Managing Concentrated Positions with Options Strategies

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Many investors accumulate a substantial portion of their stock portfolio in a single company, often through executive compensation, inheritance, or a long-term investment in a successful stock. While such concentration can lead to significant wealth creation, it also introduces considerable financial risk. Overconcentration risk can threaten retirement and legacy goals, as the fortunes of a single stock can heavily impact an investor’s net worth.

This varies based on each individual’s financial picture. To effectively assess your risk, it’s important to evaluate your broader financial plan, risk tolerance, and long-term goals. Ask yourself the following questions:

- How significant is the position relative to your liquid net worth?
- If taxes weren’t a concern, would you still hold this position?
- Is your financial plan overly reliant on the success of this one stock?
- What are your near-term cash flow needs?
- Are you willing and able to pay the taxes required to diversify?
- Do you want to use this asset for charitable giving or legacy goals?

Many investors find themselves taking on too much company specific risk, but are unwilling to diversify due to the significant tax burden that would be incurred if they were to sell the position outright. This is where options strategies come into play, they aim to reduce risk without an immediate tax bill.

Depending on your goals and financial needs, options strategies can be structured to hedge against potential losses, generate income, and unwind positions in a tax neutral way. These solutions generate tax alpha and can build in the ability to strategically liquidate the position. Option premiums paid can be used to offset taxes, and if options written expire worthless, tax losses can be offset against gains to help unwind the underlying stock position. Your wealth consultant can help you build a customized hedging strategy based on your goals

For those who are looking to use options strategies to mitigate their risk exposure from an individual stock, the following strategies may be appropriate:

1. **Protective Puts**

This strategy entails buying put options, which give you the option to sell at a predetermined price, called the strike price, for a specified period of time. Protective puts act as an insurance policy for the stocks you own, as you set a downside price that is comfortable with your risk tolerance. Ideal candidates include those looking for wealth preservation and are comfortable paying premiums. Stockholders retain ownership if the stock rises, allowing them to benefit 100% on the upside. If the price of the stock falls below the strike price, the owner is required to sell, so there is a chance a sale will happen which will trigger a taxable event.

2. **Covered Calls**

This is a risk mitigation strategy that produces income. Stockholders generate income by selling call options, which are the right to buy a stock at a specific price. If the stock goes down or stays flat, you collect premiums and dividends, if any, and keep the shares. In these scenarios, you can also utilize the tax losses from the option expiring worthless. If the stock price goes up, the upside is limited, but overall generates a positive return. It generates a tax loss on the option which gives the ability to harvest gains.

3. **Collars**

Collars provide maximum protection on the downside while generating income. This entails purchasing a put option while also selling a call option, combining the two strategies previously discussed. This sets a minimum price on the downside while limiting upside. This provides less income than the covered call strategy as premiums are both paid from buying puts and received from selling calls. This can take off up to 70% of the risk from the stock position.

It is important to take a comprehensive approach when evaluating if these strategies are appropriate. Options strategies are useful for those who are relying on the proceeds to secure their financial goals, reduce risk, and are comfortable limiting upside.

Those who are comfortable with the volatility of concentrated positions and want to attempt to maximize upside capture are not good candidates. Also, if the plan is to donate these assets to charity or to bequeath them to the next generation, this may not be the best approach.

Coordinate with your wealth consultant and tax advisor to understand how these strategies could benefit your financial plan.