TRADING CENTRAL
MARKETS NEVER SLEEP®

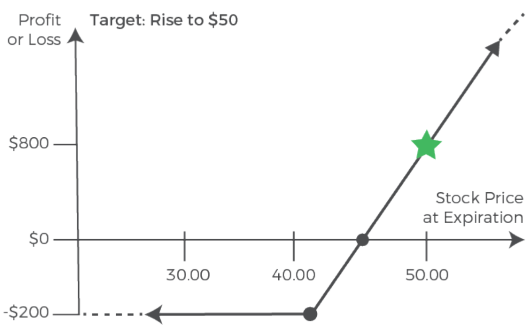
Guide to Options Strategies

A breakdown of key options strategies to help you better understand the characteristics and implications of each.

Buying Options for Leveraged Returns

Long Call (Bullish)

The strategy is to buy call options with the expectation that the stock price will rise before expiration, then sell them for a profit. It's a way to profit from a stock's growth without the up-front capital outlay and risk of owning the stock; the trade-off is that the rise must happen prior to expiration. Investors might also exercise in-the-money call options to purchase stock at a discount from market value.



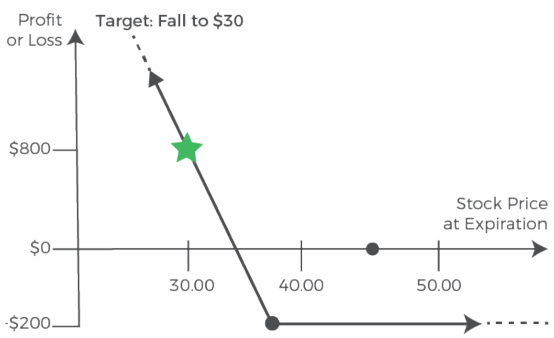
Example Trade

1. Buy 1 JUL 40 Call @ $2

- Profit is theoretically unlimited.
- If the price is $50 at expiry, there is a profit of $800. This is the maximum profit possible.
- The breakeven point is $42.
- If the price is $40 or lower at expiry, there is a loss of $200. This is the maximum loss possible.

Long Pull (Bearish)

The strategy is to buy put options with the expectation that the stock price will decline before expiration, at which point the investor could sell them for a profit. It's a way to profit from a stock's decline without the un-limited risk and margin requirements of selling the stock short; the trade-off is that the decline must happen prior to expiration.



Example Trade

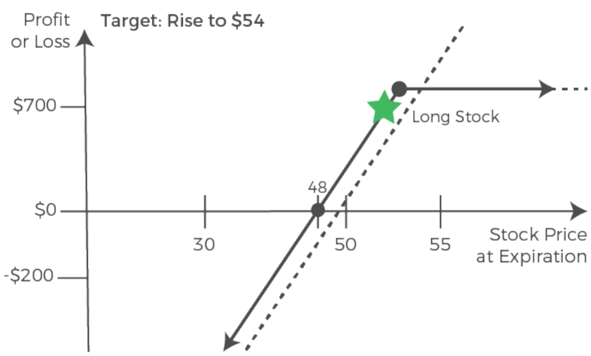
1. Buy 1 JUL 40 Put @ $2

- A lower stock price increases the profit. The maximum profit of $3800 occurs if the price is 0$ at expiry
- If the price is $30 at expiry, there is a profit of $800.
- The breakeven point is $38.
- If the price is $40 or higher at expiry, there is a loss of $200. This is the maximum loss possible.

Income or Insurance for Stock Investors

Buy Write (Bullish)

The strategy is to buy stock while selling call options to earn premium income and thereby lower the cost basis of owning the stock. The trade-off is giving up additional profits if the stock price rises above the strike price, at which point the stockowner must sell the shares. The only way to avoid assignment in this case and keep the shares is to buy the calls back, which gets more expensive during a rally.



Example Trade

1. **Buy 100 Shares of Stock @ $50**
2. **Sell 1 JUL 55 Call @ $2**

- If the price is $55 or higher at expiry, there is a profit of $700. This is the maximum profit possible.
- If the price is $54 at expiry, there is a profit of $600.
- The breakeven point is $48.
- A lower stock price increases the loss. The maximum loss of $4800 occurs if the price is $0 at expiry.

Married Put (Bearish)

The strategy is to buy stock while also buying put options for downside protection. If the stock falls below the strike, the investor may exercise the puts to sell the shares above market value. The trade-off is the cost. If the investor later decides they are unwilling to sell the shares at the strike, or no longer values the protection, they may be able to sell the puts to recoup some of the cost.

Example Trade

1. **Buy 100 Shares of Stock @ $52**
2. **BUY 1 SEP 50 Put @ $2**

- If the price is $55 or higher at expiry, there is a profit of $700. This is the maximum profit possible.
- If the price is $54 at expiry, there is a profit of $600.
- The breakeven point is $48.
- A lower stock price increases the loss. The maximum loss of $4800 occurs if the price is $0 at expiry.

