Institute of Trading and Portfolio Management

Professional Options Trading Masterclass Video Series

POTM

Video 3

Useful Options Trading Strategies

Strategy Name	D/C	Level	D/ND	Bias	POTM Core Y/N	$ Risk	$ Reward	Usefullness
Bear Put Ladder Spread	D/C	Simple	Directional	Bearish	Y	Medium Unlimited	Medium	Medium
Bear Put Spread	Debit	Simple	Directional	Bearish	Y	Low Defined	Limited	High
Bull Call Ladder Spread	D/C	Simple	Directional	Bullish	Y	Medium Unlimited	Medium	Medium
Bull Call Spread	Debit	Simple	Directional	Bullish	Y	Limited	Limited	High
Covered Call	Credit	Simple	Non Directional	Neutral	Y	Limited	Limited	Medium
Covered Call Collar	Credit	Simple	Non Directional	Neutral	Y	Limited	Limited	High
Long Call	Debit	Simple	Directional	Bullish	Y	Limited	Unlimited	High
Long Put	Debit	Simple	Directional	Bearish	Y	Limited	Limited	High
Long Straddle	Debit	Simple	Non Directional	Volatility Bet	Y	Low Defined	Unlimited	Medium
Long Strangle	Debit	Simple	Non Directional	Volatility Bet	Y	Low Defined	Unlimited	Medium
Short Bear Ratio Spread	D/C	Simple	Directional	Bearish	Y	Limited	Limited	Medium
Short Bull Ratio Spread	D/C	Simple	Directional	Bullish	Y	Limited	Unlimited	High
Short Put (Naked)	Credit	Simple	Directional	Bullish	Y	High Defined	Limited	High
Strap Straddle	Debit	Simple	Directional	Bullish	Y	Limited	Unlimited	Medium
Strap Strangle	Debit	Simple	Directional	Bullish	Y	Limited	Unlimited	Medium
Strip Straddle	Debit	Simple	Directional	Bearish	Y	Limited	Unlimited	Medium
Strip Strangle	Debit	Simple	Directional	Bearish	Y	Limited	Unlimited	Medium

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1. Long Call

Quick Explanation

The right but not the obligation to purchase a particular Stock at a specified price before a specified time.

The Long call, or buying Call Options, is about as simple as Options trading strategy gets, because there is only one transaction involved and it enables you to make potentially unlimited profits through the power of leverage, while limiting your potential losses at the same time. It works best if you are expecting a significant rise in the price of any asset that has options contracts traded on it within a specified time frame i.e. you have to be right / "In The Money" to profit from it by a certain date and the risk reward of buying a Call Option versus simply owning stock is better. See Marginal Benefits of Options Trading Video.

- **Directional Bet**
- **Bullish Strategy**
- **Simple**
- **One Transaction**
- **Net Debit (Upfront Cost)**
- **Max Risk (Limited)**
- **Max Gain (Unlimited)**

When to Use the Strategy

The primary use of the long call is when your outlook is bullish, meaning you expect a security to go up in value. It's best used when you expect the security to increase significantly in price in a relatively short period of time. Although there are still benefits to using it if you believe the security will rise more slowly over time. You just need to be aware of the effects of time decay, because the time value of calls will depreciate over time.

Generally speaking, any time you have a bullish outlook on a security you could consider using the long call. However, there are probably better alternatives if you are only anticipating that the price of the security will increase a little.

This is a very useful strategy to use for a number of reasons. For one thing it's really simple, so the calculations involved are quite straightforward. It's essentially an alternative to buying an asset that you expect to increase in value, but because of the leverage power that options have you can make a greater return on your investment. You can also use the Long Call strategy as a Hedge against a Short Stock Position.

How to Use the Strategy

The downside risk is lower than investing directly in an asset, because the most you can lose is the cost of the Calls (Premium) that you buy. No matter how much the underlying security drops in value this is true. It's also flexible, as you can effectively select the risk to reward ratio of the trade by choosing the strike price of the options contracts you buy.

The only transaction involved is to purchase calls on the security that you believe is going to increase in price.

You need to decide what expiration date to use and what strike price. If you are expecting the underlying security to quickly rise in price, then buying contracts with a short time until expiration makes sense. If you think the underlying security will take longer to rise, then you will need to buy longer term contracts. Longer term contracts will usually cost more, because they will have more time premium associated with them and a higher chance of volatility due to longer time horizon.

