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TMX

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Exchange**



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Buying Put Options



Toronto Stock Exchange | TSX Venture Exchange | **Montréal Exchange** | Natural Gas Exchange | Montréal Climate Exchange | Boston Options Exchange

Canadian Derivatives Clearing Corporation | TMX Datalinx | Equicom | PC Bond | Shorcan

Why Buy Put Options?



- Profit from a bearish move in an underlying security.
- Secure the future sale price of an underlying security to lock in profits.
- Hedge the risk associated with an existing stock position.



Alternative to Short Selling



- Based on the expectation that the underlying stock will decrease in value.
- Profits as the share value drops below the strike price.
- Unlimited profit potential.
- Risk is limited to the premium paid.



Alternative to Short Selling



	Short Stock	Long Put \$50.00 Strike
Price	\$50.00	\$2.50
Quantity	1,000	10
Capital required	\$50,000	\$2,500
Price at Expiration	\$45.00	\$5.00
Return	10%	100%
Risk	Unlimited	\$2.50



Risk/Reward at Expiration



Stock Price at Expiration	Profit/Loss Short Stock	Profit/Loss Long Put
\$65.00	-\$15,000	-\$250
\$60.00	-\$10,000	-\$250
\$55.00	-\$5,000	-\$250
\$50.00	Break Even	-\$250
\$47.50	\$2,500	Break Even
\$45.00	\$5,000	\$2,500
\$40.00	\$10,000	\$7,500

Start Price →

Strike

Break Even

-\$250

Break Even



Alternative to Short Selling



- Considerations:
 - Requires capital equal to a fraction of the underlying value.
 - Margin account required to short sell a security.
 - Risk exposure limited to the premium paid.



Lock in Future Sale Price



- Bullish on the shares.
- Insures that existing profits are protected.
- Allows to participate in the appreciation of the underlying.



Lock in Future Sale Price



- Investor originally purchased 1,000 shares of XYZ at \$40.00.
- XYZ is currently trading at \$50.00.
- 3-month put options with a strike price of \$50.00 are trading at \$2.00.
- Investor pays \$2,000 in premium to lock-in a \$50.00 sale price.



Risk/Reward at Expiration



Stock Price at Expiration	Profit/Loss Long Stock	Profit/Loss Long Put	Net Profit/Loss
\$55.00	\$15,000	-\$2,000	\$13,000
\$50.00 Strike	\$10,000	-\$2,000	\$8,000
\$48.00	\$8,000	Break Even	\$8,000
Start Price → \$40.00	Break Even	\$8,000	\$8,000
\$38.00	-\$2,000	\$10,000	\$8,000
\$35.00	-\$5,000	\$13,000	\$8,000
\$30.00	-\$10,000	\$18,000	\$8,000



Lock in Future Sale Price



- Considerations:
 - Protection against a drop in the stock price below the strike price.
 - Profits reduced by the amount of the premium.
 - Only protected until the option expires.



Protective Puts



- Investor is long the underlying security.
- Immediate protection.
- A decrease in share value will be offset by an increase in the put premium.



Protective Puts



- XYZ is trading \$50.00.
- Investor buys or owns 100 shares.
- 1-month put option on XYZ with strike price of \$50.00 is trading at \$1.00.
- Investor is guaranteed to sell the shares at the \$50.00 strike price.



The Result On Expiration



Stock Price at Expiration	Profit/Loss Long Stock	Profit/Loss Protective Put	Net Profit/Loss
\$60.00	\$1,000.00	-\$100.00	\$900.00
\$55.00	\$500.00	-\$100.00	\$400.00
\$51.00	\$100.00	-\$100.00	\$0.00
Start Price → \$50.00	\$0.00	-\$100.00	-\$100.00
\$45.00	-\$500.00	\$400.00	-\$100.00
\$40.00	-\$1,000.00	\$900.00	-\$100.00



Protective Puts

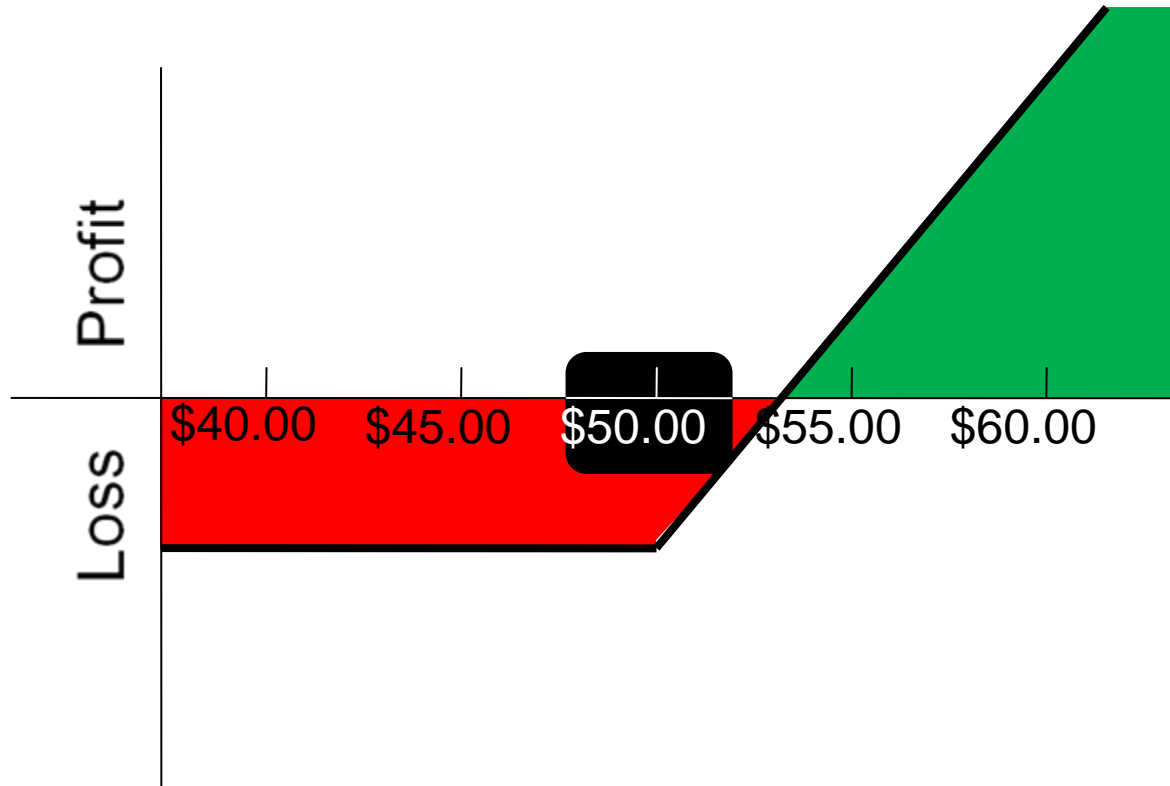


- Considerations:
 - Limited potential loss to the cost of the premium.
 - Can profit from the complete move to the upside.
 - If the put expires worthless, the long stock position is left unprotected.



Synthetic Positions

Long Stock + Long Put = Long Call





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Optionsource.net

