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# Fixed Return Optionss

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## FROs

A Comparison of Finish Low  
FROs and Standard Listed  
Put Options



# Fixed Return Options

## A Comparison of Finish Low FROs and Standard Listed Put Options.

A long Finish Low FRO and a long put are similar in that an investor purchasing either a long Finish Low FRO or a long standard listed put is bearish on the underlying security.

Standard listed put options can be sold short to establish a possible entry point for an underlying security that may be lower than the current trading price of the underlying. Both Finish Low FROs and standard listed put options can be sold short to generate income.

Long Finish Low FROs and long puts must be paid in full.

Short Finish Low FROs will require margin equal to \$100.00 less the premium received per contract. The premium received must remain in the account. Short uncovered standard listed put will have higher per contract margin requirements.

## Expiration & Settlement FROs

FROs settlement is based on an all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> which will most likely differ from the underlying's closing price on expiration Friday.

- At expiration the holder of a Finish Low FRO will automatically receive \$100.00 per contract if the Finish Low FRO finishes in the money.
- At expiration the writer of a Finish Low FRO will automatically be debited \$100.00 per contract if the Finish Low FRO finishes in the money.



- If the Finish Low FRO expires out-of-the-money the writer would keep the premium received.
- For a Finish Low FRO to be in-the-money the all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> must be below the strike price. For example, if the all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> was \$24.99 or lower, the \$25.00 strike price Finish Low FRO would be in-the-money.
- The all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> and the underlying's closing price on expiration Friday will most likely differ.
- European style, cash settled.
- Automatic exercise.

### **Standard Listed Put Options**

- In order to realize any profit at expiration, the holder of a long put must either sell or exercise the long position.
- At expiration the writer of a short put must do one of three things:
  - Let the option expire worthless.
  - Buy back the short put to end the short put obligation.
  - Let assignment take place.
- For a put to be in-the-money the closing price of the underlying security must be below the strike price. For example, if the closing price of the underlying security was \$24.99 or lower, the \$25.00 strike price long put would be in-the-money.
- American style, physical settlement.

### **Maximum Profit, Loss and Breakeven Point for Long Positions**

#### **Long Finish Low FRO**

- Maximum loss is equal to the total purchase price.
- Maximum profit is \$100.00 less the premium paid per contract.
- Maximum value of \$100.00 per contract is achieved when the Amex FRO Settlement Index<sup>(SM)</sup> is below breakeven at expiration.
- Breakeven = strike price - \$0.01.

#### **Long Standard Listed Put Options**

- Maximum loss is equal to the total purchase price.



- Maximum profit potential is the strike price less the premium paid until expiration.
- Breakeven = strike price - the premium paid

## Maximum Profit, Loss and Breakeven Point Comparison Example

XYZ \$32.50 strike price puts are trading at \$2.00.

XYZ \$32.50 strike price Finish Low FROs are trading at \$0.81.

The table below illustrates the maximum gain, maximum loss and breakeven point for the long \$32.50 strike price put and the long \$32.50 strike price Finish Low FRO used in the above example.

	1 Long Put	1 Long Finish Low FRO
Cost per Contract	\$200.00	\$81.00
Maximum Profit	\$3,050.00	\$19.00
Maximum Loss	\$200.00	\$68.00
Breakeven	\$30.50	\$32.49

## Long Finish Low FRO Example

XYZ is trading at \$49.13. The \$50.00 strike price Finish Low FRO expiring in 63 days is trading at \$0.30 and the \$50.00 strike price standard listed put expiring at the same time is trading at \$2.25. The table below compares the cost, maximum profit, maximum loss and breakeven point of each possible trade if similar amounts of capital are invested in each.

	1 Long Put @ \$2.25	7 Long Finish Low FROs @ \$0.30
Total Cost	\$225.00	\$210.00
Maximum Profit	\$4,775.00	\$490.00
Maximum Loss	\$225.00	\$210.00
Breakeven	\$47.75	\$49.99



The table below illustrates the profit and loss potential at various closing prices and expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> prices. Remember that the underlying's closing price and the all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> will most likely differ.

**\$50.00 Strike Price**

**XYZ @ \$49.13                      63 Days to Exp.**

	<b>Long 1 Put @ \$2.25</b>		<b>Long 7 Finish Low @ \$.30</b>
<b>Stock @ Expiration</b>	<b>Put P &amp; (L)</b>	<b>AFSI* @ Expiration</b>	<b>Finish Low P &amp; (L)</b>
\$25.00	\$2,275.00	\$25.00	\$490.00
\$30.00	\$1,775.00	\$30.00	\$490.00
\$40.00	\$775.00	\$40.00	\$490.00
<b>\$42.84</b>	<b>\$491.00</b>	\$42.84	\$490.00
<b>\$47.75</b>	<b>\$0.00</b>	\$47.75	\$490.00
\$49.99	(\$224.00)	<b>\$49.99</b>	<b>\$490.00</b>
\$50.00	(\$225.00)	\$50.00	(\$210.00)
\$55.00	(\$225.00)	\$55.00	(\$210.00)
\$60.00	(\$225.00)	\$60.00	(\$210.00)

\*Amex FRO Settlement Index<sup>(SM)</sup>

Note that the Finish low FRO achieves its maximum profit potential at the expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> of \$49.99. Remember that the Finish Low FRO has a maximum value of \$100.00 per contract when the all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> is below the strike price. Between \$49.99 and \$42.85 the Finish Low FRO will outperform the standard listed put option; the long put however will outperform the Finish Low FRO if the underlying security closes below \$42.84. At \$50.00 and above both the long standard listed put option and the long Finish Low FRO will expire worthless and the capital invested will be lost.