Net Debit Vertical Spread

Bull Call Spread (Bullish)

The strategy is to buy call options with the expectation the stock price will rise, while selling short (writing) an equivalent number of call options at a higher strike to help finance the long call position. The trade-off is that the short call limits the profit potential. This type of vertical spread is a way to profit from a stock's growth without the up-front capital outlay and unlimited risk of buying the stock.

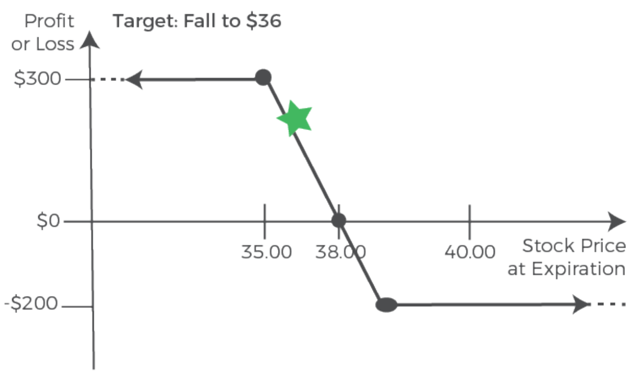
Example Trade

1. **Buy 100 Shares of Stock @ $52**
2. **Buy 1 SEP 50 Put @ $2**

- Profit is theoretically unlimited
- If the price is $57, there is a profit of $300.
- The breakeven point is $54.
- If the price is $50 or lower at expiry, there is a loss of $400. This is the maximum loss possible.

Bear Put Spread (Bearish)

The strategy is to buy put options with the expectation the stock price will decline, while selling short (writing) an equivalent number of put options at a lower strike to help finance the long put. The trade-off is that the short put limits the profit potential. This type of vertical spread is a way to profit from a stock's decline with-out the unlimited risk and margin requirements of selling the stock short.



Example Trade

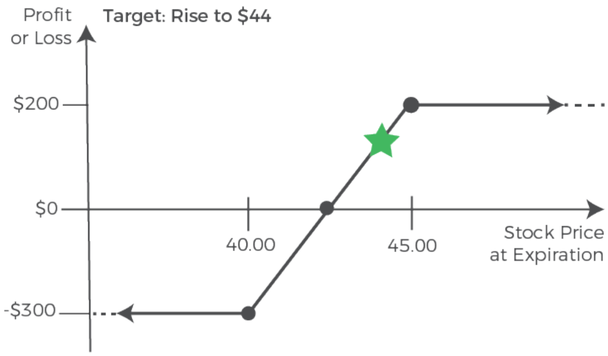
1. **Buy 1 JUL 40 Put @ $3**
2. **Sell 1 JUL 45 Put @ $1**

- If the price is $45 or higher at expiry, there is a profit of $300. This is the maximum profit possible.
- If the price is $44 at expiry, there is a profit of $200.
- The breakeven point is $42.
- If the price is $40 or lower at expiry, there is a loss of $200. This is the maximum loss possible.

Net Credit Vertical Spreads

Bull Call Spread (Bullish)

The strategy is to sell short (write) put options on a bullish stock in order to generate a known initial cash inflow, while buying an equivalent number of put options at a lower strike price to limit the downside risk. The expectation is the stock price will rise above both strikes at expiry so that the investor gets to keep the net credit received on opening theposition.



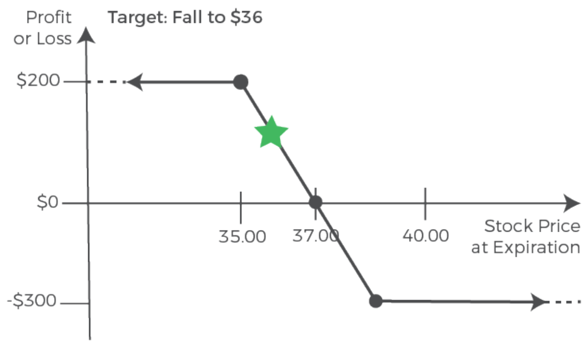
Example Trade

1. **Buy 1 JUL 40 Call @ $1**
2. **Sell 1 JUL 45 Call @ $3**

- If the price is $45 or higher at expiry, there is a profit of $200. This is the maximum profit possible.
- If the price is $44 at expiry, there is a profit of $100.
- The breakeven point is $43
- If the price is below $40 or lower at expiry, there is a loss of $300. This is the maximum loss possible.

Bear Put Spread (Bearish)

The strategy is to sell short (write) call options on a bearish stock in order to generate a known initial cash inflow, while buying an equivalent number of call options at a higher strike price to limit the upside risk. The expectation is the stock price will fall below both strikes at expiry so that the investor gets to keep the net credit received on opening the position.



