My Luck in the Markets (February 16, 2019)

“And you call yourself a stockpicker!”

This was what my adviser at a brokerage in St. Louis said to me over the phone some years ago. This was about six months after I bought Allied General, a financial services firm that fell into bankruptcy. I had carefully researched Allied for several weeks before buying a significant block of shares. That acquisition was followed by a loss in Frontline, an oil shipping company based in Bermuda. I bought 700 shares of the company at around $30, considered selling at $15--excess shipping capacity suddenly drove the market lower—and finally cashed out at $7. Yet another serious loss.

No discussion of my acumen should omit the MicroStrategy puts I sold. You familiar with the options market? This gets a bit complex, but when you sell a put, you’re selling another trader the right to sell you the stock the put is written against—in this case MicroStrategy. This gave the party on the other side of my trade the right to sell Micro to me at $50. I made money by selling the put. I made money this way without even having to buy any shares. In other words, I sold Micro puts at a strike price of $50 a share when it was trading about $150. An accounting scandal at the firm had already taken the stock down from an approximate high of $320, and I thought it was sure to find stability after falling about 60 percent. Dead wrong. Traders and investors continued to liquidate their holdings in the stock. I think it finally found support in the teens, but I was obliged to pay $50 a share for 200 shares (because I sold two put contracts). Not for nothing did a wag on the electronic message boards rename the company Macrotragedy. I may have lost as much as $4,000 on that one.

And you call yourself a stock picker. . .

So naturally I was thrilled when one of my selections turned into a success. An accidental success, perhaps, but a success nonetheless. I bought Intel at $22 a share in the summer of 2011. I had always shied away for tech stocks, because they pay such a low dividend, and often no dividend at all. Apple, Amazon, Google, FaceBook are paying a pittance or nothing at all. And I always thought, why buy a stock but for the benefit of a respectable dividend? Analysts bullish on a particular stock have often predicted share appreciation, and sometimes they’re right. That’s the substitute for a dividend. But stocks don’t always perform as expected. There are things in business that are seldom predictable--interest rates, the performance of the economy, the direction of a stock, the behavior of the market.

Who would have predicted in the spring of 2009, when the Fed drove down interest rates, that ten years later a Treasury note would still be yielding less than 3 percent?

In July 2011, the Intel board of directors raised the annual dividend to $1.26. This meant that the yield was about 3.8 percent—more than acceptable for a stable tech stock. The company’s price-earnings ratio (or multiple) was just around eight, a very reasonable figure.

These are the fundamentals that a stockpicker in the summer of 2011 was presented with: A stable company trading at a low multiple with a respectable yield and a history of raising the dividend. Even I could see the opportunity, and I took it. I bought 500 shares of the company. And it's now trading at $50. I bought it, remember, at $21.

Here are the possibilities. I can of course sell the stock and take a profit of about $14,000. I might do that just to console myself for my other trades. Or—a far more tempting possibility—I could sell call options against the stock. Calls are the opposite of puts and are far easier to understand. If I sell five call options against Intel, I am selling some other trader the right to buy 500 shares of the company from me. (Each contract consists of 100 shares of stock.) Then I have to consider the strike price—the point at which the option can be exercised by the other trader—and the month I want to trade.

I often go far out. The Chicago Board Options Exchange lists Intel calls that are trading as far away as January 2021. If I sold the January 2021 call, it would remain a valid contract until then. The counterparty to my trade, in other words, would have nearly two full years to hold the contract and consider buying from me 500 Intel shares at $50. The next question is the strike price. The January 2021 call is trading at $7.50 a contract. For five contracts—500 shares—I could receive $3,750 (minus the commission of a hundred bucks or so).

Doing so commits me to selling Intel to someone at $50 a share for the next two years. My hope would be that the stock remains at or under that price. I don't really want to lose the stock, but the $3,750 is equivalent to about six years of the company's dividends. The party buying my options, of course, wants the stock to rally, preferably to $100 a share—give or take. That way he can buy the stock from me at $50 and resell at a much higher price. That's my risk. His risk is that the stock languishes for the next two years.

So what should I do? "Don't do anything," my friend Sam told me. He's an older guy who traded foreign currency futures for years. "You've made too many blunders in the market. Don't add to your illustrious record."

©David Cohen, February 16, 2019