What strike price to use takes a little more consideration. Beginner traders should probably buy contracts that are At The Money, or very Near The Money. Obviously buying a Call that is very Out of the Money with a very short-term expiration has a much lower chance of being In The Money than a Call Option that is At or Near The Money with a Longer expiration. The probabilities of being In The Money by expiry will be reflected in the price of the Options.

Experienced traders compare the Delta values of options with different strike prices, and determine which strike price to use based on the returns that they are looking to make and exactly what they expect to happen to the price of the underlying security.

For example, if you were expecting a sharp increase in the price then buying cheaper out of the money contracts may enable you to maximize your returns. If you were expecting a more moderate increase in the price over a longer period of time, then buying in the money contracts with a higher Delta value may be the better choice. There is not a particularly a right or wrong

approach to making this decision; it ultimately comes down to your own expectations of Catalysts that are going to drive the underlying asset higher and what impact this will have on the asset price.

In another circumstance where the Long Call can be used effectively is as a Hedge against a short Stock Position. Let's say for example you are convinced that a Stock is going to halve in value in the next 6-12 Months due to your fundamental work. So, you have a Short stock position because it's better to be Short the stock than to be Long a Put because you don't know with suitable accuracy and confidence when this will happen. Now let's say you are up 15% on the Short Stock position within 10 weeks of having the trade on, however you are not sure that the Stock will go down over the next few weeks, but you don't want to miss out on the Stock collapsing if it does indeed collapse. You could of course buy some of the Short back. But you have to consider that if the Stock does collapse you will make less money on the Short Stock position. You can buy say a 5% Out of The Money (OTM) Call (Strike Price +5% from current Stock Price) with an expiry of 2-4 weeks. This will cost you some of your performance already made, however it will make you sleep at night, because if there is a "Short Squeeze" in the Stock for an unforeseeable reason, you will lose money on the Short Stock Position but you will make money on the Long Call Position. If the Stock does indeed continue to collapse and go down 50% you will only lose the premium you paid for the Call Option and maximise your Short Stock return with a Long Call Hedge.

Break Even

Break-even point is when **Price of Underlying Security = (Strike Price + Price of Option)**

Profit Calculations (Maximum Upside)

Unlimited

Profit is made when **Price of Underlying Security > (Strike Price + Price of Option)**

Profit per option owned is **Price of Underlying Security – (Strike Price + Price of Option)**

Risk Calculations (Maximum Downside)

Maximum loss is limited to the Premium paid / Net Debit

Maximum loss is made when **Price of Underlying Security < or = Strike Price**

Strategy Example

Here we have provided an example of the Long Call strategy, showing how it would be used and a few potential outcomes at the point of expiration. Please be aware this example is purely to provide a rough overview of how it can work and it doesn't necessarily use exact prices. For the purposes of this example we have ignored the commission costs.

Initial Trade

- Company X stock is trading at $50, and you expect it to increase in value.
- At the money calls on Company X stock (strike price $50) are trading at $2.
- You purchase 1 call contract (one contract = 100 shares) for an investment of $200.

If Company X stock increases to $52 by expiration

Your contracts will be worth roughly what you paid for them and you will break even on the trade at expiry. You could exercise them to buy 100 shares at $50 each and either sell them for a profit or hold on to them if you felt they would increase further in price. Alternatively, you could sell the contracts just before expiration.

If Company X stock increases to $55 by expiration

Your contracts will be worth roughly $500 and taking into account your initial investment of $200, you will have made a profit of around $300. You could either exercise them or sell them just before expiration for a profit.

If Company X Stock falls or does not increase by expiration

Your contracts would expire worthless, and you would lose your initial investment.

Remember, you don't have to hold your options all the way until expiration. Their price will increase as the price of Company X stock increases, so you can sell them for a profit at any point if you choose. Equally, if the price of Company X stock is falling or staying stable, then you could sell them to recover any remaining value and reduce your potential losses.

2. Long Put

Quick Explanation

The right but not the obligation to sell a particular Stock at a specified price before a specified time.

