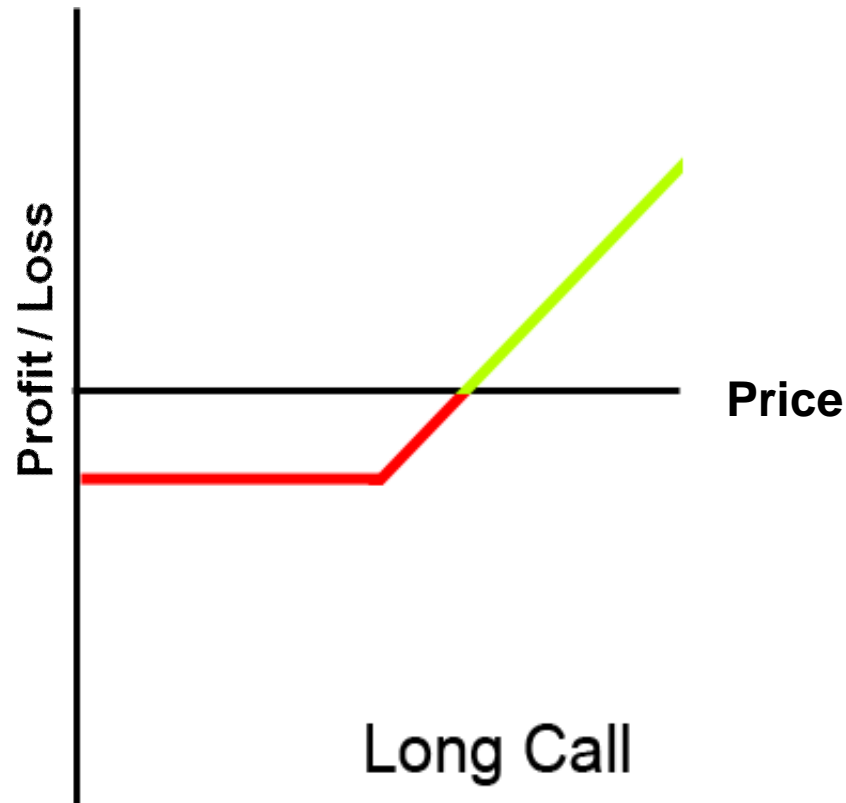
- **An option is a financial instrument that establishes a contract between two parties concerning the buying or selling of an asset at a reference price during a specified time frame.**
 - the buyer of the option gains the right, not the obligation
 - the seller incurs the obligation, not the right
- **The price of an option derives from the value of an underlying asset plus a premium based on the time remaining until the expiration of the option.**

Options – defined (cont.)

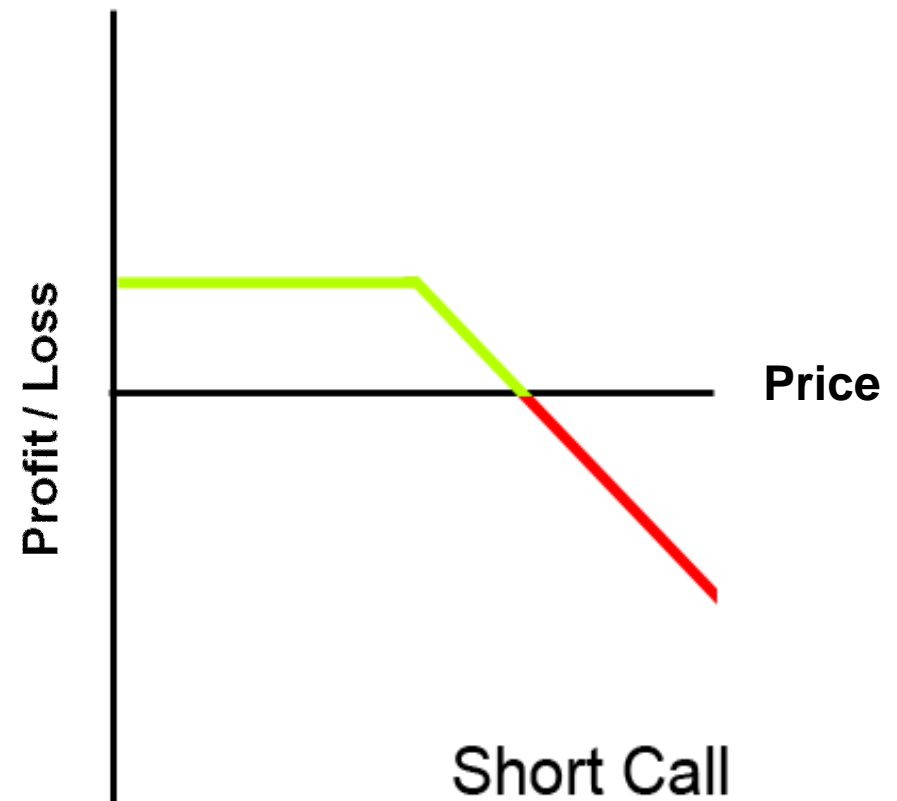
- **There are two kinds of options – an option which conveys the right to buy something (a ‘call option’) and an option which conveys the right to sell (a ‘put option’).**
- **Notable features of an options contract:**
 - **The kind of option (i.e.: call or put);**
 - **the strike price (also known as the exercise price);**
 - **the expiration date, which is the last date the option can be exercised;**
 - **the quantity and class of the underlying asset (eg: 100 AAPL shares)**
- **Options traded through optionsXpress are mostly American-style options (can be exercised on any trading day on or before expiry).**

