

Option Writing : A practical approach to out smart competitive investment sectors

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Abstract

Investment portfolios today has many segments including but not limited to bank deposits, bonds, stocks, Mutual funds, insurance , real estate etc., It's true to the extent that all segments give considerable returns based on the risk ratio that one can bear and time span invested for the same. However all these segments gives not more than 15 to 20 percent returns per annum but still inherently loaded with some amount of risk factor other than taxation. In order to overcome the risks involved and to achieve much higher returns in today's business environment let's have a unique but still very appreciable method in the investment portfolio to generate huge passive income for modern days investors by writing options.

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What Are Options?



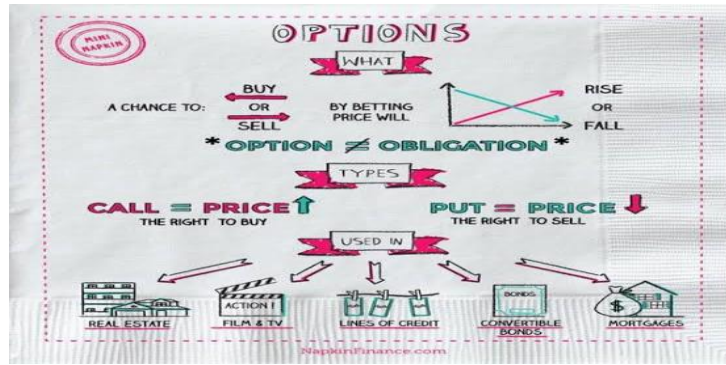
Options are contracts that give the bearer the right—but not the obligation—to either buy or sell an amount of some underlying asset at a predetermined price at or before the contract expires. Like most other asset classes, options can be purchased with brokerage investment accounts.

Options are powerful because they can enhance an individual's portfolio. They do this through added income, protection, and even leverage. Depending on the situation, there is usually an option scenario appropriate for an investor's goal.

Option Buying

It's quiet ever-present that option Buying needs low margin and hence investors will have limited risk and rewards being unlimited as compared to writing the same where theoretically involves unlimited risk with limited returns. However on a practical approach this sounds weird. The cause and effect of the same will discuss both by the way of logical as well as technical analysis of options

Segment Selection



It's quiet evident from the statistical point of view that retail investors have more leaning towards stock options as compared to index. Reason being We can see block deals being executed in stocks rather than index. It motivates retailers to go with individual stocks no matter which segment they will be in.

However on a practical observation it is quite evident that block deals are indirectly driving the index in an unpredictable direction by which retail investors suffer with stop losses being hit and slipping of sometimes leading to huge losses. So here is an attempt to educate and create an awareness in the investors specially the retail investors to be on safer side during such instances.

Option Buying

Option Buying ofcourse takes less margin as only premiums are paid for a particular contract unlike the span margin for writing the same. However statistically it is quite evident that most of the contracts ends with 5 paise thereby making huge amount of investors especially the retailers to loose their premiums. It's also true that even institutions also buy options but most of them are only for hedging rather than primary investment unlike retailers.

Probability

The probability of an option premium of a contract giving returns of more than 2x is less than 0.2 where as the probability of option premiums getting nullified is more than 0.8. also with the possibility of short strangles the gain in writing options are more probable than it's counterpart.

Logical aspect

Option Buying can never compete with writing even considering logical analysis. For example a contract whose premium is inr 100 with lot size of 50 needs only inr 5000 to buy whereas atleast 1.5 lakhs to write the same. If buying would have been a better option then the institutional traders would have made unimaginable profits by buying in huge quantities.



Practically majority of almost all institutional traders prefer to write options as time goes in favour to them. It's also evident that alpha is less volatile as compared to theta in almost all contracts with difficult time to expire. Only time when alpha overtakes theta is during expressway sessions as time is considerably less. Hence option word are always at higher advantage as compared to their counterparts.

Also if an option either call or put has to perform extremely well in order to become 3x or 4x of the premium then it is quite evident that is counterpart either put or call has to end with zero while they have started at almost same value during the start of that expiry. In that case short strangles would definitely give decent returns inspite of one side going abnormally. .

Technical aspect

It's quite event that no stock can go unidirectional through out the contract period and hence for option writers there always a time to exit with good profit if not great profit. However for option buyers once the market starts to move in reverse direction it is quite impossible to get back to the earlier premium due to theta effect. Hence it is always preferred to write options rather than buying

Strategies

Unlike stocks index gives consistent moves and also predictable. Hence it is preferred to write index options especially nifty as it's volatility is far less as compared to that of Bank nifty which moves wildly. Some of the supporting parameters might be low vix , better PCR and good support and resistance which can help option writers in a big way to get consistent income.

Conclusion

It's hereby statistically evident that writing options certainly out smarts not only buying but also generated good returns even compared to mutual funds and Bank deposits. Any index option contracts would provide considerably good returns as they are more predictable compared to stocks.

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