The Long Put, or buying Put Options, is about as simple as Options trading strategy gets, because there is only one transaction involved and it enables you to make potentially very large profits through the power of leverage while limiting your potential losses at the same time. However, unlike being long a Call Option the upside in terms of Profit although large is theoretically limited because a Stock can only go to Zero. Whereas on the flipside a Stock can theoretically go to "infinity." So being simply Long a Put is different to being simply long a Call. However, you should not let this "put you off" (no pun intended) from owning a Put option when your fundamental predisposition is bearish. There are many uses for being Long a Put and at the end of the day your risk is limited to the premium you pay for the Put and your upside is still massive. So, the risk reward is still excellent. Plus, in reality, stocks vary rarely go to Zero and NEVER go to infinity. Additionally, it is much easier to buy a Put especially on large and Mid-Cap names than it is to short a stock on Margin for many Retail Traders in the World who have high Margin requirements from Brokers. Remember there always needs to be a marginal benefit in trading an Options strategy versus simply being Long or Short a stock. Capital requirement should always be a consideration. In many cases you can get the same $ notional exposure being Long a Put or a Call (over a certain time frame) with significantly less capital than it would take to simply be Long or Short the Stock. The Capital consideration must be right, the Risk Reward must be better than simply have a Stock position and you have to be right before a certain time. See Marginal Benefits Video 4.

- **Directional Bet**
- **Bearish Strategy**
- **Simple**
- **One Transaction**
- **Net Debit (Upfront Cost)**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

The best time to use this strategy is when you have a bearish outlook and you are expecting an asset to drop significantly in value in a fairly short time frame. Although you can still use it if you think the asset will drop in price over a longer period of time. However, using a Long Put (Naked) to bet on falls in Stock prices over Long Periods of time can obviously suffer from the effects of time decay on the value of the Option. This will have a negative impact on any profits you make as Puts lose value over time and the loss of value of a Put and / or a Call Option accelerates into Expiry. There are other strategies that are probably better if you are only expecting a small drop in value, but the Long Put can be used whenever you have a bearish outlook. It can also be used for a hedging strategy if you want to protect a Stock that you own against a possible fall in value.

How to Use the Strategy

So, the Long Put strategy has two main uses. For trading purposes Naked Long, a Put can serve as a quick way to make money out of a Stock that drops quickly versus just being short the stock which may require a lot of Capital / Margin to be allocated to the Stock trade and the Long Put has limited downside. You can sell the Put as well if you make money from the fall in the stock whilst being Long the Put if you think the stock will rally and the price of the Put Option will fall. Additionally, you can trade out of the Put if it drops in value and you are wrong to get back some premium if you are wrong and the stock rallies. The same applies to Call Options when simply trading a Naked Long Call. For investing purposes, a Long put can provide a Hedge in a few main ways. If you are long a Stock that has an active listed Options market and you believe in say 3-4 weeks' time there may be a retracement in the stock of a decent magnitude due to a catalyst like Earnings, but you are a long-term holder of the stock and perhaps you want to continue to collect the dividend and you do not want to sell the stock. You can Hedge the position by buying an At The Money (ATM) or slightly Out of The Money (OTM) Put Option. Say maximum 5% Out of the Money. So, strikes to consider maybe ATM, -1%, -2%, -3%, -4%, -5% in a contract with expiry that encompasses the catalyst date. So if Earnings are due on February 8th.., you want to consider expiry's later than February 8th. This way if the stock has a fall into Earnings you will lose money on the stock position but make money on the Put. If you hold the Put position over earnings and the stock drops