Options trades – CALLS

BULL

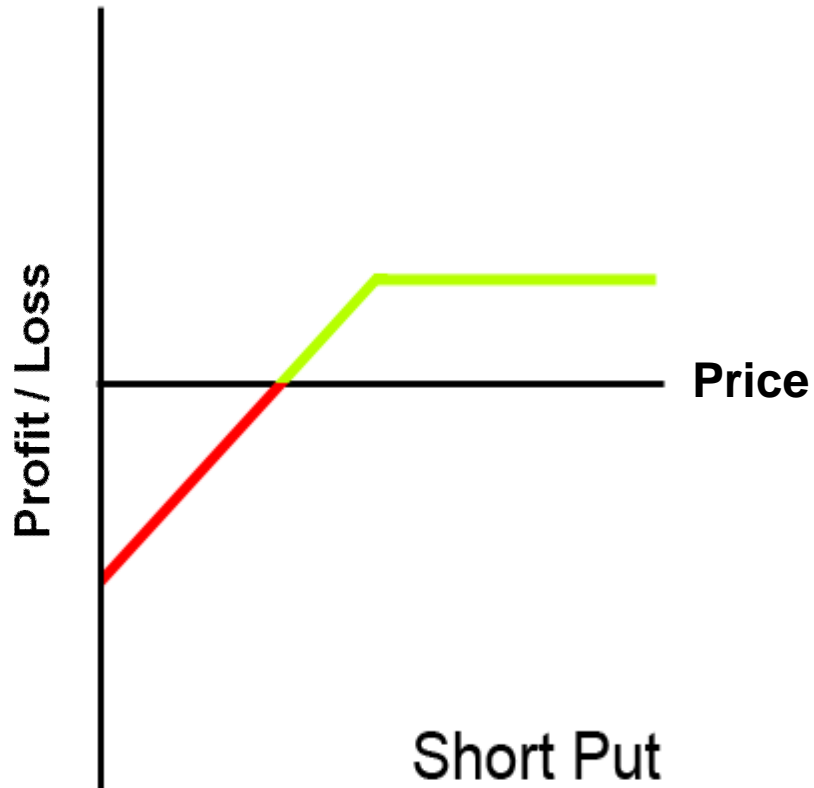


BEAR

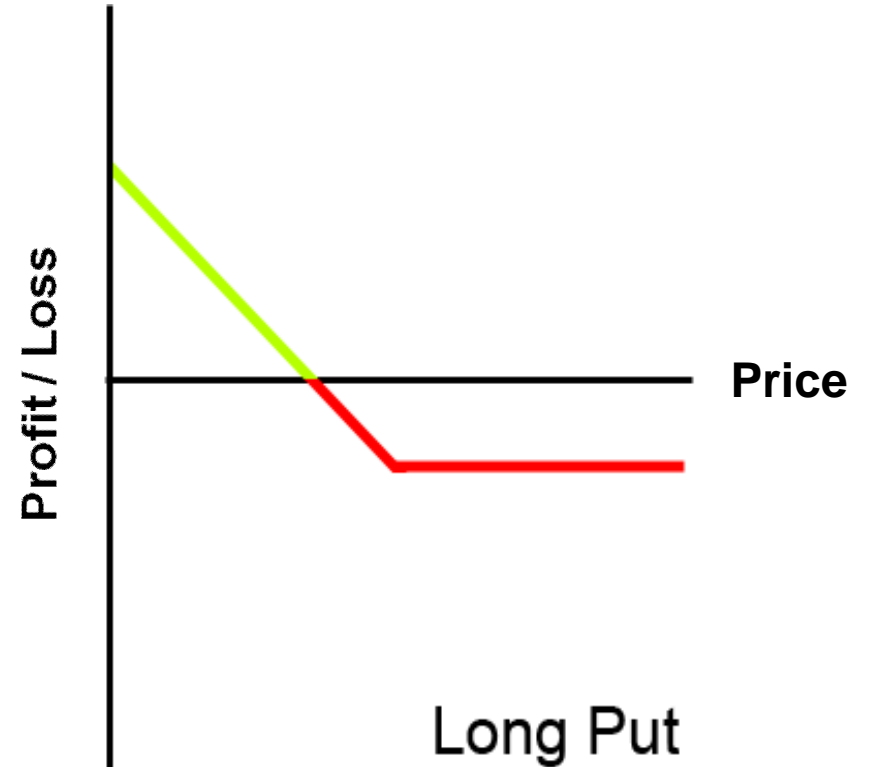


Options trades – PUTS

BULL



BEAR



Protective puts

- **Allows investors to protect their downside by buying a put against their physical position.**
- **Irrespective of the decrease in the value of the underlying, investor has the right to sell the shares at the put's strike price.**
 - **Can be used in preference to a stop loss**
- **The put option acts like an insurance policy – it costs money, which reduces the investors potential gains from the shares, but it also reduces the investors risk of losing money if the security declines in value.**

Can stocks move dramatically downwards?

