5. Uncovered Put Write .

This option trading strategy involves the selling of put options without shorting the obligated shares of the underlying stock. It is also known as naked put write or cash secured put, this is a bullish options strategy that is executed to earn a consistent profits by ongoing collection of premiums.

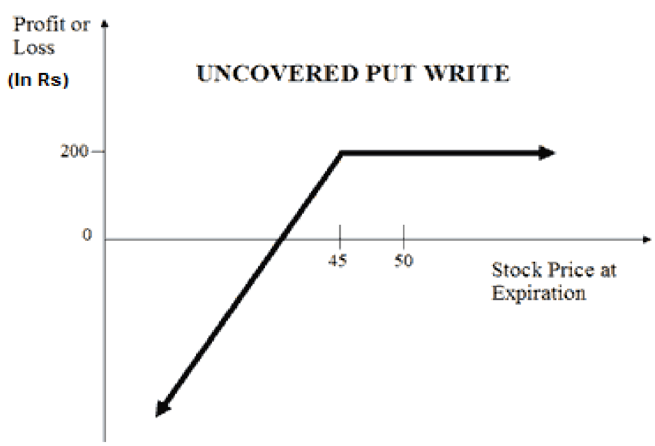
Uncovered Put Write Construction

Sell 1 ATM Put

Example:

Suppose XYZ stock is trading at Rs.45 in Mar. An options trader writes an uncovered Apr 45 put for Rs.200. If XYZ stock rallies to Rs.50 on expiration, the Apr 45 put expires worthless and the trader gets to keep the Rs.200 in premium as profit. This is also the maximum profit and is achieved as long as XYZ stock trades above Rs.45 on options expiration date. If instead XYZ stock drops to Rs.40 on expiration, then the Apr 45 put expires in the money with Rs.500 in intrinsic value. The JUL 45 put needs to be bought back for Rs.500 and subtracting the initial credit of Rs.200 taken, the resulting net loss is Rs.300.

Uncovered Put Write Payoff Diagram:



Limited profits with no upside risk

Profit for the uncovered put write is limited to the premiums received for the options sold and unlike the covered put write, since the uncovered put writer is not short on the underlying stock, he does not have to bear any loss should the price of the security go up at expiration. The naked put writer sells slightly out-of-the-money puts month after month, collecting premiums as long as the stock price of the underlying remains above the put strike price at expiration.

The formula for calculating maximum profit is given below:

- Max Profit = Premium Received - Commissions Paid
- Max Profit Achieved When Price of Underlying >= Strike Price of Short Put

Unlimited Downside risk with Little downside protection

While the premium collected can cushion a slight drop in stock price, loss resulting from a catastrophic drop in stock price of the underlying can be huge when implementing the uncovered put write strategy.

The formula for calculating loss is given below:

- Maximum Loss = Unlimited
- Loss Occurs When Price of Underlying < Strike Price of Short Put - Premium Received
- Loss = Strike Price of Short Put - Price of Underlying - Premium Received + Commissions Paid

Breakeven Point(s)

The underlier price at which break-even is achieved for the uncovered put write position can be calculated using the following formula.

- Breakeven Point = Strike Price of Short Put - Premium Received

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