quickly you are protected. This is why being Long a Put is sometimes called being long a "Protective Put…," …, because it is protecting a Stock position. Another way in which a Put is useful as a hedge is as a Portfolio or "Burn the House Down" Hedge. When Hedging by buying a Put you are buying insurance against a current Long position in either a Stock or a Portfolio. Long Dated Puts 3,6,9,12 Months that are significantly Out of The Money can be very "cheap" and effective ways of "insuring" against unforeseen events. So, if you have Pension for example that is Long Only and the market is up 15% half way through the year…, you might decide to protect your "property" by spending 1.5%-2% of your performance on a Long Dated OTM Put to protect your Net Worth against a Crash. The best way to explain and distinguish this strategy from the short-term hedge mentioned above is that in the short-term hedge example you are simply buying some insurance against a specific foreseeable potential issue and you have a high degree of confidence that it might happen and it makes you fearful that you could lose money on your Stock position. This is like buying Travel insurance for a Skiing Vacation. In the Long-Term hedge, you are buying insurance to hedge yourself against "tail risk" i.e. an unforeseeable reason why everything comes crashing down. This is more commonly known in Financial Markets as a Black Swan event. So, this is more analogous to buying Fire Insurance on your home. The premiums are low for a reason because its very unlikely to happen, BUT the unforeseeable could happen and that is why you buy Fire Insurance every year for your home i.e. because you don't want to lose your home due to an unforeseeable event. Buying a 3, 6, 9, 12 Month 5%-15% OTM Put Option provides Pension holders with "Burn the House Down Insurance" and can make you sleep at night, especially if you have spent several years watching your pension go up by 20%-30% per year for several years in a row. Of course, you have to pay for the insurance and in years when the market is up you will most likely slightly underperform the market. But who cares? In the year that a market crashes and everyone loses, you will probably not be losing money if you hedge well.

The long put is about as straightforward as it gets. There's just one transaction involved: the purchase of puts on the relevant underlying security. There are three particular factors that you need to decide upon when using this strategy; the strike of the options contracts, the expiration date and whether there is a marginal benefit in doing so over having a Stock Position i.e. Capital Requirements and Risk Reward. There are no hard and fast rules when it comes to making these decisions, because they ultimately depend on your own analysis, outlook and risk appetite / assessment.

The strike you choose will affect two things: the price you have to pay and the potential profits you can make. Beginners traders should at first stick to buying At The Money (ATM) contracts (where the strike is equal to the current trading price of the underlying security) or slightly Out of the Money (OTM) contracts (strikes below the current trading price), because this is a good place to start to get used to trading Options. For Retail Traders that seek Long Only Portfolio / Long Pension Asset insurance it is best to go for Long Dated 3, 6, 9, 12 Month Put Options that are way Out of The Money (OTM) say 10%+ OTM. The Puts will be cheaper than ATM or slightly OTM Puts and you are putting on a trade that serves its purpose i.e. protecting against a crash / the unforeseeable tail event so when your "house burns down" you don't lose your house. You keep it!

Out of the money contracts are cheaper, but you will need the underlying security to fall further to make a profit than with at the money contracts. In the money contracts are more expensive, but they have a higher delta value which means their value will increase more rapidly in relation to a drop in the price of the underlying security.

Choosing an expiration date is really just a matter of deciding how quickly you think the underlying security will fall in value. If you are expecting a quick drop, then it would be logical to buy contracts that have a short time until expiration. If you are expecting the price to drop more slowly, then longer term contracts would be a better choice.

Break Even

Break-even point is when **Price of Underlying Security = (Strike Price – Price of Option)**

Profit Calculations (Maximum Upside)

Limited only in the sense that a Stock can only go to Zero, but still large.

Profit is made when **Price of Underlying Security < (Strike Price - Price of Option)**

Profit per option owned is **(Strike Price – Price of Underlying Security) – Price of Option**

Risk Calculations (Maximum Downside)

Maximum loss is limited to the Premium paid / Net Debit

Maximum loss is made when **Price of Underlying Security > or = Strike Price**

Strategy Example

Here we have provided an example of the Long Put strategy, showing how it would be used and a few potential outcomes at the point of expiration. Please be aware this example is purely to provide a rough overview of how it can work and it doesn't necessarily use exact prices. For the purposes of this example we have ignored the commission costs.

Initial Trade

- Company X stock is trading at $50, and you expect it to fall in price.
- At the money puts on Company X stock (strike price $50) are trading at $2.
- You purchase 1 put options contract (one contract = 100 shares) for an investment of $200.

If Company X stock falls to $48 by expiration

At the time of expiration, the puts will be worth approximately $2 due to their intrinsic value. You could therefore sell them for around $200, meaning you will break even on the trade.

If Company X stock falls to $45 by expiration

In this scenario the puts will be worth around $5, meaning you could sell them for $500. This would give you a profit of $300 from a $200 investment.

If Company X Stock increases or is still at $50 by expiration

The options would expire worthless, and you would lose your initial $200 investment.

