



OPTIONSMART  
3-D OPTION TRADING STRATEGIES

# 3-D Research Note on CSCO



Chart courtesy of StockCharts.com

| # | Date   | Most Recent News   | Stock's Reaction |
|---|--------|--|------------------|
| 1 | 14-Jul | CSCO combined R&D investment in China hit US\$155 million by the middle of this year, fivefold compared with its original schedule   | negative         |
| 2 | 16-Jul | CSCO downgraded at Credit Suisse to Neutral from Outperform, tgt cut to \$24 from \$31 regarding the co. as best in class with attractive valuation for long-term oriented investors | positive         |
| 3 | 17-Jul | CSCO to develop new generation of data centers   | positive         |
| 4 | 25-Jul | CSCO agreed to acquire software and services firm Pure Networks for \$120m to provide integrated home networking-management applications for the development of new products         | positive         |
| 5 | 30-Jul | CSCO enhances data security for healthcare and retail organizations  | negative         |
| 6 | 31-Jul | CSCO is expected to report a 10% rise in Q4 revenue as demand for infrastructure-networking gear remains strong  | negative         |

**OUR RECOMMENDATION: STRONG BUY**

**RECOMMENDED TRADING VEHICLE:**

Open Debit Call Spread:

Buy to Open CYQIR CSCO Sep 17Call IV 43.2 Delta .96

Sell to Open CYQIZ CSCO Sep 21Call IV 37.7 Delta .67

Debit 3.20

Position Net Delta .29

Max Gain 0.80

Max Risk 3.20

Target Credit 3.77

WEEKLY CHART



Chart courtesy of StockCharts.com

| Key sector components    | Fundamentals   |
|--------------------------|--|
| AT&T INC. (T)            | Trailing P/E (15.61); Forward P/E (9.56); PEG (1.09); EPS Trends-bearish         |
| MICROSOFT CP (MSFT)      | Trailing P/E (15.03); Forward P/E (10.78); PEG (1.09); EPS Trends-mixed          |
| APPLE INC (AAPL)         | Trailing P/E (34.06); Forward P/E (25.89); PEG Ratio (1.24); EPS Trends- mixed   |
| CISCO SYS INC (CSCO)     | Trailing P/E (16.92); Forward P/E (12.82); PEG Ratio (1.02); EPS Trends-neutral  |
| INTL BUSINESS MACH (IBM) | Trailing P/E (16.94); Forward P/E (13.28); PEG Ratio (1.32); EPS Trends- bullish |

|   |   |   |
|---|---|---|
|   | Residential construction will likely decline at a 25% annual rate and take about 1% off the GDP change, but the rate of decline is slowing.   | ✓ |
| ✓ | Consumer Confidence: 51.9 vs. 50.1 consensus and 51 in June - "suggesting there has been no significant improvement, nor significant deterioration, in business or labor market conditions."  |   |
|   | Initial Q2 GDP estimates of +1.9% fell well short of the +2.3% consensus, although it was still more than double last quarter's 0.9%. 2007 annual growth was revised up 1.0% to 4.8%, while Q4 GDP growth was revised down 0.8% to -0.2% - prompting further speculation that may have been the launching pad of a U.S. recession. The IMF said there's no end to housing slump in sight. The fallout will continue to leak outside of just housing | ✓ |
| ✓ | ICSC Retail Sales: +1.2% (previous two weeks +0.1% and +0.2%). Strong June same-store sales reports from retailers confirm that the fiscal stimulus checks are providing a huge boost to consumer spending.   |   |
|   | Initial Jobless Claims came in much higher than expected - 448,000 vs. 393,000 consensus. The 4-week average jumped to 393K from 382K.  | ✓ |
|   | Q2 Personal Consumption rose 1.5%, just short of the +1.7% consensus. Core PCE +2.2% vs. +2% consensus.   | ✓ |

## 3D CHECK LIST

| BULLISH | FACTORS  | BEARISH |
|---------|--|---------|
|         | <b>Technicals</b>  |         |
|         | Bullish daily MACD, bearish weekly MACD                                    |         |
|         | Daily Stochastic Oscillator oversold, bearish weekly Stochastic Oscillator |         |
| ✓       | The stock is in the short-term upward trend                                |         |
| ✓       | Support at 21.5, 20.8  |         |
|         | Resistance at 23.3   | ✓       |
|         | <b>Fundamentals</b>  |         |
| ✓       | Forward P/E (13.01) < Trailing P/E (17.18)                                 |         |
| ✓       | PEG (1.05)   |         |
| ✓       | P/S (3.36)   | ✓       |
| ✓       | Operating Margin (24.00%), ROE (25.85%)                                    |         |
|         | Neutral EPS revisions trend  | ✓       |
|         | <b>Market Play</b>   |         |
| ✓       | Program trading buy orders at 21.7 after Jul 23                            |         |
| ✓       | Implied volatility (41.54%) > Historical volatility (26.28%)               |         |
|         | Mixed reaction on the latest positive news (see the chart above)           | ✓       |
| ✓       | Trading volumes go up after Jul 28   |         |
| ✓       | Unusually high option trading volumes for Aug-Jan9 20-25 Calls and Puts    |         |

