

Barron's

The Trader: When Records Prove Elusive

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Excerpts from the article:

“SPEAKING OF OPTIONS, HERE'S A HANDY STRATEGY with stocks straining at record peaks. "Collars" allow conservative investors to participate in rallies up to a certain target but limit downside risk should the market slide. You accomplish this by selling out-of-the-money calls and using the proceeds to buy protective puts, so collars require little or no out-of-pocket expense.

Given the market's upward bias, call prices have become rich. And collars "are most attractive when potential gains under the collar substantially exceed potential losses," says Thomas Schwab of Summit Portfolio Advisors.

Schwab screened for other stocks with lopsided call-to-put prices. An [Amgen](#) (AMGN) collar, for instance, allows potential gains of 29% versus downside risk of 8%, while [Newmont Mining](#) (NEM) has potential upside of 30% with 9% downside. The list includes rallying stocks like [Franklin Resources](#) (BEN) and [ConocoPhillips](#) (COP), as well as declining ones where the option market seems to be eyeing a rebound, like [Limited](#) (LTD) and Newmont.

Collars are also useful for hedging broader portfolios. With the [S&P Depositary Receipts](#) (SPY) near 152, selling 175-strike calls that expire December 2008 will buy 135-strike puts, leaving room for an annualized gain of 10% with 5% downside risk. Here, the upward pricing slant still works in your favor but is less lopsided, since broad-market puts already are in heavier demand.”

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