It's worth pointing out that you are under no obligation to keep hold of your options all the way until expiration. If they go up in price and you want to take your profit at any point then you can sell them whenever you want. You can also sell them if they start to go down in price and you want to cut your losses.

3. Short Put (Naked)

Quick Explanation

Opposite position to Long Put (Naked). You are obligated to buy stock at a specified price before a specified time if the contract is In The Money. Also known as Selling Put Options. you are essentially agreeing to buy the underlying security at a fixed price at some point in the future. If the underlying security goes up in price, then you make a profit, but if it goes down in price, then the puts you have written could be exercised. Although the short put is simple because it involves one transaction, you are exposed to a lot of potential risk. The short put is often referred to as having unlimited loss potential, but this isn't strictly true as the maximum you can lose per option written is the price of the underlying security, and that can only happen if the price of the underlying security falls to zero. Despite this fact, the short put can be a useful strategy to profit from a short-term price rise in an underlying security.

- **Directional Bet**
- **Bullish Strategy**
- **Simple**
- **One Transaction**
- **Net Credit (Upfront Payment Received)**
- **Max Gain (Limited)**
- **Max Loss (Limited)**

When to Use the Strategy

The Short Put (Naked) is a bullish options trading strategy, so you would use it when you expect a security to go up in value. You can only make a fixed amount of profit, it's best used when you are expecting a security to go up in value by just a small amount. You can actually also profit if the price of the security doesn't move at all. This is because the short put involves selling options contracts and you can therefore profit from the fact that time decay reduces the value of those contracts over time.

This strategy offers you no real protection against the underlying security falling significantly in value, so you should only use it if you are confident that the security isn't likely to decrease in price.

Additionally, if your intention is to OWN the underlying Stock, shorting a Naked Put that is OTM can be a really effective way to "enter" a new Long Stock position. You can decide exactly how much stock you would be willing to buy at a certain price below the current market price of the stock. For example, let's say your fundamental pre-disposition on a particular stock is Bullish however you believe that your timing might be off. You could Short (write) and Naked Put with a Strike Price that is say 5% Out of The Money (OTM) (below current market price of the Stock and receive a credit for doing so. If the stock falls to the strike price you are happy for the contract holder who is long the Put to exercise and sell you the Stock. So, you just added 5% value to your execution. If the Put expires Out of The Money i.e. Worthless then you keep the credit. If the stock is the same price as when you wrote / shorted the naked Put you just added the value of the credit to your execution and you can may now decide to buy the Stock using Capital you just obtained by writing the Put + the Capital you would have used previously to buy the Stock. Meaning it requires less of your previously side-lined Capital to purchase the Stock. Of course, the risk is that you write the Put and because your upside is limited to the premium you write you could miss the opportunity to own the Stock. If the Stock goes up higher than (current market price X the amount of Stock you intended to buy) i.e. by a value higher than the dollar value you received on your Credit then you have negative value to your execution capability.

"Selling a Put" is not strictly the same as Shorting a (Naked) Put because you can hold other positions that offset the change in value of the Put Option. For example, selling a Put could provide a short term Hedge to a Short Stock Position. If you are holding a Short Stock Position and you think that there might be a risk of a short-term squeeze higher in the Stock you could Sell an At The Money or Out of The Money Put and collect some premium i.e. take some profits off the table. If the Stock falls through the Strike Price before Expiry you will have to cover some or all of your Short. If the Stock Squeezes higher at least you collected some premium to offset any losses you may incur on your Short Stock Position. This however is not as effective as a Hedge against a Short Stock Position as buying a Call Option that is Out of The Money as the upside of shorting a Put is Limited to the Premium you collect. You would have to be very confident that the Strike Price of the Put you sell is going to be achieved and you will cover some or all of your short at the price, then the stock will rally afterwards. Otherwise you would be better off just either covering some or all of your Stock Short or buying an AT The Money or slightly Out of The Money Call. Remember the Long Call Option has unlimited Upside so if the Stock you are Short goes on a huge rally for no particular reason or for good reason your profits on the Call are unlimited and your losses on your Short Stock Position are unlimited. So being Long a Call is a much better hedge to a Short Stock Position.

