What?

A cash covered put contains two separate positions: 1) cash and 2) written put option.

With a cash covered put position, a trader writes a put option against cash that is enough to buy a financial security. There can be two purposes: 1) speculate and 2) lower the purchase price of a financial security.

Example

We have $20,000 cash which is enough to buy 100 shares of AAPL at $200 per share. We write a put option (one contract) with a strike price of $200 and with a maturity date of January 18th at $1 per share. We collect $100 in total for writing the put option.

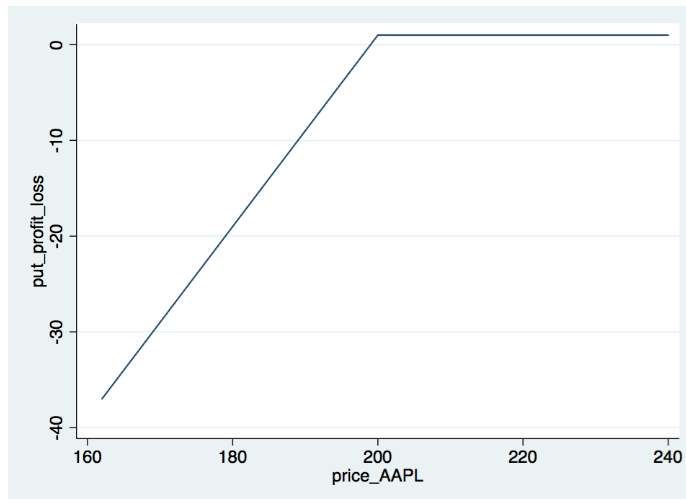
Possible outcomes:

- AAPL stock price goes below $200 (i.e. $180)
  - We get option assignment (i.e. buy 100 shares of AAPL at $200). We could have bought our AAPL shares at the market price ($180) but since we wrote a put option, we have to buy them at our strike price of $200.
  - Profit and loss from the option: $100 (option writing)
  - Profit and loss from AAPL shares: $180 (current market price) - $200 (AAPL cost, strike price) = -$20 per share (i.e. -$20 $\times$ 100 shares = -$2,000 total)
  - **Total profit and loss**: $100 - $2,000 = -$1,900.
- AAPL stock price stays above $200 (i.e. $210)
  - We do not get option assignment. We will keep our cash.
  - Profit and loss from the option: $100 (option writing)

Chart

We will now evaluate possible outcomes of writing the put option in our previous example. Note that, since it is hard to determine the premium, our exercise is based on exercise value.

```
set obs 40
gen price_AAPL = 160 + (_n*2)
gen put_price = 1
gen strike = 200
gen put_profit_loss = -(max(strike-price_AAPL,0) - put_price)
twoway (line put_profit_loss price)
```



The horizontal axis is the possible AAPL share price in the market. The vertical axis is the profit and loss based on possible AAPL share prices.

If our intention is to buy AAPL shares through writing the put option: written put makes is cheaper to buy AAPL as much as the option price we collected. However, if AAPL stock price goes above our strike price then we would not be able to purchase the AAPL shares.

If our intention is to speculate through writing the put option: as AAPL price goes above our strike price, we would not buy the AAPL shares and our speculation would be successful. However, if AAPL stock price goes below our strike price then we would end up buying the AAPL shares at our strike price.