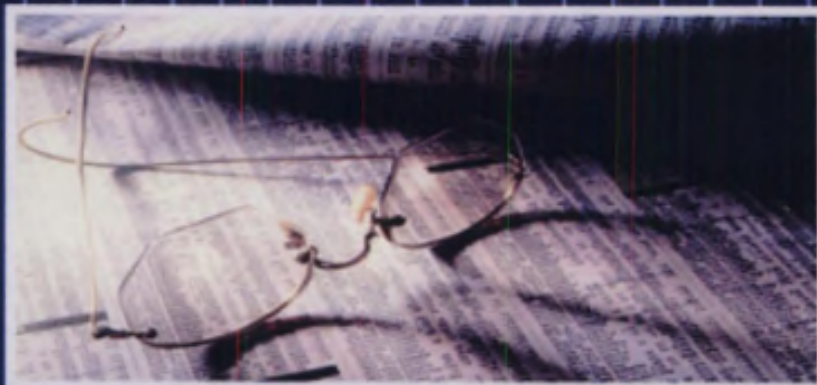


WILEY INVESTMENT

THE CONSERVATIVE INVESTOR'S GUIDE TO TRADING OPTIONS

Updated with an Introduction by
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A MARKETPLACE BOOK

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Buying Calls Can Make Sense Even for Conservative Investors

Buying call options is normally viewed as a highly speculative option activity, one that is somewhat akin to gambling. In fact, most market observers and participants equate option buying with betting on horse races, betting on dog races, buying instant lottery tickets, and casino gambling. In some respects, buying call options (or puts) *is* like gambling, particularly in the sense that it is a positively skewed investment activity. *Positively skewed* is a mathematical term used to indicate that the amount placed at total risk of loss is finite, or fixed, and that the amount that could be won is much larger than the amount that could be lost.

Although buying call or put options is often placed in the gambling category, it differs greatly from normal forms of gambling in that all losses from buying options qualify as tax deductible items! Any losses from buying options can be used to offset capital gains earned! In addition, any losses from buying options that are not used to offset capital gains may be used as deductions against highest taxed income up to \$3,000 in any single tax year.

Losses from buying options that are greater than those used to offset capital gains and as a deduction against highest taxed income may be carried forward indefinitely into future years until they are used up as deductions or offsets to capital gains earned. The Internal Revenue Service obviously views option speculation as being very different from the common, well-known forms of gambling.

In addition to tax benefits, losing option purchasers usually get more time to root for a winner! In a horse or a dog race, the result is known in a couple of minutes. In casino gambling, the outcome is determined in

seconds. Through option purchases, the investor (gambler!) often has months to cheer for a winner.

A third benefit of option purchases over other forms of gambling is the right option purchasers have to change their minds and terminate the investment. You can buy a put or a call with a life of six months, but you can change your mind and terminate the position after holding it a few days or weeks. The sum realized from the termination may be more or less than the sum originally invested, or bet. But at least some recovery is possible if you change your opinion.

Once you have placed a bet on a race and the race has begun, can you make a change? No! When the roulette wheel spins, can you make a change? No! By now you should have grasped that buying options, although it can be and most often is a speculative activity, is certainly not analogous to gambling. In fact, there are several activities in purchasing options that even conservative investors should understand and possibly employ when the proper occasion arises.

Let's examine several examples of situations in which conservatives might buy call options and still be considered to be in a conservative investment posture.

Example 1

Substituting a deep-in-the-money long call option (with little time premium) for common stock in order to collateralize a short call option.

Let's assume that XYZ is a volatile stock that you have been closely watching. Judging the outlook to be positive for near-term earnings growth and for a dividend increase, you decide to write covered calls. In late February with XYZ at 44, the call option quotations for the June expiration are as follows:

<i>Strike Price</i>	<i>Option Price</i>
35	10
40	5
45	3
47 ¹ / ₂	2

You could simply buy 500 XYZ (the position being considered an amount appropriate for your overall stock risk exposure) and write 5 XYZ June 47¹/₂s for 2. Instead of that "normal" form of a covered write, you decide