Stocks

Business

Stocks signify that the person owning the stocks are part owners of the corporation where they had put their hard –earned cash and other assets. Equity call options are contracts that give the option purchaser the right to purchase stocks within a certain time period. The following paragraphs explain in detail the advantages of purchasing an equity call option.

What do you understand by equity call options?

Equity call options are used by the buyers. Whereas, equity put options are exercised by the sellers. Basically, the purchaser of the equity call options is interested to invest in stocks (usually common stock). An equity call option gives the purchaser of the equity call option the right to invest purchase shares of stocks in the near future. For, the equity call option gives the option purchaser a certain number of days to invest in the stocks Brown, 2002; p. 1).

For example, the purchaser of an equity call option is given the right to purchase shares of stocks 200 shares of stocks at a March 2007 option price $50 the right to buy 200 shares of stocks until March 31, 2007 at the prevailing price of $ 50. This means that the purchases will only $ 50 for 200 shares or $1, 000 on March 25, 2007 if the price of the stock on March 25, 2007 is $ 58 per share. In short, the equity call option is a legal contract between the buyer (termed as call) and the seller (termed as put).

Also, the equity call option gives the caller or purchaser the right to purchase the stocks in the future without the added obligation to purchase it compulsorily. For, the purchaser of the equity call option can change his mind and let his equity call option expire without purchasing the stocks indicated in the equity call option contract. Here, the equity call option purchaser will pay a minimal premium amount to purchase a call equity option plan.

Describe situations where this type of investment would be applicable, to the individual and institutional investor.

Give Examples

The situations where this type of investment would be applicable to the individual and the institutional investor are as follows:

First, the equity call option gives both the individual and institutional investor the added right of benefiting from increases in the prices of each share of stock without the hassle of paying for the cost of purchasing the stocks outright (Nowak 1993, 173). For example, Mr. X bought an equity call option to purchase 100 shares of stocks on December 13, 2007 at the current stock market price of $10 per share of stock which will expire on February 28, 2008. On February 25, 2008, he exercises his right and buys the 100 shares at $10 per share. Mr. X then sells his stocks at the February 26, 2007 prevailing market price of $13 per share. He gains $3 per share from selling his shares of stocks. Another way to gain here is to sell his equity stop option to another person. If Mr. X will also generate profits if he bought the equity option contract at $ 5 and later sells this contract at $15.

Second, the equity call option gives both the individual and institutional investor the advantage of increasing their income against the present stocks owned. The stockholders will receive dividend income based on his number of share held. This means that if he exercises his equity call option, he or she will increase his total dividend income (Culp 2001, 81). For example, the company announces on December 13, 2007 that it will distribute dividends to stockholders on record as of January 10, 2008 on the dividends amounting to $10, 000. the dividend per share is arrived at by dividing the $10, 000 dividends declared by the total outstanding shares of stocks as of January 10, 2008.

The dividend income is then arrived at by dividing the $10, 000 dividends by the outstanding shares. The dividend per share of stock is $ 0. 10 if there are 100, 000 shares outstanding on January 10, 2008. Thus, the exercise of the equity call option to will increase the number of shares and consequently the total dividend income received.

Third, the equity call option gives both the individual and institutional investor the advantage of getting more control votes in the corporation they invests in. the stockholder have to right to vote on issues of expansion, closure of a branch, branch expansion into uncharted competitors' territories and increase or decrease in the company's products and services offered to the public (Trigeorgis 1995, 26). For example, the exercise of the equity call option will increase the equity call option purchaser's number of shares of stocks. Consequently, he will also increase the number of votes he or she can cast on vital business issues. More importantly, the institutional investor could use his equity call option to invest in stocks of the competitors.

Advantageously, this investor will now know the business secrets of the competitors because all stockholders will be given a copy of the balance sheet and income statement of their invested companies.

The equity call option gives the purchaser of the option the right to purchase the shares of stocks within a given time period. There are many advantages in purchasing equity call options. One such advantage focuses on profiting from the increase in the prices of the stocks listed in the stock exchanges like Wall Street. Conclusively, the purchaser of the equity call option will gain profits through dividends declared by the companies and the selling of his or her option stocks at a price bigger than his purchase price (Garrison 1990, 132). The above paragraphs have proven through examples why equity call option is an excellent and popular investment strategy.