LEAPS Options Made Simple: A Beginner's Guide to Long-Term Investing

June 5, 2024

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Welcome!

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Long-Term Equity Anticipation Securities

- Long-term options (LEAPS) are generally listed about 2.5 years before they expire.
- LEAPS are typically options whose expiration dates are one year or longer.
- About a third of stocks have LEAPS options; however, they are more commonly found among ETFs and Index options.
- The factors for pricing all options are the same, but the biggest difference is the effect of volatility, risk-free interest rates, and dividends.
- Options strategies involving LEAPS are similar to short-term strategies. Variables like time and the individual’s goals might favor buyers of LEAPS.

Factors that Influence Option Pricing

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1. Underlying Stock Price
2. Strike Price
3. Time Remaining

More Influence on Short-Term Options

4. Volatility
5. Risk-free interest rate
6. Dividend rate

More Influence on LEAPS

Volatility

- Changes in volatility can influence the price of all options.
- Small changes in volatility can have a large impact on LEAPS.
- A rise in volatility will have a beneficial effect on long LEAPS even if the price of the underlying is unfavorable.
- It is critical to assess volatility on a historical level before using LEAPS in any options strategy.

Interest Rates & Dividends

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- Rising interest rates increase the cost of capital, increasing the price of calls and decreasing the cost of puts.
- Falling interest rates will have the opposite effect, decreasing the value of calls and increasing the cost of puts.
- Buying call LEAPS as a substitute to ownership of the underlying and investing the cash not invested into a CD or T-bill could be more beneficial.
- Dividends have an inverse effect on pricing. With rising dividends, puts become more expensive, and calls decrease in value. Reflection of the dividend payout in the absolute price of the underlying.
- It's essential to know total dividend payouts and the consistency of dividend increases.

Deltas

- ATM call LEAPS' deltas are larger than comparable short-term options.
- With ITM call options of about 5%, LEAPS and short-term are about equal. The deeper ITM will find comparable lower LEAPS option deltas.
- Deltas of LEAPS remain relatively stable as the underlying moves, unlike short-term options. This stability in LEAPS prices gives buyers a reliable expectation of increases and decreases.
- LEAPS puts have an inverse relationship with the underlying security. Short-term puts move faster than LEAPS.
- LEAP put buyers' leverage will be dampened with the downside price movement of the underlying.

Takeaways

LEAPS are long-term options that adhere to the same option strategies as short-term options. The main difference is the effect of time, interest rates, and dividends on LEAPS pricing.

Buying LEAPS calls offers a flexible alternative to ownership, empowering you to invest your excess cash in interest-rate securities.

Buying LEAPS puts act as an insurance policy against market declines.

LEAPS have a low rate of time decay and relatively stable deltas, which buyers of LEAPS will come to appreciate.

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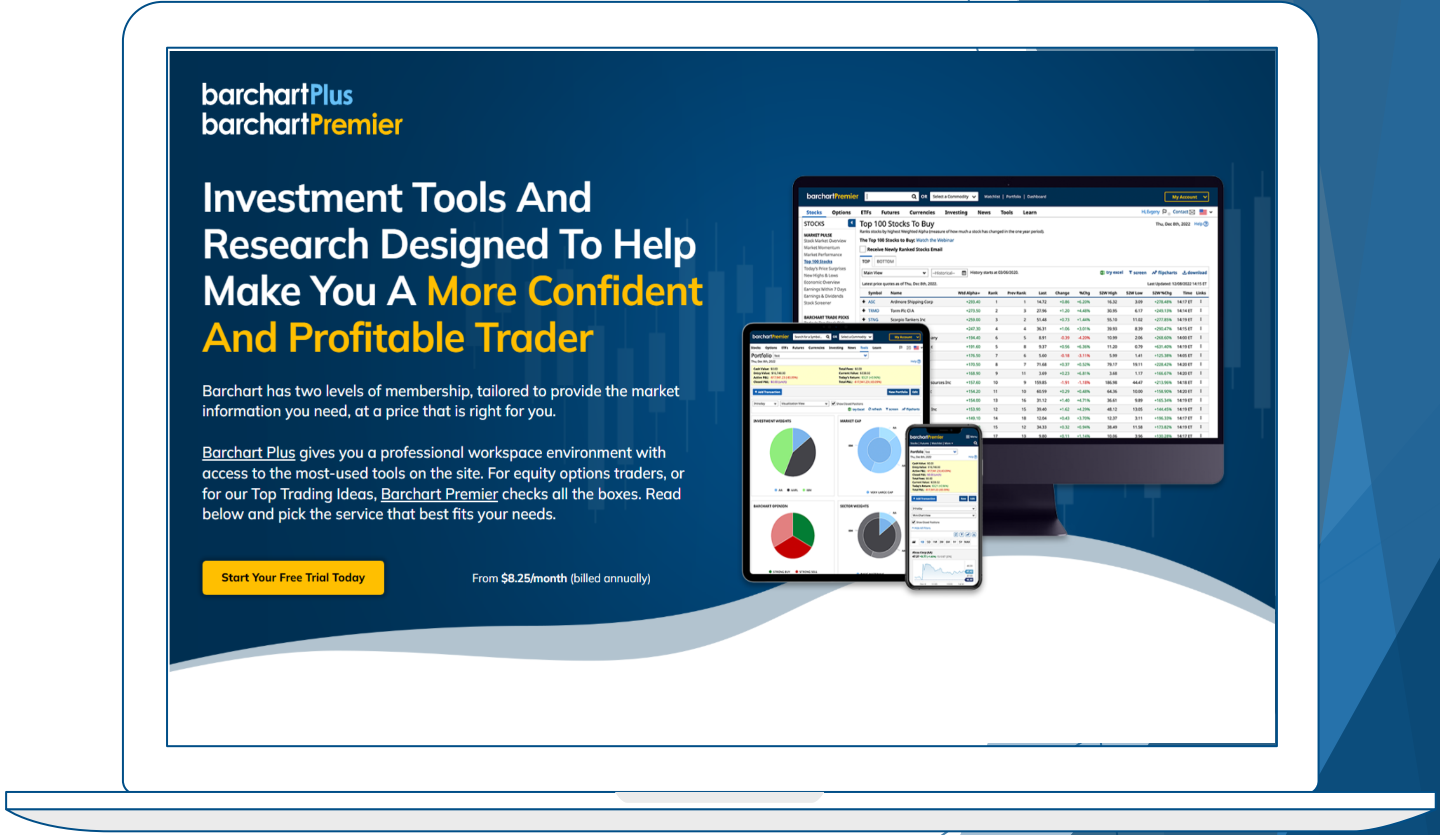

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