OBJECTIVE: REDUCING RISK BY USING LONG-TERM EQUITY CALL OPTIONS

# How a couple acquired the right to purchase stock at a future date while mitigating risk.

Jim and Ann were looking to buy stock in a company that, according to the research they received from their financial advisor, had the potential to go up in value. But they knew that it would require more capital than they were willing to fully commit at once.

Their advisor told them about a stock alternative options strategy called a long-term equity call.

Instead of investing the full cost of a stock purchase, it would allow them to instead pay a smaller premium and hold the balance in reserve for the right to purchase the stock outright at a later date.

So Jim and Ann purchased a call with a two-year expiration date on the stock at a strike price a few dollars below the actual stock price, plus an additional charge for time value. Should the value of the stock fall to or below the strike price at expiration, the most they would lose would be the amount of premium paid for the call. However, if their bullish outlook for the stock held true, they would theoretically have unlimited profit potential once the price of the stock moved above the strike price plus the premium they paid for the long-term call.

In this example, Jim and Ann's patience paid off when the stock's share price rose and they exercised the call, allowing them to purchase the stock outright at the strike price, with significantly less risk taken.

> "If Jim and Ann's bullish outlook held true, they would theoretically have unlimited profit potential.*"

*This is a hypothetical illustration and is not intended to reflect any actual outcome. Please review the "How it Works" section of this brochure for other possible outcomes when using this strategy.

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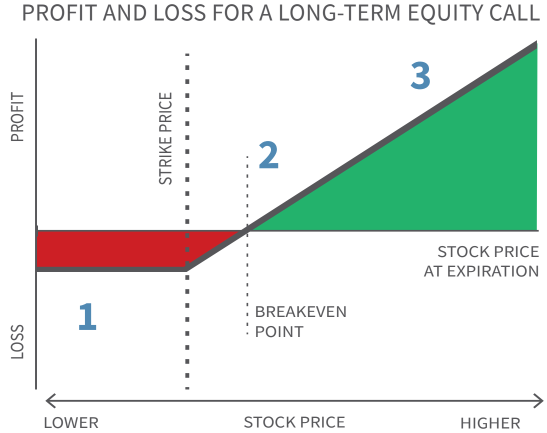
ACQUIRING THE RIGHT TO PURCHASE STOCK AT A FUTURE DATE WITH LESS OVERALL RISK:

# The primary goal of using a long-term equity call

A long-term equity call option gives you the ability to participate in the upside appreciation of a stock at a cost less than the full price of purchasing those shares in the stock market. This option contract gives you the right – but not the obligation – to buy the underlying stock at a designated strike price anytime between the date of purchase and the expiration date of the contract. We recommend purchasing in-the-money calls, where the strike price is set around 80% of the stock's current price, and the price of the call is the difference between the strike price and the current price (intrinsic value), plus an additional time value premium. Should the stock's price fall below the strike price, the call would expire worthless and the investor would lose the amount invested in the call (the intrinsic value plus the time value premium). However, if the stock's price rises, the investor can theoretically participate in unlimited profit potential since the option will eventually move dollar-for-dollar with the underlying stock if the price moves higher, or deeper "in-the-money."

Long-term equity calls (or LEAPS®) are used in an effort to attempt to profit from any upward movement of the underlying stock, so you will want to purchase a call on a stock that is "in-the-money" – i.e., the strike price is below the current stock price. Doing so also lessens your cost to break even and minimizes your potential loss to only the price paid for the call.

PROFIT AND LOSS FOR A LONG-TERM EQUITY CALL




### HOW IT WORKS

With a long-term equity call, there are three potential outcomes:

**1** The stock falls below the strike price of the call at the expiration date. In this case, the call will expire worthless and your maximum loss is limited to the premium paid to purchase the call and significantly less than if you had purchased the stock directly at the original stock price.

**2** The stock price remains around or slightly rises above the original price at which you purchased the call. If this were to happen, your loss or gain would be small and roughly consist of the difference between the strike price and the current price of the stock, plus the remaining time value premium (also known as time decay). Breakeven is achieved at the point where the intrinsic value of the call (without the addition of time premium) is equal to the premium originally paid to purchase the call.