Example Trade

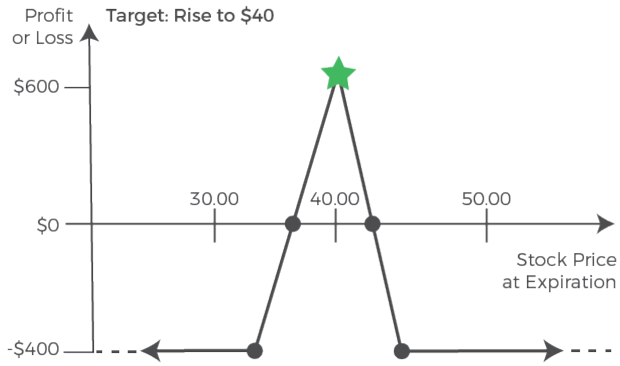
1. **Buy 1 JUL 40Put @ $1**
2. **Sell 1 JUL 35 Puts @ $3**

- If the price is $35 or lower at expiry, there is a profit of $200. This is the maximum profit possible.
- There is a profit if the price at expiry is between $36 and $100.
- The breakeven point is $37.
- If the price is below $40 or higher at expiry, there is a loss of $300. This is the maximum loss possible.

Crafting a Profit Range Using Three Legs

Long OTM Call Butterfly (Bullish)

The strategy is a combination of a bull call spread and a bear call spread that fixes a profit range around a bullish target price. As the price moves away from this target in either direction, profits diminish toward a maximum loss. The trade involves selling two out-of-the-money (OTM) calls at a middle strike, while buying one higher strike and one lower strike call. Investors aim to take profits before expiry.



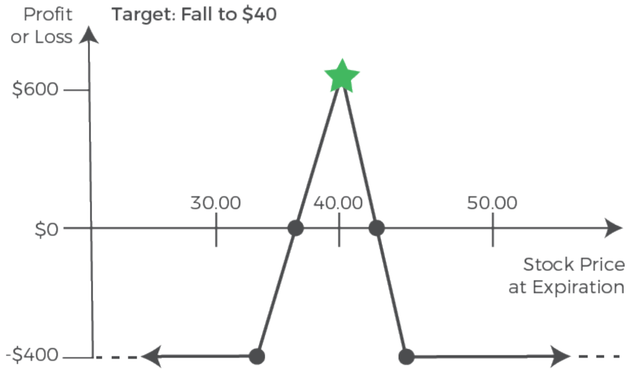
Example Trade

1. **Buy 1 JUL 30 Put @ $11**
2. **Sell 2 JUL 40 Puts @ $4**
3. **Buy 1 JUL 50 Call Put @ $1**

- If the price is $40 at expiry, there is a profit of $600. This is the maximum profit possible.
- There is a profit if the price at expiry is between $34 and $46.
- If the price is below $30 or above $50 at expiry, there is a loss of $400. This is the maximum loss possible.

Long OTM Put Butterfly (Bearish)

The strategy is a combination of a bull put spread and a bear put spread that fixes a profit range around a bearish target price. As the price moves away from this target in either direction, profits diminish toward a maximum loss. The trade involves selling two out-of-the-money (OTM) puts at a middle strike, while buying one higher strike and one lower strike put. Investors aim to take profits before expiry.



Example Trade

1. **Buy 1 JUL 30 Put @ $1**
2. **Sell 2 JUL 40 Puts @ $4**
3. **Buy 1 JUL 50 Call Put @**

- If the price is $40 at expiry, there is a profit of $600. This is the maximum profit possible.
- There is a profit if the price at expiry is between $34 and $46.
- If the price is below $30 or above $50 at expiry, there is a loss of $400. This is the maximum loss

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Glossary of Options Terms

Assignment – this is a notice received by an option writer stating the option sold has been exercised by the purchaser of the option, and the seller of the option has the obligation to sell shares.

Call – a call is a type of option contract that gives the owner or holder the right to buy an underlying security at a certain price within a specific period of time.

Exercise – to exercise an option contract means to use the right to buy or sell an underlying security at a specified (strike) price before the expiration of the options contract.

Expiration Date – this is the last day an options contract is valid.

In The Money (ITM) – refers to either a call option with a strike price that is lower than the current market price of the underlying asset, or a put option with a strike price higher than the current market price.

Open Interest – this refers to the total number of options contracts that are not closed or delivered on a particular day.

Options Spread/Vertical – an options strategy with either calls or puts involves simultaneously buying a contract at one strike price and selling a contract with a different strike price for the same expiration date.

Out of The Money (OTM) – refers to either a call option with a strike price that is higher than the current market price of the underlying asset, or a put option with a strike price lower than the current market price.

Put – a put is a type of option contract that gives the owner or holder the right to sell an underlying security at a certain price within a specific period of time.

Strike Price – the price at which an options contract can be exercised. For call options: the price at which the buyer has the right to purchase an underlying security and the seller (writer) has the obligation to sell. For put options: the price at which the buyer has the right to sell an underlying security and the seller (writer) has the obligation to buy.