

THE AMAZING STOCK REPAIR STRATEGY

How the options react in three different scenarios: up, down, and stagnant.

Let's look at how the options will react in the three scenarios: up, down, and stagnant. Remember, we have entered this trade already down \$5,000 from the stock purchase.

If the stock continued to trade down, the option position would produce no additional loss. Because it didn't cost you anything (ideally) to initiate this strategy, you will not lose anything additional on the spread as the stock trades down further.

This is a major advantage over doubling down, because the spread cannot add to the existing losses of the stock position.

With the stock trading down and closing below \$30.00, the February 30 calls and the Feb. 35 calls will both expire worthless. Since the cost of construction of the stock repair strategy didn't cost you anything (in our example), and the trade is now worthless, then you haven't lost anything additional. Although your stock position will continue to lose, it will not be compounded by doubling your stock position or doubling down.

If the stock stays stagnant and closes at \$30.00, again the position will not make or lose anything additional. With the stock at \$30.00, both the February 30 calls and the February 35 calls will expire worthless.

The up scenario is where the stock repair strategy is really powerful. The best way to see how this strategy works on the upside is to fix the stock price at different levels. With the stock at \$31.00, the Feb 30 calls are in the money and will be worth \$1.00 while the Feb. 35 calls that you sold are out-of-the-money and will be worth 0.

This gives the 1 by 2 spread a value of \$1.00. You purchased the spread for "even money" so you now have a \$1.00 profit on the spread. Meanwhile, since you still own the stock, it is also up \$1.00. So, with this \$1.00 movement, you have recovered \$2.00 of your losses back. This continues to work this way as the stock rises up to \$35.00. At \$35.00, the Feb. 35 calls will still have no intrinsic value, therefore the 1 x 2 spread which you own is now worth \$5.00.

At this moment, with the stock recovering from \$30.00 to \$35.00 and the



spread earning \$5.00, you are now even in your overall position. You had originally lost \$10.00 on the stock trading down from \$40.00 to \$30.00. Now, with the help of the Stock Repair Strategy (1 x 2 spread) you have made your loss back on a 50% retracement bounce from the original loss (\$40 -> \$30 -> \$35) without having to take on any additional risk, as in the case of doubling down.

Now, if you were concerned about being long only 5 options versus being short 10 options, you should be congratulated for your observation of potential risk. Once the stock trades over 35, the Feb. 35 calls become in-the-money and have value. As the stock continues up the Feb 35 calls will start to outpace the Feb 30 calls in value.

However, there is not cause for concern because the 5 ITM calls that you own, coupled with the 500 shares of stock that you originally bought, are now moving up in tandem with your short calls, so any loss you experience with them over \$35 will be 'covered.'

Remember, you still own 500 shares of XYZ. No matter how much higher above \$35.00 the stock goes, each of the Feb. 35 calls is covered. Five are covered by the long Feb. 30 calls, which created a 1 x 1 vertical call spread (Feb. 30 – 35 call spread.) and the other Feb. 35 calls are covered by your long stock. You own 500 shares and that matches the 10 short Feb. 35 calls exactly when coupled with your long Feb 30 calls. This is why the exact volume construction we talked about earlier is so important.

Therefore, after the stock trades through \$35.00 the positions' maximum return is locked.

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