▲ Crocs Inc

0.000

()

Buy

Sell



Can stocks move dramatically downwards?

Starbucks Corp

0.00

()

Buy

Sell

SBUX (5Y - D)

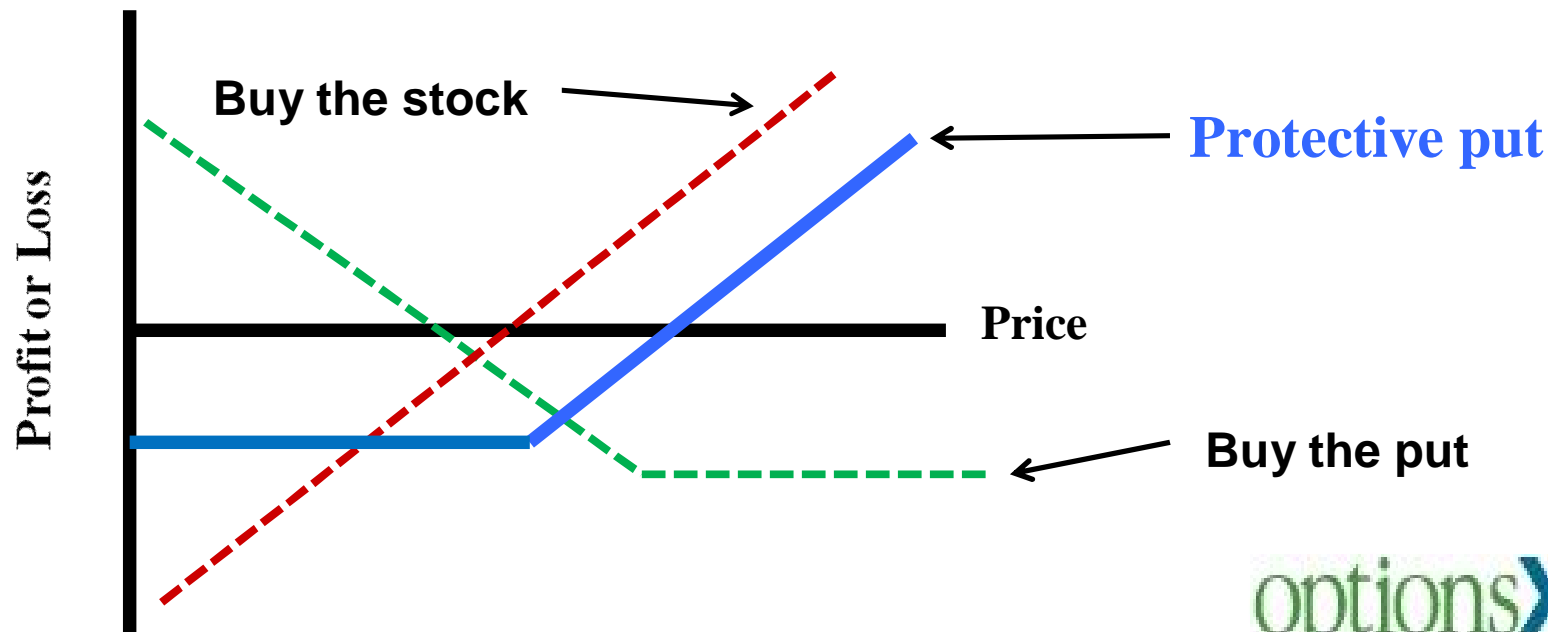
+

O:14.55 H:15.14 L:14.51 C:14.69 R:0.63 07/31/2008 33.73



What does a protective put do:

- **Protective puts offer a way to ‘insure’ against a decrease in stock price.**
 - It establishes a floor to allow continued upside potential (through holding the stock) and limiting the downside (the profit on the put is offset by the loss on the stock)



In Summary – Benefits of a Protective Put

- **Risk management tool, especially in volatile markets.**
- **It can be less risky than using a stop loss; specifically where stocks for example gap down on bad news.**
- **Allows value investors / long term investors to stay in the position for longer, especially if the investor believes the stock has a good chance of rebounding.**
- **Investors retain the benefits of stock ownership.**
- **Maximum loss is limited; equal to the premium paid for purchasing the put option.**

About optionsXpress

- **optionsXpress is a pioneer in equity options and futures trading, offering an innovative suite of online brokerage services for strategy evaluation, trade execution and investor education.**
- **optionsXpress has offices in 5 countries and services over 370,000 customers worldwide, undertaking around 1 million trades per month (2010).**
- **optionsXpress is listed on NASDAQ (ticker: OXPS) and has a market capitalisation of circa US\$1bn.**
- **optionsXpress Singapore is licensed by the Monetary Authority of Singapore (MAS).**

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