Overall Rating: **BULLISH**

## BULLISH PLAY

## BUY STOCK

| Stock Symbol | Last Stock Price | Recommended Entry Stock Price | Break-even | Sum Invested (per share) | Projected Stop Price | Max Loss (per share) | Max Profit (per share) | Exit Price (Target Price) | Target Profit (per share) | Target Return |
|--------------|------------------|-------------------------------|------------|--------------------------|----------------------|----------------------|------------------------|---------------------------|---------------------------|---------------|
| CSCO         | 22.05            | 21.50                         | 21.50      | 21.50                    | 20.50                | 1.00                 | Unlimited              | 22.60                     | 1.10                      | 5.1%          |

## BUY CALL

| Stock Symbol | Last Stock Price | Expiration Month | Strike Price | Option Symbol | Recommended Entry Stock Price | Entry Call Option Price | Break-even | Max Profit (per one contract) | Sum Invested (per one contract) | Exit Price (Target Price) | Target Profit (per one contract) | Target Return |
|--------------|------------------|------------------|--------------|---------------|-------------------------------|-------------------------|------------|-------------------------------|---------------------------------|---------------------------|----------------------------------|---------------|
| CSCO         | 22.05            | Sep-08           | 21.00        | .CYQIZ        | 21.50                         | 1.43                    | 22.43      | Unlimited                     | 1.43                            | 1.64                      | 0.21                             | 15.0%         |

## BULLISH PUT SPREAD

| Stock Symbol | Last Stock Price | Expiration Month | Lower Strike | Option Symbol | Higher Strike | Option Symbol | Recommended Entry Stock Price | Entry Credit | Break-even | Max Profit (per one contract) | Sum Invested (per one contract) | Exit Debit (Target Debit) | Target Profit (per one contract) | Target Return |
|--------------|------------------|------------------|--------------|---------------|---------------|---------------|-------------------------------|--------------|------------|-------------------------------|---------------------------------|---------------------------|----------------------------------|---------------|
| CSCO         | 22.05            | Sep-08           | 17.00        | .CYQUR        | 21.00         | .CYQUZ        | 21.50                         | 1.15         | 19.85      | 1.15                          | 2.85                            | 0.75                      | 0.40                             | 14.1%         |

## BULLISH CALL SPREAD

| Stock Symbol | Last Stock Price | Expiration Month | Lower Strike | Option Symbol | Higher Strike | Option Symbol | Recommended Entry Stock Price | Entry Debit | Break-even | Max Profit (per one contract) | Sum Invested (per one contract) | Exit Credit (Target Credit) | Target Profit (per one contract) | Target Return |
|--------------|------------------|------------------|--------------|---------------|---------------|---------------|-------------------------------|-------------|------------|-------------------------------|---------------------------------|-----------------------------|----------------------------------|---------------|
| CSCO         | 22.05            | Sep-08           | 17.00        | .CYQIR        | 21.00         | .CYQIZ        | 21.50                         | 3.20        | 20.20      | 0.80                          | 3.20                            | 3.77                        | 0.58                             | 18.0%         |

## SHORT GLOSSARY

**Break-even.** Point at which gains equal losses. This is the market price that a stock must reach for an option to avoid loss if exercised. For a call, the break-even equals the strike plus the premium paid.

**Call option.** The right, but not the obligation, to buy the stock at a predetermined price (also known as the strike) at any moment before the expiration date for a paying a premium.

**Put Option** - the right, but not the obligation, to sell stock at a predetermined price (also known as a strike) at any moment before the expiration date.

**Expiration Date.** The day when an option contract becomes void (the Saturday after the third Friday of the expiration month).

**In-the-Money Option.** An option that has intrinsic value. A call (put) option is in-the-money if the strike is less (greater) than the current market price of the stock.

**Intrinsic Value:** The value of an option if it were to expire immediately with the underlying stock at its current price or the amount by which an option is in-the-money. For call options, this is the difference between the stock price and the striking price, if that difference is a positive number, or zero otherwise. For put options it is the difference between the striking price and **Spread.** A position with long and short options of the same type on the same underlying stock or index.

**Time Value.** Amount by which the current market price of an option exceeds its intrinsic value (the difference between the stock price and the strike). This additional value of an option is due to the volatility of the market and the time remaining until

### Auto-trade in 5 easy steps

| optionsXpress  | thinkorswim   |
|--|---|
| 1. Log into your brokerage account.  | 1. Log into your brokerage account.   |
| 2. Select Xecute, select OptionSmart as an Investor Publisher  | 2. Select Autotrader, click Sign Up/Newsletter Providers and choose OptionSmart as newsletter provider                          |
| 3. Select a service  | 3. Select Autotrader Management, click Allocations (per trade)  |
| 4. Determine Amount Type (Specific Dollar Amount, # of Contracts/Shares, % of Cash Available, % of Buying Power, % of Total Account Value) | 4. Determine Amount Type (Specified Dollar Amount, Specified Quantity, % of Available Buying Power, % of Net Liquidating Value) |
| 5. Select a Trade Amount   | 5. Select a Trade Amount  |

There is risk in trading options. One's financial suitability should be considered carefully before placing any trades. Past performance is not indicative of future results.

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