## Maximum Profit, Loss and Breakeven Point for Short Positions

### Short Finish Low FRO

- Maximum profit is the premium received from the sale.
- Maximum loss is equal to \$100.00 less the premium received.



- Maximum loss occurs when the Amex FRO Settlement Index<sup>(SM)</sup> is below breakeven at expiration.
- Breakeven = strike price - \$0.01.

### Short Standard Listed Put Options

- The maximum loss is equal to the strike price less the premium received from the sale.
- Maximum profit is the premium received from the sale.
- Breakeven = strike price - the premium received.

### Maximum Profit, Loss and Breakeven Point Comparison Example

XYZ \$32.50 strike price puts are trading at \$2.00.

XYZ \$32.50 strike price Finish Low FROs are trading at \$0.81.

The table below illustrates the maximum gain, maximum loss and breakeven point for the short \$32.50 strike price put and the short \$32.50 strike price Finish Low FRO used in the above example.

	1 Short Put	1 Short Finish Low FRO
Premium per Contract	\$200.00	\$81.00
Maximum Profit	\$200.00	\$81.00
Maximum Loss	\$3,050.00	\$19.00
Breakeven	\$30.50	\$32.49

### Short Finish Low FRO Example

XYZ is trading at \$49.13. The \$50.00 strike price Finish Low FRO expiring in 63 days is trading at \$0.30 and the \$50.00 strike price standard listed put expiring at the same time is trading at \$2.25. The table below compares the income generated, maximum profit, maximum loss and breakeven point of



each possible trade if similar amounts of income are generated through short sales.

	<b>1 Short Put @ \$2.25</b>	<b>7 Short Finish High FROs @ \$0.30</b>
<b>Total Premium Received</b>	\$225.00	\$210.00
<b>Maximum Profit</b>	\$225.00	\$210.00
<b>Maximum Loss</b>	\$4,775.00	\$490.00
<b>Breakeven</b>	\$47.75	\$49.99

The table below illustrates the profit and loss potential at various closing prices and expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> prices. Remember that the underlying's closing price and the all day expiration Friday Amex FRO Settlement Index<sup>(SM)</sup> will most likely differ.

**\$50.00 Strike Price**

**XYZ @ \$49.13                      63 Days to Exp.**

	<b>Short 1 Put @ \$2.25</b>		<b>Short 7 Finish Low @ \$.30</b>
<b>Stock @ Expiration</b>	<b>Put P &amp; (L)</b>	<b>AFSI* @ Expiration</b>	<b>Finish Low P &amp; (L)</b>
\$25.00	(\$2,275.00)	\$25.00	(\$490.00)
\$35.00	(\$1,275.00)	\$35.00	(\$490.00)
\$40.00	(\$775.00)	\$40.00	(\$490.00)
\$42.84	(\$491.00)	<b>\$42.84</b>	<b>(\$490.00)</b>
<b>\$47.75</b>	<b>\$0.00</b>	\$47.75	(\$490.00)
<b>\$49.99</b>	<b>\$224.00</b>	\$49.99	(\$490.00)
\$50.00	\$225.00	\$50.00	\$210.00
\$55.00	\$225.00	\$55.00	\$210.00
\$60.00	\$225.00	\$60.00	\$210.00

\*Amex FRO Settlement Index<sup>(SM)</sup>

Note that at \$50.00 and above both the standard listed put option and the Finish Low FRO will expire worthless and the maximum profit potential



will be achieved. Between \$49.99 and \$42.86 the short standard listed put option will outperform the short Finish Low FRO. However, at \$42.84 and below the loss for the short Finish Low FRO will remain constant while the loss for the short standard listed put option will continue to increase until the maximum loss is reached when the underlying drops to \$0.00.

## **Summary**

At expiration, many standard listed option strategies will require the investor to take action. These actions may include buying or selling to close a position, exercising a long position, or accepting assignment on a short position. Additional trades will carry additional transaction costs that will reduce the profitability or add to the loss incurred with original trade. Exercises and assignment will change the risk reward parameters of the original trade. For example, if a short put position was assigned, the new risk now becomes the risk of stock ownership. If a long put was exercised without the underlying stock being held in the account, a short stock (unlimited risk) position would be established. Since Finish Low FROs are cash settled no additional transactions are necessary and risk reward parameters remain the same as the day the transaction was initiated. Finish Low FROs will probably outperform standard listed puts for a neutral to moderately bearish outlook, but will probably under-perform in a truly bearish situation. With a fixed maximum value, the profit and loss potentials of long and short Finish Low FROs are known and easily managed.



For the sake of simplicity, the examples shown do not take into consideration commissions and other transaction fees, tax considerations, or margin requirements, which are factors that may significantly affect the economic consequences of a given strategy. An investor should review transaction costs, margin requirements and tax considerations with a broker and tax advisor before entering into any options strategy.

Fixed Return Options (FROs) involve risk and are not suitable for everyone. Prior to buying or selling a FRO, a person must receive a copy of *Characteristics and Risks of Standardized Options*. Copies may be obtained from your broker, one of the options exchanges or The Options Clearing Corporation, One North Wacker Drive, Suite 500, Chicago, IL 60606 or call 1-888-OPTIONS or visit [www.888options.com](http://www.888options.com).

FROs exercise and assignment is based on an all day expiration day Amex FRO Settlement Index<sup>(SM)</sup> so it is possible for the standard listed options to be in-the-money at expiration and the FROs to be out-of-the-money or for the FROs to be in-the-money and the standard listed options to be out-of-the-money. An investor must understand FROs settlement before entering into any FROs transaction.

Any strategies discussed, including examples using actual securities and price data, are strictly for illustrative and education purposes and are not to be construed as an endorsement, recommendation or solicitation to buy or sell securities. Supporting documentation will be supplied upon written request.

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