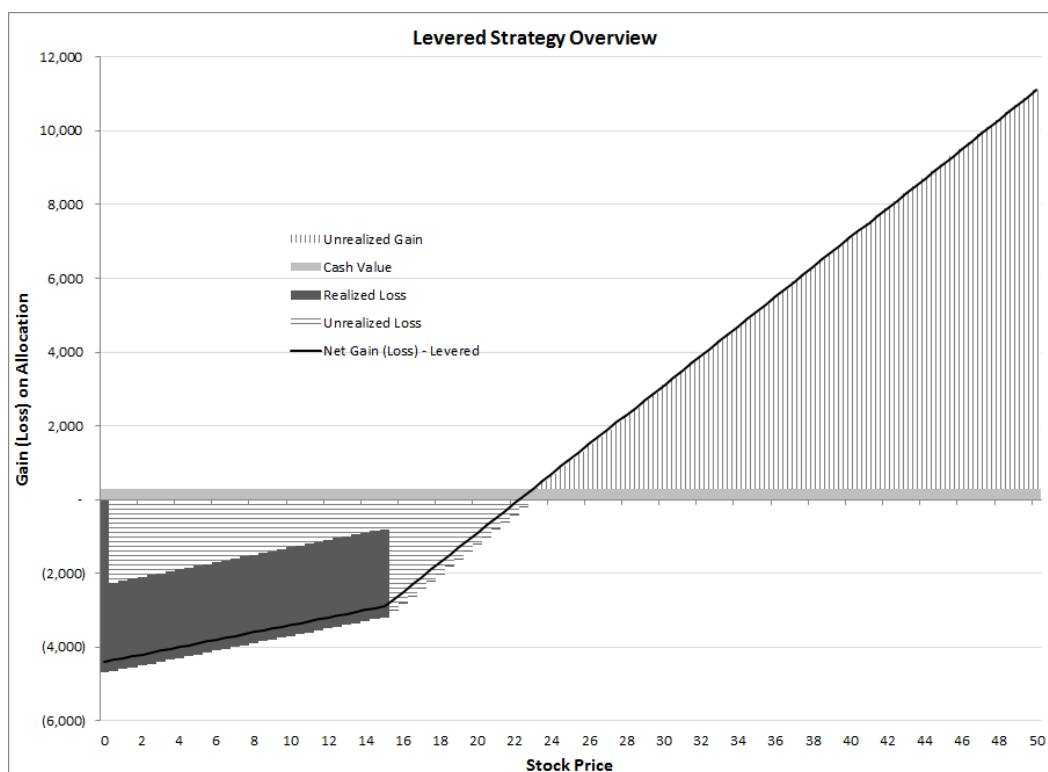


# Erratum

Chapter 8: Understanding Leverage (pp 181-182)

Similar to setting a cash reserve, one might also select to make an investment that combines cash, stock, and options. For example, I might buy 100 shares of Intel, three ITM option contracts, and leave the rest of my 5% allocation in cash. Here is what that profit and loss profile would look like.



Instrument	Maximum Loss Price	Net Profit at FV Estimate
Stock	\$0	\$1,472
Option	\$15 (1.4x stock loss)	\$2,801 (1.9x stock profit)

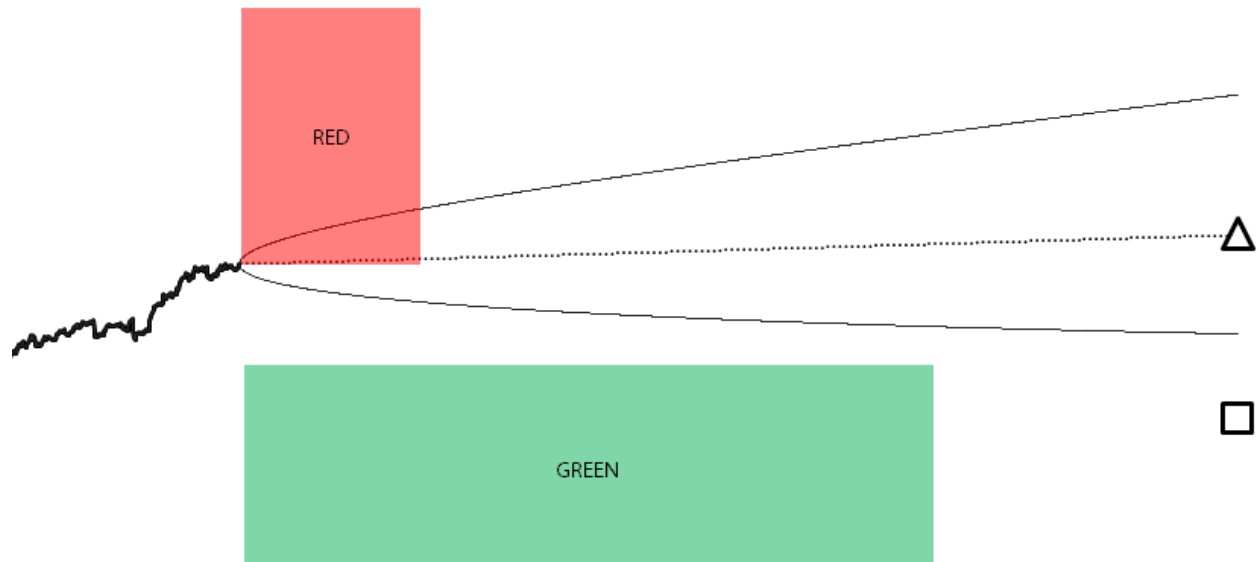
Three \$800 option contracts represent \$2,400 of capital or 48% of this allocation's capital. 48% of the capital was lost with a 34.8% move downward in the stock, generating a -1.4x value for the options, which represents the figure you see on the loss side. Of course, if the option loss is realized, we still own 100 shares, so the maximum loss will not be felt until the shares hit \$0 as shown in the diagram above.

