

Stock Collar

When market conditions create rapidly fluctuating stock prices, an investor may look for a more cautious approach to market participation; one solution is a “stock collar.” A collar entails the sale of an out-of-the-money call and the simultaneous purchase of a protective put, against a common stock position.

In selling an out-of-the-money call, the writer (seller) has the obligation, if exercised, to deliver 100 shares of the underlying stock at the exercise price until the expiration of the option. This is known as covered call writing. The term “covered” refers to the fact that the option writer’s obligation is “covered” by ownership of the underlying stock. For assuming this obligation, the writer is paid a premium when the call option is written.

A put option is a contract that gives the holder the right to sell a fixed number of shares (normally 100) of the underlying stock at the exercise price, at any time before the expiration of the option. Buying a put option is protective in that it establishes a minimum price the investor will receive, regardless of how far the stock declines, upon liquidation of the shares through an exercise. It should be noted that the purchase of a put option could affect the holding period for a stock position that has not been held long-term. Investors should consider the tax implications prior to purchasing a protective put option.

A collar strategy is a combination of the properties of a covered write and a protective put. In a collar, the purchase of a put is used to protect the stock position. The premium collected from the sale of the covered call helps to offset the cost of the protective put.

The strategy provides upside potential through the covered call, while providing downside protection, for the life of the put option, based on the strike price on the put. The risk in a collar strategy is limited; however, so is the potential profit. The strategy can be tailored according to an investor’s risk tolerance and upside objectives. Below is just one example. For purposes of illustration, tax considerations and the costs involved in margin accounts have been omitted.

Example:	Buy 500 shares XYZ at 41.25 + 395.00 commission	=	\$21,020.00
	Sell 5 XYZ January 50 calls at 2.00 - 80.00 commission	=	920.00
	Buy 5 XYZ January 40 puts at 2.50 + 80.00 commission	=	1,330.00
	Net debit/breakeven 42.86 per share	=	21,430.00

Maximum Risk (Stock at or below \$40.00 at expiration) – The purchase of the put has assured a minimum selling price of \$40.00 on the stock until the January expiration. If the stock is below \$40.00 at expiration, you could exercise the long put and sell the stock at \$40.00. The net cost on the position is \$42.86; therefore, the maximum risk is \$3.64 per share, or \$1,820.00.

Example:	XYZ below 40 @ January expiration		
	Sell 500 shares XYZ @ 40.00 - 390.00 commission	=	\$19,610.00
	Cost basis	=	21,430.00
	Realized loss 3.64 per share	=	1,820.00

Maximum Profit (Stock at \$50.00 or above at expiration, the investor's stock is called away) – As in any covered write, the maximum profit would be realized with the stock called away at the strike price of the call. In this case, the stock would be sold at \$50.00, which creates a profit of \$6.26 per share, or \$3,130.00.

Example:	XYZ above 50 @ January expiration		
	Sell 500 shares XYZ @ 50.00 - 440.00 commission	=	\$24,560.00
	Less the cost basis	=	21,430.00
	Realized gain 6.26 per share	=	3,130.00

Breakeven (Stock at \$42.86 at expiration, options expire) – With the stock at \$42.86 at the January expiration, the long put and the short (covered) call would both expire worthless. There would be a loss on the put premium paid and a gain on the call premium received, but the stock would continue to be held unencumbered and unprotected. Note the gains on this position are hedged only to the extent of the lifetime of the options. Once the options have expired, the position is subject to the risks of stock ownership. However the stock could be sold, held alone, or possibly “re-collared” with both a new long put and short call, or become the underlying securities of a straight protective put or a covered write, depending on the investor's outlook at that time.

It is important to note that option trades incur commissions and fees. Therefore, strategies that require more than one transaction, such as a collar strategy, may incur double the commissions when opening a position. Any strategy that expires with an unexercised option, such as a covered call that has not been assigned, will not pay any commissions or fees when exiting a position. Investors should consider fees when calculating the potential profit and loss in any option strategy.

This report should be read in conjunction with the basic option disclosure document titled *Characteristics and Risks of Standardized Options* (link: <https://www.theocc.com/company-information/documents-and-archives/options-disclosure-document>), which outlines the purposes and risks of option transactions. Options are not suitable for all investors. There are risks involved in any option strategy, including the option strategies discussed herein. Individuals should not enter into option transactions until they have read and understood the option disclosure document. This booklet is available from your Stifel Financial Advisor or from Stifel, Nicolaus & Company, Incorporated, 501 North Broadway, St. Louis, Missouri 63102. Margin requirements and transaction and commission costs should be discussed with your Financial Advisor before entering into any option strategy. Tax ramifications of buying or selling options should be discussed thoroughly with your tax advisor before engaging in option transactions. Supporting documentation for any claims, comparisons, recommendations, statistics, or other technical data will be supplied upon request

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