How to Use the Strategy

How you use the Short Put (Naked) Strategy depends very much on your intentions. If you are just Bullish on a Stock and want to own it then due to its limited upside i.e. the credit you receive, then it doesn't make much sense to short Naked Puts At The Money or In The Money. Just Buy the Stock. If you are Bullish on a Stock Fundamentally and you are either already Long the Stock and intend to add to your position at a certain price below market price or you intend to open a new position to go Long a Stock at a certain price and / or you want to Fundamentally buy a Stock but you are unsure that your short-term timing is right, then Shorting a Put can add value to your execution as a Trader. Otherwise the Short Put (Naked) strategy doesn't add much value.

Warning! The Graveyard of former Options Traders is littered with the bodies of Naked Short Put Sellers. Do Not Short Naked Puts just for the hell of doing it / to "receive an income" from Trading. Many Traders use Shorting Naked Puts as a strategy to "take income from the market." They Short Naked / Write Naked Puts that are either Out of The Money or way Out of The Money thinking that because there is only a very small chance that a stock will go down by say 10% in a Week or 20% in a month that Shorting Naked Puts is like "free Money" or "taking candy from a baby." Nothing in the Financial Markets is free and there is no difference here in Shorting Naked Puts that are Out of The Money in order to take the credit as "income." Inexperienced Retail Traders look at the historical data of Stocks and figure out that a 2 Standard Deviation Move (2STD) in a week is let's say 9%. So, they Short Naked Puts continuously in order to "Bank the Premium." The odds are in their favour, and they can get away with banking premium for a long time, however they always in the end blow up because they have no Fundamental understanding of the Stock(s) they are Shorting OTM Naked Puts on and in the end, they always get caught out and give up all their gains and more when the Stock falls much more than expected due to a Fundamental change. They end up having to buy the Put back at a massive loss or they get assigned a Stock that they don't even know anything about, at a price way above the new market price after the stock has tumbled massively through the Strike Price where they are Short Naked Puts. Additionally, Selling Puts (and Calls) Naked Requires a lot of Capital and the Return on Invested Capital and Return on Notional Exposure is extremely low. This is because when writing way OTM Puts, credits are small yet exposure is massive. Way OTM Puts and Calls are much lower priced than At or In The Money Puts and Calls.

This is why when Shorting a Naked Put it is better to actually have an intention to Buy the Stock when you Short the Put. This way you can add value to your execution and you can sleep at night. Additionally, it just simply is not good discipline as a Trader to have massive amounts of unnecessary exposure for very little gain. As Traders we want to be taking as little risk as possible for as much gain as possible.

We have included the Short Put (Naked) Strategy in the "Useful" PDF because it does have its uses in adding value to traders but only when you intend to Buy a Stock. As above it is not even really a good hedge for Short Stock Positions. Other than as an execution tool to get into Long positions at certain prices that you actually want, the Short Put (Naked) Strategy is pretty useless. We also included it here and in the POTM Video Series (with examples) as a cautionary tale as a deliberate message to Retail Traders NOT to do it for the sake of income / banking premium. Do not do it! You have been warned! .., if you ever come across an educator who tells you to do this as an "easy money strategy" you should be taking them to school, not the other way around!

Break Even

Break-even point is when **Price of Underlying Security = (Strike Price - Price of Option)**

Profit Calculations (Maximum Upside)

Profit is limited, per option written, to "Price of Option"

Maximum profit is limited and made when **"Price of Underlying Security > or = Strike Price**

Risk Calculations (Maximum Downside)

Maximum loss is limited only by how much the underlying security can fall.

Loss is incurred when **Price of Underlying Security < (Strike Price – Price Per Option)**

Loss per option written is **Strike Price – (Price of Underlying Security + Price Per Option)**

Strategy Example

Below you will find an example of this strategy using At The Money (ATM) Puts. The purpose of this example is purely to provide an overview of how the strategy works and it doesn't use precise prices. Commission costs haven't been included for the sake of simplicity.

Initial Trade

- Company X stock is trading at $50, and you expect it to increase slightly in price.
- At The Money (ATM) Puts of Company X stock (strike price $50) are trading at $2.
- You write 1 Put contract (1X Contract = 100 Shares) for a credit of $200.

If Company X stock increases to $51 (or higher) by expiration

The options will be out of the money at expiration, and therefore worthless. You'll have no further liability and the $200 credit you received when writing them will be your profit.