This erratum is copyright 2014 by Erik Kobayashi-Solomon and is intended to correct the text of [The Intelligent Option Investor: Applying Value Investing to the World of Options](#) (2014, McGraw-Hill). Please visit the [Intelligent Option Investor](#) website for more information and [IOI Tools](#) for online valuation tools.

# Erratum

Chapter 11: Mixing Exposure (p 238)

## Short Diagonal



*Downside:* Undervalued

*Upside:* Overvalued

*Execute:* Sell an ATM call option while buying one to cover at a higher price (short call spread) and simultaneously buy an OTM put option (long put)

*Risk:* The price of the put option less net credit for selling the call spread. If short diagonal is implemented using a “naked” call sale rather than a call spread, the risk is theoretically limitless.

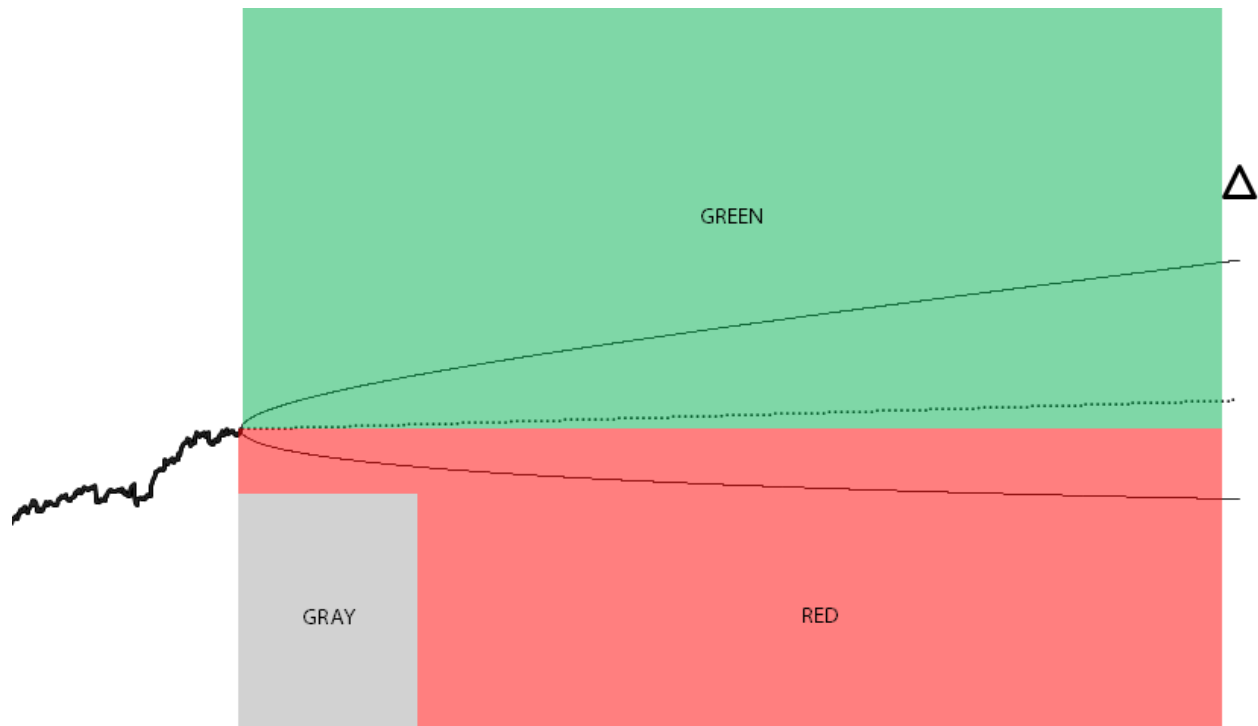
*Reward:* Amount equal to the put’s strike price, less any net premium paid for it.

