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THE WALL STREET JOURNAL.
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OPTIONS | SEPTEMBER 4, 2009

More Investors Trying the Options Play

By JEFF D. OPDYKE

Most investors are hoping stock prices push higher. The short-sellers want stocks to sink lower. And then there is Marlene Sackheim: She hopes the market goes nowhere.

The 57-year-old chief financial officer of her husband's pain-management clinic in Pensacola, Fla., trades options for herself and other family members. Her preferred strategy -- colorfully dubbed a naked strangle -- rakes in the money when the Standard & Poor's 500-stock index has no big swings. That has been tough in a year when stocks first tumbled and then soared. Still, by constantly adjusting her positions, Ms. Sackheim says she is "having a great year so far."

Whether seeking income, mitigating risk or just speculating on price movements, investors are trading options in record numbers these days. Cumulative volume on the nation's seven options exchanges hit a record 2.4 billion contracts through the first eight months of the year, 2% higher than the same period in 2008 -- though volume surged even higher last fall when the financial crisis exploded.

Of course, professional money managers account for much of the volume. But Charles Schwab Corp. found in a July survey that 47% of its "active" investors regularly trade options these days, up seven percentage points from last summer. The number of investors attending Schwab's options-trading seminars "has grown dramatically this year," says Randy Frederick, Schwab's director of trading and derivatives. He has hosted seminars in more than 40 cities this year.

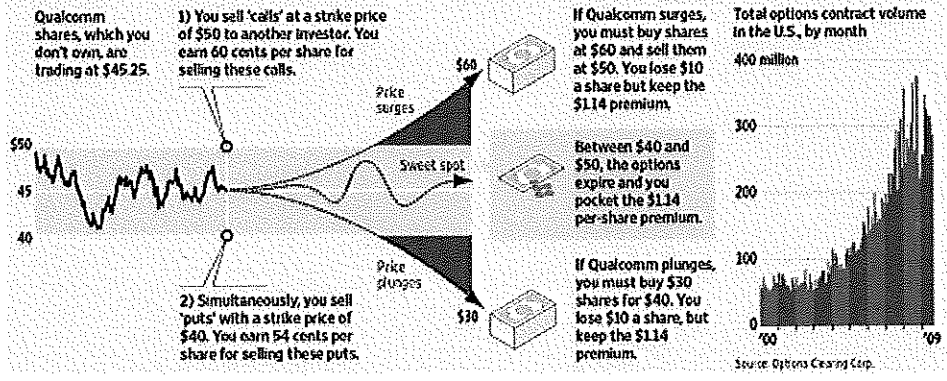
Options trading can be risky. Depending what side of the trade you are on, an option involves the right or obligation to buy or sell a stock or index at a certain price on or before a certain date. In the most conservative strategies, the most an investor can lose is the price of a contract, often just a few dollars. At their most speculative, options can leave investors exposed to huge losses.

Some options strategies work best in up markets, others in down. And some work best when markets go sideways. Bet wrong and you can lose big. Options traders who were betting on market stability earlier this year, "incurred some big losses" in the volatility of late February and March, says Jim Bittman, a senior instructor at the Chicago Board Options Exchange's Options Institute. In a two-week stretch, stocks fell more than 16%, only to rise 17% days later.

Stephen Figlewski, a finance professor at New York University, formerly traded options professionally and enjoyed it. But he adds: "I'm not sure I'm any better off than having put money in a Vanguard index fund. Lots of strategies seem smart, and people can make money at it for years. But then suddenly the year their strategy fails, they lose everything they made before -- and more."

Many of the most popular options strategies today

The Naked Strangle | A risky options strategy betting on price ranges



are focused on generating income. Investors sell options contracts to other investors and collect premiums in return. If the contract expires worthless -- and 30% of all options contracts do -- the seller

keeps the premium. If the contracts end up "in the money," the seller of the option is obligated to buy or sell the underlying shares at a predetermined price.

A popular strategy is selling covered calls. Mike Pera, a 65-year-old retiree in Eagle River, Wis., does that regularly by selling call options on stock he already owns. Selling a call is an obligation to sell shares at a certain price until a certain date.

In one recent example, Mr. Pera owned U.S. Steel Corp. at \$27 a share and sold call options obligating him to sell those shares at \$30 several weeks into the future. He received a premium of 50 cents per share, or \$50 for each 100-share contract. U.S. Steel closed below \$30 at expiration, and the options were never exercised. Mr. Pera pocketed the premium and immediately sold more calls, bringing in additional money.

"I'm not comfortable with the rapid ascent of stocks since March, so selling calls is a stream of income in a market that's really in flux," he says.

But he faces a risk selling calls into a market rally. Had U.S. Steel jumped to \$40 a share, Mr. Pera's profit would have been limited to \$3.50 a share -- the \$3 price gain from \$27 plus the 50-cent premium for selling the call. But he would have missed out on an extra \$9.50 in potential gains because he sold his shares.

Schwab's Mr. Frederick has been advocating another income-oriented strategy that involves selling a put. He calls it "an excellent way to ultimately own shares you're comfortable with if the market comes down, yet bring in a little cash in the meantime."

Say you want to own Amazon.com Inc. at a price lower than the current \$78.50. You could sell a \$70 put for the October expiration, giving another investor the right to sell Amazon shares to you at that price. For that, you would receive a premium of \$1.41 per share.

If Amazon's share price declines, the other investor will sell you the shares at \$70. You will end up owning Amazon at an effective price of \$68.59, or \$70 minus the premium you already pocketed.

If Amazon doesn't hit \$70, you keep the premium and then can sell another put. The downside: Amazon's share price soars, in which case you would have done better by buying the shares outright. And, of course, if Amazon shares fall sharply, you will take a loss, though it will be offset in part by the premium income.

Strong Figures Prompt Positioning in Costco

Several retail companies managed to generate more sales in August than Wall Street expected, prompting a decent amount of action in the options market.

Traders were quick to take positions in Costco Wholesale after it turned in better-than-expected sales results.

However, some options traders appeared to question the ability of the stock to maintain the day's momentum.

Activity in Costco jumped to nine times the normal level, with investors picking up 33,000 calls that allow them to buy the company's stock and 26,000 puts that allow them to sell it, according to Track Data.

But while the stock enjoyed gains, traders appeared to be selling calls and buying puts, signaling mildly bearish expectations.

Costco rose \$4.34, or 8.6%, to \$54.99.

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Printed in The Wall Street Journal, page C1

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