

The Poor Man's Covered Call

- Debit Spread
- Defined Risk
- Defined Reward
- Mildly Bullish

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1. Poor Man's Covered Call Explained

The Poor Man's Covered Call strategy is like the Covered Call on steroids. You will get all of the benefits of a Covered Call with a fraction of the risk. You will learn how to generate a covered call without tying up capital buying the stock! Fasten your seat belts...your mind is about to be blown wide open!

1.1. Short Explainer Video

[CLICK HERE](#) to view.

1.2. Construction

The Poorman's Covered Call is made up entirely of Call options on the same underlying stock (or index). It's constructed by purchasing a Call LEAP with one strike price and selling (writing) another shorter term expiry Call with a strike price ATM or OTM. The ratio of long calls to short must be 1:1.

The result is a position consisting of a Long Call Leap (lower strike) and a Short Call (higher strike). casual terms to be long a call spread.

Poorman's Covered Call

= buy lower-strike call LEAP + sell short term higher-strike call

1.3. Debit vs. Credit

Since the long, lower-strike call will cost more than the premium received for the short, higher strike call with the same expiration, a Poorman's Covered Call will always be established at a net debit. In other words, the amount of cash paid out is more than the cash received.

Poorman's Covered Call = debit spread

1.4. Example

To establish a Poorman's Covered Call with XYZ options, an investor might buy 1 XYZ January 60 call for \$2.50, and at the same time sell (write) 1 XYZ June 65 call for \$0.50. The result is the investor holding 1 XYZ 60/65 Poorman's Covered Call, or being long 1 XYZ 60/65, at a \$2.00 (\$2.50 – \$0.50) net debit.

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XYZ 60/65 Poorman's Covered Call

Action	Quoted Price	Total Price
Buy 1 XYZ Jan 60 call	- \$2.50	- \$250.00
Sell 1 XYZ June 65 call	+ \$0.50	+ \$50.00
Net Debit	- \$2.00	- \$200.00

The Poorman's Covered Call is a moderately bullish position. An investor employing this strategy is bullish on the underlying stock (or index), and expects to profit from an increase in its price. However, it's a moderately bullish position since the investor generally expects the underlying stock (or index) to increase up to or slightly above the short call's higher strike price by expiration. Above that level, the profit is capped. A more bullish investor might simply buy calls outright.

Poorman's Covered Call: moderately bullish

1.5. Motivation for Spreading

Since the investor is only moderately bullish on the underlying stock (or index), the cost of buying a call might represent more downside risk than he is willing to take. By selling the higher-strike call and taking in premium, the cost of the long call is in effect reduced. This premium will at least partially offset a loss on the long call if the investor's bullish forecast is incorrect and the underlying stock (or index) goes down instead. The trade-off for protecting some of the long call's value in this manner is of course the limited upside profit potential.

Poorman's Covered Call: reduce risk of long call

1.6. Maximum Profit

The maximum upside profit for a Poorman's Covered Call is limited to the difference between the calls' strike prices, less the debit initially paid for the spread plus the remaining value left on the Long LEAP Call. This profit will be seen if the underlying stock (or index) closes at or above the higher strike price of the short call at expiration, no matter how high the underlying stock (or index) increases.

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Maximum profit

= difference in strike prices – net debit paid plus value remaining on Long Call

1.7. Maximum Loss (at LEAP Expiry)

The maximum downside loss for a Poorman's Covered Call is limited entirely to the net debit initially paid for it. This loss will be seen if the underlying stock (or index) closes at or below the lower strike price of the long call at the Long Call Leap expiration, no matter how low the underlying stock (or index) declines.

Maximum loss = debit paid

1.8. Break-Even Point (Short Term Expiry)

Because the Poorman's Covered Call has two expiries we must consider the fact that the Long Call Leap will have Time Premium left at the short term call expiry. The break-even point (BEP) for a Poorman's Covered Call at the shorter term expiration is a closing underlying stock price (or index level) equal to the lower strike price of the long call plus the debit paid minus the time premium of the Long Call LEAP.

Break-even point (Shorter Term Expiry)

= lower strike price + net debit paid – time premium of Long LEAP

1.9. Break-even point (Longer Term Expiry)

Of course, if the Short Call Option finishes OTM at expiry this allows you to repeat the process again by selling another Call Option for the following month expiry. The Breakeven point should you get to the longer term expiry of the Long Call will depend on the amount of premium received on Short Calls.

