QQQ Buy-Write for Added Income

Situation
The Nasdaq-100 Tracking Stock (QQQ) is at 41.50 and has been steady since a tech-related sell-off began a few weeks ago.

Outlook
In this example, you are neutral on the QQQs for the short term, and believe that, while the tech sell-off appears to be over and QQQ shouldn’t decline further, it will not recover within the next month. You are interested in the possibility adding some extra income.

Possible Strategy
Enter into a “Buy-Write” position (also known as a Covered Write, Covered Call Sale, or Overwrite position) by buying 100 shares of QQQ at 41.50, and selling one Sept. 45 call at 2.00. There is a net cost of $3,950 ($4,150 - $200) for the position.

Possible Outcomes
Some of the many possible outcomes of this QQQ Buy-Write strategy are shown in the accompanying table and graph. The values shown in the table and graph are at the time of expiration. (Taxes, commission costs and other transactions costs, have been omitted for the sake of simplicity.)

<table>
<thead>
<tr>
<th>Index % Change</th>
<th>QQQ @ Expiration</th>
<th>Short 45 Call Value</th>
<th>Long QQQ Profit/(Loss)</th>
<th>Short Call Premium Received</th>
<th>Buy-Write Net Profit/(Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>-27.7%</td>
<td>30.0</td>
<td>$ 0.00</td>
<td>- $1,150.00</td>
<td>$ 200.00</td>
<td>- $ 950.00</td>
</tr>
<tr>
<td>-15.7%</td>
<td>35.0</td>
<td>$ 0.00</td>
<td>- $ 650.00</td>
<td>$ 200.00</td>
<td>- $ 450.00</td>
</tr>
<tr>
<td>-3.6%</td>
<td>40.0</td>
<td>$ 0.00</td>
<td>- $ 150.00</td>
<td>$ 200.00</td>
<td>$ 50.00</td>
</tr>
<tr>
<td>0.0%</td>
<td>41.5</td>
<td>$ 0.00</td>
<td>$ 0.00</td>
<td>$ 200.00</td>
<td>$ 200.00</td>
</tr>
<tr>
<td>8.4%</td>
<td>45.0</td>
<td>$ 0.00</td>
<td>$ 350.00</td>
<td>$ 200.00</td>
<td>$ 550.00</td>
</tr>
<tr>
<td>20.5%</td>
<td>50.0</td>
<td>- $ 500.00</td>
<td>$ 850.00</td>
<td>$ 200.00</td>
<td>$ 550.00</td>
</tr>
</tbody>
</table>
At expiration in September, the break-even point for this Buy-Write on the QQQ is 39.50, or a -5% change in the underlying index value. If the QQQ remained unchanged, a gain of $200 would be realized. The maximum gain is $550 if the QQQ is greater than 45.

**Background on Covered Calls**

**Who Should Consider Covered Calls?**

- An investor who is neutral to moderately bullish on some equities in his/her portfolio.
- An investor who is willing to limit his/her upside potential in exchange for some downside protection.
- An investor who would like to be paid for assuming the obligation of selling a particular stock at a specified price.

The strategy could work equally well for cash, margin, Keogh account or IRA accounts. Although this strategy may not be suitable for everyone, any of the investors above may benefit from using the covered call.

**Definition.** Call writing is either the simultaneous purchase of stock and the sale of a call option or the sale of a call option against a stock currently held by an investor. Generally, one call option is sold for every 100 shares of stock. The writer receives cash for selling the call but will be obligated to sell the stock at the strike price of the call if the call is assigned to his/her account.

In other words, an investor is "paid" to agree to sell his/her holdings at a certain level (the strike price). In exchange for being paid, the investor gives up any increase in the stock above the strike price.

**How to Use Covered Calls.** If an investor is neutral to moderately bullish on a stock currently owned, the covered call might be a strategy he/she would consider. Let’s say that 100 shares are currently held in his account. If the investor was to sell one slightly out-of-the-money call, he/she would be paid a premium to be obligated to sell the stock at a predetermined price, the strike price. In addition to receiving the premium, the investor would also continue to receive the dividends (if any) as long as he/she still owns the stock.

The covered call can also be used if the investor is considering buying a stock on which he/she is moderately bullish for the near term. A call could be sold at the same time the stock is purchased. The premium collected reduces the effective cost of the stock and he/she will continue to collect dividends (if any) or as long as the stock is held.

In either case, the investor is at risk of losing the stock if it rises above the strike price. Remember, in exchange for receiving the premium for having sold the calls, the investor is obligated to sell the stock.
For more information on QQQ options, please visit http://www.cboe.com/qqq

For more examples of options strategies, please visit http://www.cboe.com/strategies

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