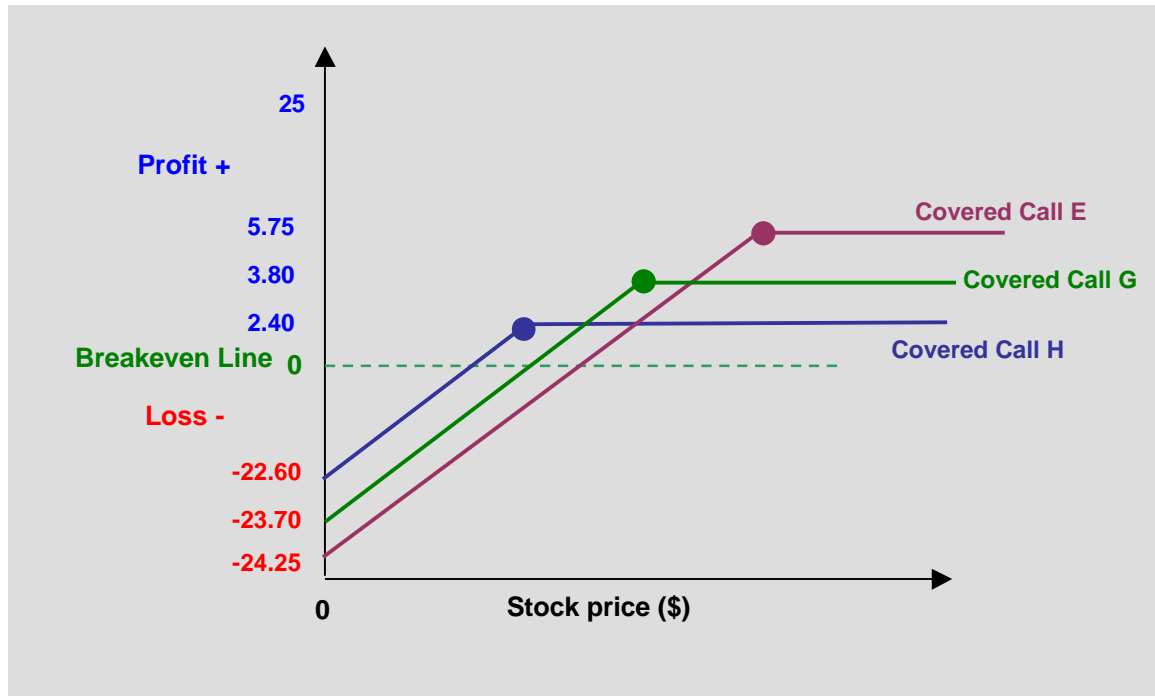


Chart 5.2.2 | Covered Calls E, G and H (not to scale)



How to improve the Covered Call

The problem with a Covered Call is the risk profile to the downside. I generally don't like to see that diagonal line going all the way down! So, how would you suppose you could limit that risk on the downside? The answer is to buy a protective Put. This is an advanced strategy, outside the scope of this book, known as a *Collar*. There are several ways to play a Collar but for now, we're just going to look at the protective Put option as an additional leg to the Covered Call.

If you're a fan of trading Covered Calls but would like to have some protection on the downside, then you might want to look at this approach:

- Step 1** Understand the context of your trade and how long you're looking to hold the stock for (say 6 months).
- Step 2** Buy the stock.
- Step 3** Sell the Calls on a monthly basis.
- Step 4** Buy a protective Put for half the period of time you're looking to hold the stock for.

What you're doing here is akin to a finance deal. You're buying an asset, financing it (by selling calls every month) and insuring the transaction (by buying the protective Put). I have suggested only insuring the deal for half your expected