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Understanding Options: How We Think About Options

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In the final installment of our Understanding Options series, Senior Investment Analyst Tom Dunlap brings together the key concepts behind calls, puts, covered calls, and collars to explain how options fit into a broader investment strategy. Rather than focusing on speculation or generating income, Tom explores how options can be used as thoughtful risk management and portfolio construction tools. Tom discusses how Grimes evaluates whether an options strategy is appropriate based on a client's financial plan, portfolio, and long-term objectives. Learn why the most effective options strategy isn't necessarily the most complex, but the one that best supports an investor's overall wealth management goals.

OTHER VIDEOS IN THIS SERIES:

- Understanding Options: Understanding Calls, Puts, and Why Options Exist
- Understanding Options: The Hidden Risks of Covered Calls
- Understanding Options: Protective Puts and Collars

VIDEO TRANSCRIPTION:

Hi, I'm Tom Dunlap, Senior Investment Analyst at Grimes & Company. Throughout this series, we've discussed calls, puts, and collars.

We believe all options conversations should start with the overarching objective, based on a financial plan.

That's because, in our view, options are simply tools.

The goal is not to maximize premium. It is not to maximize protection. And it is certainly not speculation.

The goal is to improve the range of potential outcomes.

At Grimes, we use options as risk-management and portfolio-construction tools designed to support broader financial planning objectives.

The client objective comes first. The strategy follows.

Every options discussion begins with one question:

What are we trying to accomplish?

Different objectives call for different tools.

If the goal is to protect capital over a specific period, a protective put may be appropriate.

A protective put creates a downside floor beneath a position. The investor pays a premium for that protection, much like an insurance policy.

That can make sense when a client wants to limit downside risk over a defined period.

The cost of protection can be high, and in some cases the objective may not even be pure protection. Oftentimes a collar is more appropriate.

A collar combines a put and a call. The put helps define the downside, while the call can help offset the cost of that protection.

The result is a narrower range of potential outcomes.

For many investors, that added predictability can be valuable.

Or maybe the client owns a concentrated stock position and wants to diversify over time.

Now a covered call may enter the discussion—not because we are trying to maximize income, but because we may be creating a disciplined framework to sell stock at a future price the client finds acceptable.

The key point is options can be complicated. We try to keep options strategies straightforward by letting the objective and financial plan drive the decision making process.

Once the objective is clear, we evaluate the underlying position, before even entering into a position with options.

Not every stock is equally suitable for an options strategy.

We look at the company's fundamental outlook, the technical backdrop, historical volatility, and how expensive options appear in the current market.

We also consider upcoming earnings announcements, dividend dates, and other company-specific events.

Then we look at the position within the client's broader financial plan.

How large is it? How concentrated is it? What are the unrealized gains? What role does it play in the household balance sheet?

Every conversation we have about options strategies is unique to the client.

Context matters.

We also analyze the options market itself.

We evaluate liquidity, bid-ask spreads, implied volatility, strike prices, expiration dates, and assignment risk.

Most importantly, we ask whether the premium being paid or received is reasonable relative to the outcome we are trying to create.

Just because an option is available does not mean it is worth using. The structure has to efficiently support the objective.

If it does not, we move on to a different tool or strategic plan.

Finally, we build the solution. The customized solution is based on client objectives, their financial plan, our view of the underlying stocks, and what the options market is giving us.

Every client situation is different. An options strategy, and any tax managed solution, should reflect those differences.

At Grimes, we use analytical tools to model potential outcomes and evaluate how different structures may behave across market scenarios.

The objective is not to predict the future. It is to prepare for it.

The biggest misconception about options is that they are mainly return-enhancement tools.

We view them differently.

Options can reshape risk, create more defined outcomes, support tax planning, assist with diversification, and improve decision-making.

In some cases, they can also help investors stay committed to a long-term plan during uncertain markets.

The best options strategy, if one is warranted at all, is usually not the one with the highest income, the most protection, or the most complexity.

It is the one that most efficiently supports the client's broader financial objectives.

Thank you for watching this series on options strategies.

If there's one lesson we'd leave you with, it's this: options are tools. And using them is, well, optional.

Their value doesn't come from the contracts themselves. It comes from how thoughtfully they're integrated into a broader investment and financial planning process, and that's where we believe they can provide the greatest benefit.

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