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Stock Contingent Option Trades

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As with all investments, your capital is at risk

Stock Contingent Option Trades

What Is a Stock Contingent Trade

Strategies for Targeted Goals and Risk management

What Is a Stock Contingent Option Trade

When you initiate an order for options, you have the capability to construct a complex strategy involving multiple options, such as a call spread, which requires simultaneous execution.

A stock contingent option trade integrates a stock element with the options order, ensuring that both the stock and options are executed together at a predetermined price.

What Is the Purpose of A Stock Contingent Trade

When you have an option tied to a stock, you can achieve potential better trade execution, target a specific type of risk exposure or help mitigate risk of your strategy such as directional risk.

-Execution Quality

-Target Goals

-Risk Mitigation

Execution Quality

Covered Call

In a covered call strategy, the call option and the stock are executed at the same time.

The order is placed as a call option transaction that includes a contingent stock component.

This contingent approach is chosen to achieve the execution simultaneously, avoiding the risk of unfavorable pricing that can occur when entering parts of the trade separately.

Mitigate Directional Risk

Trade Delta Neutral

When your objective is to trade an option, like a call, focusing on its implied volatility while minimizing directional risk, using a stock contingent order can be strategic. This involves hedging the option's delta with the corresponding stock. By placing an option order that includes a stock contingent component tied to the option's delta, you effectively lessen the impact of directional movements. This allows you to concentrate more on managing other aspects of option risk, such as implied volatility, theta, gamma, and rho.

Targeted Goals: Cost-of-Carry

Conversion/Reversal

Another motivation for employing a stock contingent trade is to manage the cost of carry effectively. This strategy entails simultaneously buying and selling call and put options at the same strike price, along with executing an equivalent stock trade.

This coordinated action aims to mitigate the strategy's directional risk. By executing a conversion or reversal strategy in this manner, you can focus on the cost-of-carry components, such as interest rates, dividends, and the cost of borrowing stock. This approach provides a targeted way to manage specific exposures related to carrying positions over time.

Some Risks of Stock Contingent Trades To Consider

1. Risk Management Post-Execution

Does not eliminate all strategy risks; ongoing risk management required.

2. Execution Challenges

Potential difficulty in execution if no counterpart is willing to accept the contingent order.

Lower liquidity compared to executing options without the stock component.

3. Risks Associated with Holding Stock

For Short Positions:

Borrow rates and availability challenges for shorting stock.

For Long Positions:

Carry costs of purchasing and holding the stock.

Stock Contingent Trade Examples

We will examine recent stock contingent trades as recorded on the trading tape, analyzing their components and possible strategic intentions.