

K.I.S.S. Options Allocations

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One of the most frequent questions asked is in regard to allocations; how much per suggestion and how big an overall allocation to the K.I.S.S. Options service will suffice or is the minimum.

We cannot directly answer any of these questions but we can offer some examples as to how the numbers work and our assumptions.

First just to make sure we are all on the same page: Options are traded in contracts. One option's contract equals 100 shares. So when an option is quoted @ \$1 per share (the standard way) then the contract is \$100. If you buy 1 contract it will cost you \$100 (plus commissions) and if you sell you will receive \$100 (minus commissions).

Ok, now if we suggest buying a call (or put) option for \$10.85 per share the cost per 1 contract is then \$1,085 (10.85×100). So if one allocates \$5,000 per suggestion then in this case he/she will be able to purchase 4 options' contracts ($5000 / 1085 = 4.6$). Since we cannot trade partial contracts and since we do not want to spend more than \$5,000 per suggestion, then we need to round the result DOWN.

Let's take it one step further, assuming still the \$1,085 cost per contract. Since we are buying 4 contracts then the total cost (before commissions) is $1085 \times 4 = \$4,340$ (plus commissions) used out of the \$5,000 and the rest remains in cash.

So clearly, the price of one option contract will determine how many contracts one can trade based on the size of the allocation per suggestion.

So let's look at some numbers: An allocation of \$2,500 per suggestion will clearly allow a trade of no more than \$25 per share or \$2,500 per contract. An allocation of \$3,000 will allow a trade of no more than \$30 per share or \$3,000 per contract. An allocation of \$5,000 will allow a trade of no more than \$50 per share or \$5,000 per contract.

Let's also assume that one has \$25,000 allocated for the K.I.S.S. Options service and \$5,000 allocated for each suggestion; clearly the maximum open trades available in this scenario is 5 and each suggestion cannot cost more than \$5,000.

Examples:

Example 1: We suggest to open a DEBIT spread (buying one option at one strike and selling another at the same time but at a lower price and different strike) on XYZ stock (or ETF) for a NET DEBIT PRICE (the cost to buy the option MINUS the sale of the second option) of \$13.50. One spread cost \$1,350 (13.50×100) and therefore one must have at least \$1,350 (a bit more due to commissions) available to execute this suggestion.

Example 2: We suggest to buy shares of ABC stock (or ETF) and SELL a call option against it (commonly known as Covered Call) for a net price of \$42.50 (cost of share MINUS the sale of the option). In this case, one will need a minimum of \$4,250 allocation for one contract.

Example 3: We suggest to open a CREDIT spread (buying one option and selling another at the same time but at a higher price) for a NET CREDIT PRICE of \$2.50. In this case, most likely the client will need to have a margin approved account AND approval to trade credit spreads (something one will need to speak with his/her broker about). USUALLY the margin calculation is the WIDTH of the spread (the difference in the options' strike prices) MINUS the premium received. Lets assume that we sold a call option with a strike of 40 and bought a call with a strike of 50 (10 point spread) for a \$2.50 credit. Here is how the math will work:

$10 \text{ points} \times 100 = \$1,000$ (remember option contract is based on 100 shares) MINUS \$250 premium (price of option is called a premium) received = \$750 margin required PER contract. Therefore, in this case, if one allocated \$5,000 per suggestion then one could trade 6 contracts in this example. BEWARE that margin trades sometimes need more cash to close the position (if it is in a loss), so one should have extra cash in the account for that possibility.

Now that we know how the numbers work, at K.I.S.S. Options we use these assumptions:

- \$5,000 allocated for each suggestion
- \$14.95 PER STRIKE minimum commissions if less than 10 contracts traded (so in a spread it will be $\$14.95 \times 2$) or \$1.50 per contract if more than 10 contracts traded
- \$9.99 to buy or sell a shares of a company or ETF
- \$15 per strike for assignment and/or exercise. If both sides of a spread are assigned/exercised then 15×2 .

- Therefore, we ALWAYS make suggestions at a cost of \$50 or less per suggestion, as to enable us to have the option of executing at least one contract.

So, if one allocated \$2,500 per suggestion and as per example 2 above, we make a suggestion of \$42.50 (or any other number larger than \$25) then clearly this suggestion would not be executed in this scenario.

By the way, in example 1, the commissions' costs would have been, based on \$5,000 allocated for each suggestion, $\$14.95 \times 4$ (to open and close the spread) or \$59.80. $\$5,000 / 1350 = 3$ contracts, and since it is less than 10 contracts the \$14.95 minimum per strike is being used. Since we open the trade (2 strikes) and then close the trade (2 strikes) then $4 \text{ strikes} \times 14.95$.

In example 2, the commissions' costs would have been \$49.80 if we opened and closed the suggestion exactly the same (buying shares and selling calls and then selling shares and buying back the calls). If the call expired and the shares sold afterwards, then the commissions' costs would have been \$34.85. If the position was assigned then the commissions' costs would have been \$34.90.

In example 3, the commissions' costs would depend on whether the spread expired worthless (which is good for us), whether we closed it or whether it was assigned.

Clearly one has to account for commissions costs when allocating the overall funds.

It is up to the individual to decide what is BEST FOR HIM/HER, and how comfortable s/he is with an allocation amount.

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