Long S&P 500® (SPX™) Call Options to Gain Market Exposure

Market Assumption
Bullish on the U.S. stock market.

Situation
A fund recently received a cash inflow and is deciding where to invest the proceeds.

Possible Market Action
Buy S&P 500 call options for market exposure.

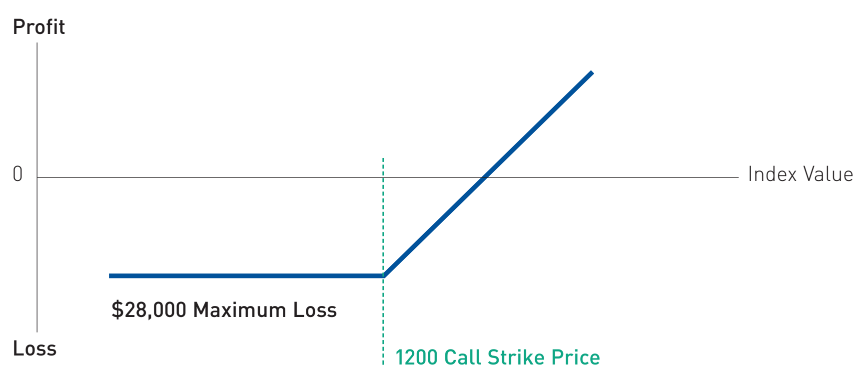
More Discussion
Index option contracts can provide a portfolio manager with the market exposure necessary to participate in upside gains at a fraction of the cost of transacting in the index components.

A cash influx can pose a strategic dilemma for a portfolio manager. The classic "eat-well/sleep-well" problems posed by the conflicting desires for both high returns and investment security apply whenever a manager makes a determination regarding new or additional investments. By purchasing call options, a manager can preserve cash in declining markets and retain it for various purposes, such as meeting redemptions or for investment in lower yield but essentially "riskless" instruments such as U.S. Treasury securities.

As a simple hypothetical, assume an additional $1,200,000 of cash flows into Fund X's $120 million portfolio. Instead of simply adding an additional one percent to its portfolio of common stock, the fund manager can purchase SPX call options. With the SPX at a level of 1200, the 1200 strike call with 30 days until expiration might be quoted at a premium of 28. The fund purchases 10 call options (1,200,000/120,000 = 10) for a total cost of $28,000 (10 x 28 x 100).

The call purchase provides exposure to the broad market in proportion to the $1,200,000 influx, limits the downside risk to the cost of the calls, and the portfolio retains the remaining cash, in the amount of $1,172,000.

Long Calls on S&P 500 (SPX) Options (At expiration)



If you would like to read more about protective strategies, please visit http://www.cboe.com/protection.

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