If Company X stock remains at $50 by expiration

If the Options are At The Money (ATM) at expiration, also making them worthless. The $200 credit is your profit.

If Company X stock falls to $48 by expiration

The Options will be In The Money; therefore, you will have a liability. In this case, you will have around $2 per option for a total of $200. Taking into account your upfront credit of $200, you will have roughly broken even.

If Company X stock fell below $48 by expiration

You would start to lose money. You should be aware, though, that at any point prior to expiration you can buy the contracts back. This will incur a loss if the stock has fallen in value, but it will prevent further losses from a continued fall.

4. Covered Call

Quick Explanation

The Covered Call is an Options Trading Strategy can be used when you have an existing long position in a stock and you want to generate some returns if you believe the price of the Stock will be stable / neutral for a short period of time. It can also be used to provide a small measure of protection should the price fall.

The Covered Call strategy is a very straightforward strategy; you simply write call options on the stock that you own. As your expectation is that the price won't increase short term, your view is that these Options will expire worthless and you will have effectively made income from your stagnant stock. The Covered Call Strategy can also be used if you are losing money on a Long Stock position in an attempt to theoretically lower the average price of the Long Stock Position.

- **Non-Directional Bet**
- **Neutral Strategy**
- **Simple**
- **One Transaction**
- **Net Credit (Upfront Payment Received)**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

Although the Covered Call is technically considered an Options Trading Strategy, it isn't a strategy that is used to make profits solely from Options. It's designed primarily to return a profit when stock that you own goes through a period of remaining neutral i.e. it neither goes up nor down in price.

Typically, you would use it if your outlook on stock you own is neutral, but you don't particularly want to sell it and you would prefer to try and make some profits out of the price not moving. You can also use it to reduce any losses you may incur if the stock falls in price, although it's not particularly effective if it falls by a lot. The protective put (Long Put) is a better choice if you are looking for protection against any sizable fall.

Establishing a Covered Call is very simple. You just have to write enough Calls to cover the number of shares that you own. You can write these at whatever strike you choose, but traders will usually write them at a strike that is slightly higher than the current price of the shares.

By writing Options with a higher strike, you stand to make a higher return if the price of the underlying stock increases (because you are Long Stock on the other side), but you will make less if it stays the same. You will also have less protection should the underlying Stock fall.

In terms of choosing an expiration date for the Options you write, the general rule is to write them with an expiration that is close, typically at or within the nearest month. By doing this you stand to benefit from a quick rate of time decay and there's a shorter period of time for the underlying stock to move in price.

Establishing a Covered Call has 4X main uses; -

1. Hedge against Long Stock Position that is positive P/L and collect Premium.
2. Hedge against Long Stock Position that is Negative P/L and collect Premium.
3. Hedge against Long Stock Position in a Dividend paying Stock that is going ex-Dividend very soon and collect Premium.
4. Getting a "better" execution price on an intended Long Stock Position.

Although the Covered Call Strategy is a "Non-Directional" Neutral strategy overall, we include it in the "Useful" PDF because it has Medium usefulness in the real world for Retail Traders. Especially for Retail Traders that have a Long Only Portfolio i.e. a Pension. The Covered Call Strategy can be used in the U.S. IRA pensions scheme whereas selling naked Calls cannot. For International Investors, opening up an Options trading account in order to Hedge Long Only pensions infrastructure is the only real way to use strategies like the Covered Call strategy to ensure money is not lost when Stock Markets go down. The main uses for the strategy apply globally to anyone with a Long Only Pension or anyone with a trading account with Long Stock positions. It is useful and can add a lot of value over time to your Retirement Accounts and / or Trading Accounts if you know what you are doing and you stay active i.e. you add value to your account by using the Strategy. The only reason we mark its usefulness as "medium" versus a Covered Call Collar strategy as "High" is because it has defined limited risk and limited upside that is small in comparison. This will become clearer in the next section on Covered Call Collar Strategy when we compare the two Strategies.

How to Use the Strategy

As mentioned above there are 4X main uses for the Covered Call Strategy.

