



When Should I Cover My Downside?

Covering ones downside risk is a function of your time horizon. It's also a measure of your ability to stick with the strategy you find yourself trading. Finally covering is a measure of understanding the market is capable of inflicting more pain than you have capital.

The RUT condor in my account has a shorter "leash" than the GE I bought for my IRA. You have to make distinctions of how you want to trade a position. The key is how you want to make your position. As long as I make money who's to say what the right way to manage my position. Trading is an "art and not a science" so if you're comfortable with long a thousand GE, inherent is the potential risk of a long stock position. A short put spread is a lot different because of the time horizon and the nature of options.

Warren Buffet made 2 very public trades last year in GS and GE. Both trades might be considered buy writes because they he was issued stock with a convertible feature or warrant that gave him varied writes associated with the risk of owning stock. Both trades went against him in a very public ways that call his strategy into question. Neither trade looks as bad today as a matter of fact one is profitable while the other isn't a loser unless he takes it off now.

His time horizon is different than any other investor because of his time horizon. My time horizon's is different than yours or anyone else and ultimately there is no right answer how long to hold versus fold.

Ego can cloud the vision of when to get out of a loser or at least covering the downside risk of a bad trade. It's a struggle once you've come up with several good reasons to

get into a trade to end it quickly. If you buy a stock as a swing trade or a day trade and it's against you immediately maybe you ought to consider a tight stop or a short leash. If you're considering an individual equity for a core holding because you're buying a business you may have more patients with the trade. Use an option to protect yourself and potentially create a dividend or an upside stop limit.

Option Traders can always buy puts to cover downside risk yet few actually act on that tact. I personally like using a calendar spread downside to protect an index condor. A collar is buying a put and selling a call to hedge a long stock position. An old option trader saying is "puts are your friends" so get familiar with the feeling owning a put or two to cover downside risk.

In conclusion always understand your risk is partly a function of having a solid time horizon for a trade. Never be afraid to own a few puts that provide the protection your downside dictates.