**3** The stock price rises above the original price before or at expiration. In this case, the intrinsic value of the option will increase along with the share price. If you choose to sell the option, your profit potential will increase along with the stock price, once the stock price rises above the original strike price plus the option premium paid. Remember, instead of selling the option to close the position, the holder of the call has the right to purchase the shares at the strike price by exercising the contract.

## Talk to your advisor about long-term equity call options

Buying a long-term equity call is a way to venture into the stock market with a limited amount of risk. Talk to your Raymond James advisor today to see whether you are suitable and whether your portfolio could potentially benefit from this stock alternative options strategy.

## IMPORTANT LONG-TERM EQUITY CALL DEFINITIONS

**Ask** – The disseminated price at which exchanges indicate options can be bought.

**American-style** – An option that can be exercised/assigned at any point before expiration. Equity options are American style.

**Assignment** – Writers of American options can be assigned at any time. Upon assignment they receive cash from the option owner and must deliver the underlying securities.

**Bid** – The disseminated price at which exchanges indicate options can be sold.

**Breakeven Point** – The call strike price plus premium paid to purchase equity option.

**Call Option** – An option contract that gives the owner the right but not the obligation to buy the underlying security at a specified price (its strike price) for a certain, fixed period (until its expiration). For the writer of a call option, the contract represents an obligation to sell the underlying product if the option is assigned.

**Decay** – A term used to describe how the theoretical value of an option erodes or declines with the passage of time. Time decay is specifically quantified by Theta.

**Delta** – A measure of the rate of change in an option's theoretical value for a one-unit change in the price of the underlying stock.

**Ex-Dividend Date** – The day before the date that an investor must have purchased the stock in order to receive the dividend. On the ex-dividend date, the previous day's closing price is reduced by the amount of the dividend because purchasers of the stock on the ex-dividend date will not receive the dividend payment. This date is sometimes referred to simply as the ex-date.

**Exercise** – To invoke the rights granted to the owner of an option contract. In the case of a long call, the option owner purchases the underlying stock.

**Holder** – Any person who has made an opening call purchase transaction and has that position in their brokerage account.

**In-the-money / In-the-money option** – A term used to describe an option with intrinsic value. For standard options, a call option is in-the-money if the stock price is above the strike price.

**Intrinsic value** – The in-the-money portion of an option's premium.

**LEAPS® (Long-term Equity AnticiPation Securities) / Long-dated options** – Calls with an expiration of over nine months when listed. Currently, equity LEAPS® have two series at any time with a January expiration.

**Long Call option position** – The position of an option purchaser (owner) which represents the right to buy stock (in the case of a call) at a specified price (strike price) at or before some date in the future (the expiration date). This position results from an opening purchase transaction (long call).

**Options Contract** – One options contract typically represents 100 shares of stock.

**Premium** – The price you pay if you're an option buyer, or the amount you receive if you're an option writer.

**Strike** – The price at which stock is traded upon exercise/assignment of an option contract. Some options have multiple underlying stocks. In these cases, the strike times the multiplier is the total price paid for all of the option's underlying securities.

**Theta** – A measure of the rate of change in an option's theoretical value for a one-unit change in time to the option's expiration date.

**Time Decay** – The decline in value of your option as the expiration date approaches.

**Time Value** – The perceived and often changing value of the time left until an option's expiration.

**Underlying** – The cash or securities that are delivered upon exercising an option. Most options deliver 100 shares of a single stock.

**Options involve risk and are not suitable for all investors. When appropriate, options should comprise a modest portion of an investor's portfolio. Prior to buying or selling an option, a person must receive a copy of "Characteristics and Risks of Standardized Options" (ODD).** Copies of the ODD are available from http://www.optionsclearing.com/about/publications/character-risks.jsp or by contacting Raymond James at 880 Carillon Parkway, St. Petersburg, FL 33716. The information in this document is provided solely for general education and information purposes and, therefore, should not be considered a complete description of listed options. No statement within this document should be construed as a recommendation to buy or sell a security or to provide investment advice. Please consult a tax advisor for the tax implications involved in the use of options. Supporting documentation will be supplied upon request.

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