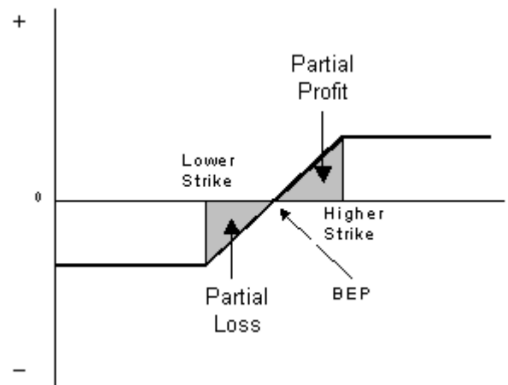
Break Even point (Longer Term Expiry) =

lower strike of the call + net debit paid minus income from selling short term calls

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1.10. Partial Profit or Loss

At expiration, if the underlying stock (or index) closes at a point between the breakeven point and either of the two strike prices, either a partial loss or partial profit would be seen. Above the break-even point there would be a partial profit; below the breakeven point there would be a partial loss.



1.11. Profit & Loss Before Expiration

Before expiration, an investor can take a profit or cut a loss by selling the position if it has market value. This involves selling the long call and buying the short call, which will be done at a net credit, and these closing trades may be executed simultaneously in one spread transaction. Profit or loss would simply be the net difference between the debit initially paid for the spread and the credit received at its sale.

1.12. Impact of Volatility

The financial impact of a change in volatility depends on whether one or both of the calls are in-the-money and the amount of time until expiration.

1.13. Impact of Delta

[CLICK HERE.](#)

1.14. Impact of Time Decay

[CLICK HERE](#) to watch the impact of Theta.

For a Poorman's Covered Call, if the underlying stock (or index) is closer to the lower strike of the long call, losses should increase at a faster rate as time passes.

Conversely, if the underlying stock (or index) is closer to the higher strike of the short call, profits should increase at a faster rate with time.

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Poorman's Covered Call Example Continued

Action	Quoted Price	Total Price
Buy 1 XYZ Jan 60 call	- \$2.50	- \$250.00
Sell 1 XYZ June 65 call	+ \$0.50	+ \$50.00
Net Debit	- \$2.00	- \$200.00

1.15. Maximum Profit

If at expiration the underlying stock (or index) closes at or above the higher (short call) strike price of \$65, then the maximum profit would be realized. To realize this profit, an investor has two choices.

- First, the spread could be closed out at its maximum value (difference between strike prices) by selling the long June 60 call and buying back the short June 65 call, both at their individual intrinsic values.
- Second, if assigned on the short call the investor would sell underlying shares at its \$65 strike price (or be debited the index cash settlement amount), but could exercise his long call to buy and deliver shares at its lower \$60 strike price (or be credited the index cash settlement amount).

With either method, the investor would receive the aggregate difference between the strike prices (\$5 difference in strikes x \$100 x number of contracts), or \$500 total. Maximum profit would be this amount less the \$200 debit paid for the spread, or \$300 total plus the value left in the Jan \$60 Call. Let's say that amounts to \$3.75.

Maximum profit =

\$5.00 strike difference – \$2.00 debit paid = \$3.00, or \$300 total plus \$375=\$675 total

1.16. Maximum Loss

At the Long LEAP expiration, if the underlying stock (or index) closes at or below the lower strike price of \$60, both call options would expire with no value, and the net \$2.00 debit paid for the spread would be lost.

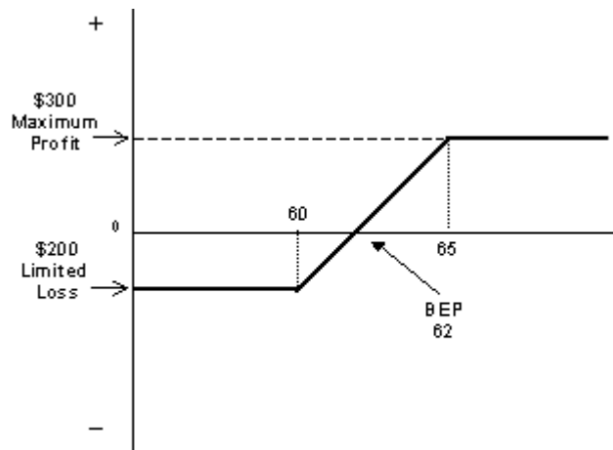
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Maximum loss = \$2.00 debit paid, or \$200 total