*Margin:* Amount equal to spread between call options

# Erratum

Chapter 11: Mixing Exposure (p 248)

## Protective Puts



NOTE DIFFERENCE IN DIAGRAM AS WELL

*Downside:* Irrelevant

*Upside:* Undervalued

*Execute:* Buy common stock and simultaneously buy a put option (the above diagram shows the purchase of an OTM put option)

*Risk:* Purchase price of stock – Strike price of put option – Premium paid.

*Reward:* Unlimited, less premium paid for put option, which cannot be recovered

*Margin:* None because this is a purchase of an option

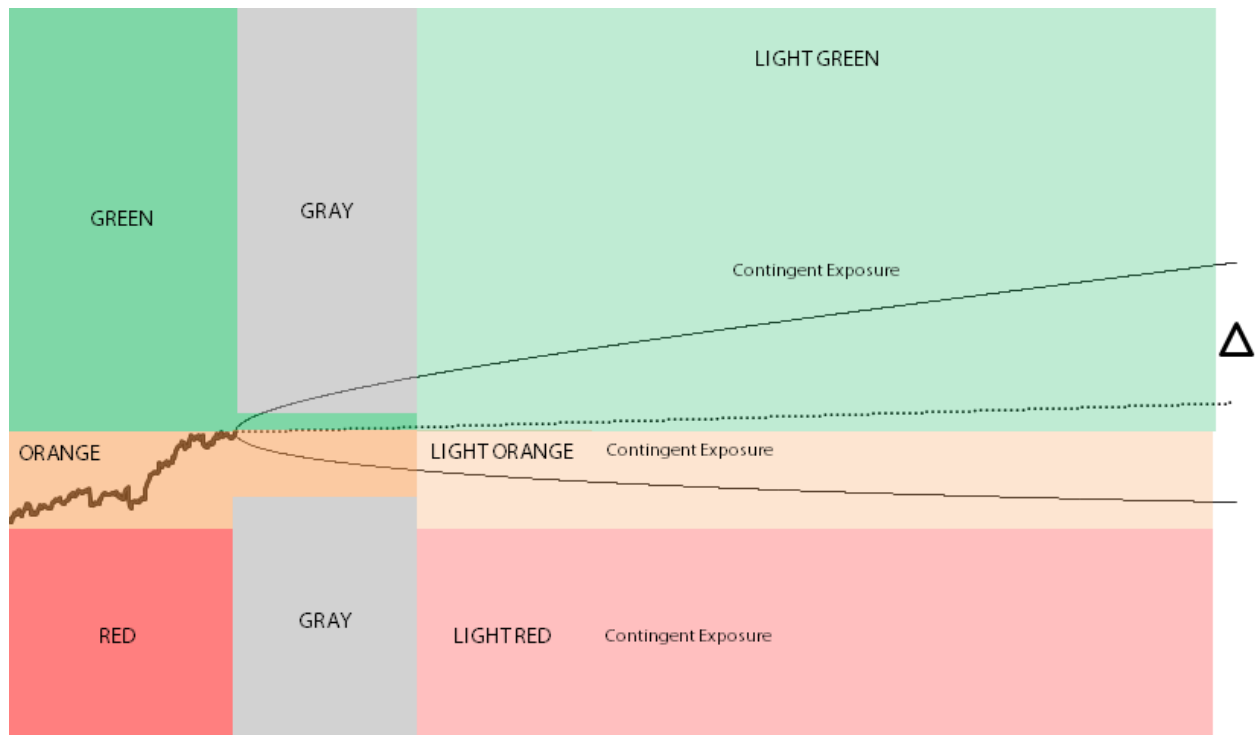
### The Gist

If one looks just as far as the option tenor lasts on the diagram above, one will see it the risk and return profile is identical to that of an ITM Call.

# Erratum

Chapter 11: Mixing Exposure (p 258)

## Collar



NOTE DIFFERENCE IN DIAGRAM AS WELL

*Downside:* Irrelevant

*Upside:* Overvalued

*Execute:* Sell a call option on a stock or index you own and on which you have a gain, and use the proceeds from the call sale to buy an OTM put

*Risk:* Flexible, depending on selection of strikes

*Reward:* Limited to level of sold call strike

*Margin:* None because the long position in the hedged security serves as collateral for the sold call option and the OTM put option is purchased, so does not require margining