

CommSec Options Report: 6 October 2015

- Taking advantage of the volatility in the resource stocks
- Bull Collar/Synthetic Long: A strategy for the sophisticated investor/trader with an appetite for risk

No doubt in the past few months we have seen increased volatility on share markets across the world.

One sector that has been more volatile than most in the past few months, if not extremely volatile has been the materials sector. For the better part of the past six months we have seen a persistent sell-off in most resource stocks, as fears of a Chinese led global growth slowdown, and in turn falling commodity prices took hold. This volatility in the sector was further emphasised with the monumental moves we saw offshore in Glencore (GLEN:L) recently, with moves of 20% or more on a least two occasions, as theories swirled from various broking houses/financial press in regards to its balance sheet and potential viability.

Given these events unfolding, we are now seeing signs from some market participants/brokers/the financial press about whether the bottom in the resources share price rout has been found, precipitated by the move of KKR acquiring a 10% stake in OZ Minerals (OZL) late last week - citing the company being undervalued at current levels.

As such we felt it was worthwhile highlighting a few ETO strategies to potentially take advantage of movements in the resource names. Rather than use BHP Billiton (BHP) or Rio Tinto (RIO) as an example we thought the BHP spin off South32 (S32) would be appropriate, considering the company's solid balance sheet and the continued speculation it could be a potential take-over target from the likes of former Xstrata boss Mick Davis's X2 vehicle.

The most obvious and simple strategy would be to buy **Calls**, however with Implied Volatility at current levels the cost of an outright Call position is rather expensive and you are banking on a rapid rise in the share price to cover the cost. As such we'll look at two alternative strategies in a **Buy Write** (with pay off diagram below) and the more risky strategy of a **Bull Collar/Synthetic Long** for the sophisticated investor/trader.

Bull Collar/Synthetic Long: Is a strategy for the sophisticated investor/trader with an appetite for risk, a very bullish view and the ability to acquire the shares should the short put leg be assigned. This strategy is similar to holding a share with a limited/low initial capital outlay. The example trade we have applied here is selling the **S32 December 135 put @ \$0.085** and buying the **S32 December 155 call @ \$0.09** for a **total outlay of \$0.005**. Break even on the **downside is at \$1.355** and clearly below this level the Put seller runs the risk of being exercised the stock or taking a loss on the overall strategy by closing it down. Clearly if there is a substantial rally in the **share price above \$1.555** the trade becomes profitable quickly for a very small premium outlay. Please note that brokerage charges have not been taken into account. **Buy Write:** Given we have discussed this strategy in recent notes we won't go through the definition again. However, we must point out that this trade is designed to take advantage of selling expensive ETOs to create income. It does limit/cap your upside in the event of a rapid rise in the share price above the strike price in the ETO. The inputs we have used for this trade are below as is the overall Return/Pay Off calculator outcome.

Clearly these strategies can be applied to any number of ASX listed resource names that have ETO's attached and the above security is purely used as an example and is not a recommendation

| Buy Write Return : S32NL7.AOM | | | | | |
|-------------------------------|----------------|------------------------------------|----------------|----------------|------------------|
| S32NL7.AOM | | | | | |
| No. contracts : | 1 | Received | Nominal | Grossed | |
| Strategy date : | 06-Oct-2015 | Dividends received : | 0 | 0 | |
| Stock price : | 145 | Final stock price : | 145 | 145 | |
| Option price : | 9 | Stock value : | 145 | 145 | |
| Strike price : | 155 | Exercise/Sale comm : | 0 | 0 | |
| Expiry date : | 17-Dec-2015 | Exercise stamp : | 0 | 0 | |
| Assumptions | | Net value : | 145 | 145 | |
| Stock purchase % : | 0 | Profit : | 8.86 | 8.86 | |
| Stock sale % : | 0 | Standstill Return (%) | | | |
| Stock expiry sale % : | 0 | Return in 72 days : | 6.11 | 6.11 | |
| Stock stamp duty % : | 0 | Annual straight line : | 30.97 | 30.97 | |
| Option sale % : | 0 | Annual compound : | 35.06 | 35.06 | |
| Option stamp % : | 0 | Exercise at Expiry (%) | | | |
| ACH costs/contract : | 0.143 | Return in 72 days : | 13.85 | 13.85 | |
| Shares per contract : | 100 | Annual straight line : | 70.22 | 70.22 | |
| Ex div stock fall % : | 0 | Annual compound : | 93.02 | 93.02 | |
| Outlay (\$) | | Exercise Next Dividend (%) | | | |
| Stock purchase : | 145 | Return : | | | |
| Purchase comm : | 0 | Annual straight line : | | | |
| Purchase stamp : | 0 | Annual compound : | | | |
| Option sale : | 9 | Exercise Final Dividend (%) | | | |
| Option comm : | 0 | Return : | 0 | 0 | |
| Option stamp duty : | 0 | Annual straight line : | 0 | 0 | |
| ACH charges : | 0.14 | Annual compound : | 0 | 0 | |
| Net outlay : | 136.14 | Protected to : | 136.14 | | |
| | | % : | 6.11 | | |
| Dividends | | | | | |
| ExDivDate | DivAmnt | Yield% | Frk% | TaxRate | GrossedUp |

Source-IRESS

South 32 (S32) Inputs as at 6/10/2015

Share Price = \$1.45

December 135 put mid-point price = \$0.085

December 155 call mid-point price = \$0.09

Upcoming expiry dates

SPI expiry = 15/10/2015

ETO expiry = 29/10/2015

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