1.17. Break-Even Point (Longer Term Expiry)

At expiration, the break-even point for this Poorman's Covered Call would be a closing underlying stock price (or index level) equal to \$60 (lower strike price) + \$2.00 (net debit paid) = \$62.

$$\text{BEP} = \$60 \text{ lower strike} + \$2.00 \text{ debit paid} = \$62$$



XYZ June 60/65 Poorman's Covered Call paid \$200

XYZ price at Expiration	Long 60 Call Value	Short 65 Call Value	Value of Spread	Spread Profit/Loss
\$59	0	0	0	-\$200
\$60	0	0	0	-\$200
\$61	+\$100	0	\$100	-\$100
\$62	+\$200	0	\$200	0
\$63	+\$300	0	\$300	+\$100
\$64	+\$400	0	\$400	+\$200
\$65	+\$500	0	\$500	+\$300
\$66	+\$600	-\$100	\$500	+\$300
\$67	+\$700	-\$200	\$500	+\$300
\$68	+\$800	-\$300	\$500	+\$300

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1.18. How Bullish?

Some Poorman's Covered Calls can be considered more bullish than others. The degree of bullishness depends primarily on the strike price of the short call, which determines how high the underlying stock (or index) needs to increase for maximum profit to be realized at expiration.

- Most bullish: a spread bought when both calls are out-of-the-money.
- Moderately bullish: a spread bought when the underlying stock (or index) is between the two strike prices.
- Least bullish: a spread bought when both calls are already in-the-money (primarily to take advantage of time decay).

1.19. Assignment Risk

Assignment on any Equity option or American-style index option can, by contract terms, occur at any time before expiration, although this generally occurs when the option is in-the-money.

1.20. Equity Options

For an equity call option, early assignment usually occurs under specific circumstances; such as when underlying shareholders are about to be paid a dividend. Assignment at that time might be expected when the dividend amount is greater than the time value in the call's premium, and notice of assignment may be received as late as the ex-dividend date. If a Poorman's Covered Call holder is assigned early on the short call, then he may exercise his long call and buy shares to fulfill the assignment obligation. In this case, maximum profit on the Poorman's Covered Call would be realized.

1.21. American-Style Index Options

If early assignment is received on the short call of a Poorman's Covered Call, the cash settlement procedure for index options will create a debit in the investor's brokerage account equal to the cash settlement amount. This cash amount is determined at the end of the day the long call is exercised by its owner. After receiving assignment notification, usually the next business day, when the investor exercises his long call the cash settlement amount credited to his account will be determined at the end of that day. There is a full day's market risk if the long option is not sold during the trading day assignment is received.

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1.22. Powerpoint Video

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1.23. P&L Tables

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2. **Placing and Managing a Poorman's Covered Call Trade**

2.1. **How to place a Poor man's Covered Call on TWS**

[CLICK HERE](#) to view.

2.2. **How to manage a Poorman's Covered Call**

[CLICK HERE.](#)

2.3. **Rolling out the 'Short' Call**

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2.4. **Closing down the trade**

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2.5. **Position Sizing**

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2.6. **Test Your Knowledge 1**

[CLICK HERE](#) to take the quiz

2.7. **Test your knowledge 2**

At this stage it is best if you start practicing for real so this is what we want you to do:

1. Pick any option able stock that you think is trending sideways
2. Buy the LEAP Call with Delta of at least 0.7 (Long Term Option)
3. Sell the Covered Call 1-2 months out at a strike price slightly OTM.
4. Do a profit & Loss table
5. Place the trade in a 'Simulated' or 'Demo' account with an online broker
6. Identify your breakeven
7. Identify your Max Loss
8. Identify your Max Profit
9. Share your insights on our daily members web meetings

2.8. **Please leave a Review on Google**

[CLICK HERE](#) to leave a review of this course on Google. We would love to get your feedback. Thank you.

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3. Mentoring Service

Embark on a streamlined journey to financial proficiency with our Stock and Options Mentoring Service. Elevate your learning curve by enlisting a **personal** mentor who will guide you through the intricacies of stock and options trading. Our comprehensive program offers:

- Weekly one-on-one mentoring sessions, ensuring personalized attention and targeted skill development.
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