To: P&G Employees
From: John B. Cornetet, CPA, J.D., CFP 513-771-2444

Re: No Cost Stock Collars

One of the ways to protect the downside risk of P&G stock dropping rapidly, either just prior to exercising stock options or just after retirement and before you can diversify, is to use a stock collar. First, some terminology.

CALL
A Call is the right for someone else to call your stock away from you. For example, I will give you $4 per share for the right to call your stock (buy it from you) at $62 dollars per share. The current trading price is $56 per share. I have the right to call your stock anytime in the next four months. While you hold the stock, you receive the dividends. If the price doesn't get to $62, I will not buy your stock and you keep the $4 per share.

PUT
A Put is the right to force someone to buy your stock at a prescribed price for a prescribed time period. You have the right to put the stock to them. Thus you pay me $4 per share for the right to force me to buy your stock for $50 per share anytime within the next four months. You keep the dividends. If the stock does not drop, I keep the $4 and you never force me to buy. You are free to sell on the open market for the current trading price.

NO COST COLLAR
Assume you have a 1,000 shares of P&G stock trading at $56. You must sell these shares in the near future and you are afraid the market may drop. You can protect the stock by selling a call at $62. Thus, the most you will get is $62. You take the $4 Call money and buy a Put at $50 which cost $4. Thus, you are not out of pocket any money. However, you have put a collar around the stock. You will not get any more than $62 but more importantly not less than $50.

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When the stock propped from $114 to $65 overnight, if you had stock options that had to be exercised, you would have lost hundreds of thousand of dollars without this protection. Those who protected the options with a stock collar got over $100 per share when the market was at $65.

Consider using a no cost collar on any block of stock that must be sold in the near term either as a part of the diversification plan, or for living expenses and on stock options coming due and you want to eliminate the downside risk

John