



WHAT'S IN YOUR PORTFOLIO? GOT OPTIONS? THE OPTIONSELLERS.COM CRASH AND EXPLOSION

By: Jeremy E. Deutsch *

Many of you will have heard about OptionSellers.com going under as a result of bad trades in connection with the crazy surge in energy volatility. The CEO, James Cordier, put out an emotional video apologizing for crashing his firm, losing all of his clients' money, and even leaving his clients owing money on the failed options trades. I was discussing this fact – the losses beyond the actual amounts of the investment – with a couple of very financially sophisticated friends of mine this morning and they were confused about how the firm's clients could lose more than the actual amount of their investments trading options. If they were confused, perhaps you are, too.

Options are bets on the price movement of the underlying reference security or thing, be it a stock price or a commodity (like oil or natural gas) or a basket of things. You can have a call option, the right to make someone sell you the thing if the price of the thing rises above a certain point, or a put option, the right to make someone buy something from you if the price falls to a certain level. Let's focus for a moment on "writing a call". This happens when a person essentially sells a call option to you. This means that you, the buyer, can "call" the option if the thing reaches a certain price, right? Well, the writer of the call can sell the call to you as either a covered call, meaning that the writer owns the thing that he or she may be required to deliver when you call the thing in which case his or her liability is limited, or a naked call, meaning that he or she DOES NOT OWN the thing. If you have written naked calls, the province of only the most sophisticated and risk seeking traders, than you have potentially unlimited liability for the loss as there is really no ceiling on how high a price for a stock can go and you can't, as with a covered call, just deliver the thing and walk away. You may have to go into the market to cover, if you can. (With naked puts, at least, the floor is zero as the price of the stock can't go below zero but with naked calls, the sky is the limit). You could thus lose all the money you put into the trade and then still be on the hook for more on that trade. Pretty scary, no?

That could be what happened to the OptionSellers.com customers. They may have had, in their individual accounts, naked calls. This may be why they lost all their money and then found themselves on the hook for more losses. Those losses could have theoretically been unlimited and would have been until the clearing house liquidated their positions and stopped the bleeding (and then sent them all bills for the realized losses).

Suitability is a concept most investment professionals are aware of. Broadly, the professional performs an evaluation of what the appropriate investment is for a particular person given that person's objectives, status, sophistication, time horizon, and risk tolerance. If your investment professional is not making suitable investments for you, and has the discretion to determine what you will invest in, then you have a problem.

To borrow from an old advertising line, let me ask you this: What's in your portfolio? Do you know?

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