1. Hedge against Long Stock Position that is positive P/L and collect premium.

The easiest to understand is in the first example in which you own a Stock (Long) and you are making a Profit from the trade. Stocks of course never go up in a straight 45-degree line. There will be periods where a Stock goes sideways or down during a fundamental and technical uptrend. If your fundamental view of a Stock is Long Term Bullish but in the Short term you believe that the Stock may struggle to rally through a certain Fundamental Valuation point or Technical Level you can become a more efficient trader and maximize returns by deploying a Covered Call Strategy. Your view here is not that the Stock has the potential to collapse, but it has the potential to either stay where it is for a while or go down short term. Instead of taking profits on the Stock and simply selling some Stock and trying to buy it back at a lower price you may simply decide to sell a Short-Term Call Option that is At the Money or Out of the Money to collect some Premium. The best way to do this is decide yourself on a discretionary basis (no rules) the level you believe the Stock to be capped at Short Term and sell that Strike. You will receive a credit for doing so and your Break Even is the Strike + Premium Collected per share. If the Stock stays below the Strike Price you have sold the contract will expire worthless and you will have added value to your Long position. You will receive the Max Gain if the Stock closes on the day of expiration at exactly the Strike Price you have sold. If the Stock goes above the Break-Even level you will be making money on the Stock Long but Losing Money on the Option and you would have added no value to your Long Position. Infact in this scenario you have lost because you would have been better off just staying long the Stock and not writing a Covered Call Option. If the Stock Rallies to between the Strike you sold and your Break-even level then the Call will be "In the Money" and you will be losing Money on the Call Option but making money on the Long Stock Position. You will most likely be making slightly more on your Stock Long than losing on your Call Option Short but only very marginally. What you really want is that the Stock doesn't move much and closes at or as near to the Strike as possible to get the Max Gain, whilst you have the Covered Call Options short on and then the Call Option contract to expire worthless, then for the Stock to go up through the Strike Price when you don't have a Covered Call Option Strategy on. So, your timing has to be good. Notice that this differs from

being bearish or seriously concerned about the stock falling in value by a large amount. If this was the case then you would likely sell stock. Here you are simply hedging a long-term position you believe will go up over the Long term but for a short period of time will trade sideways or perhaps down small.

Something you must be careful of when considering this simple strategy is publicly known upcoming events that could see Volatility increase..., for example earnings announcements. See Volatility Video .,

2. Hedge against Long Stock Position that is Negative P/L and collect Premium and collect premium.

The Covered Call Strategy is very useful in this scenario. Let's say for example you are Long a Stock and it is down say 7% since you bought it. But you have a Fundamental Pre-Disposition that the Stock will rally 40% over the next year. Your timing may have been off by 1-2 Months. In Trading we must assume that we are never going to Buy at exactly the bottom and Sell at exactly the top. For this example, we will use some theoretical numbers. Let's say you are Long a Stock at $100 and since you bought the Stock 3 weeks ago it has fallen to $93. If your Fundamental Predisposition has not changed and you still believe the Stock will go to $140 in the next 12 Months, you can consider a Short Term Covered Call Strategy. Let's say for example you pull up the Options Chain and you see that the 2-week Call Option with a Strike Price of $97 is trading at $1.15 ..., if you Sold the Call and it expired worthless you would make $1.15 and your theoretical average price per share would drop from $100 to $98.85 per share (as long as you are perfectly hedged). Then if the Stock rallies above once your Covered Call Position is closed you have managed to lower your average price by $1.15. Don't forget you can also trade the Option itself. Let's say in this example you Short the Call at $1.15 and it drops $1 in value and you decide to buy it back at $0.15 to lock in Profits on the value of the Call and / or you believe the Stock may now rally. Then your average price would drop to $99.

The beauty of the Covered Call Strategy overall is that if you know you have the option to Sell Covered Calls prior to owning a Stock, you know before you go into a position that you can choose to be active in always attempting to add value to your execution or in times when you believe the Stock will go sideways or fall. In the circumstance when you are losing money this may keep you from "cutting" a Long Stock Position and missing out on all the upside once the Stock rallies. The above example of when you are making money on a Long Stock position is really no different except the P/L is positive. You are simply attempting to add value to your Long Stock Position and managing risk in your portfolio more optimally than just simply sitting with a Long Stock Position and riding the up and down moves in the Stock.

In practice this doesn't simply mean the average price on your Long Stock position will change when you decide to buy back the Short Call or it expires worthless. What will happen is that the average price on your Long Stock position will remain in the above example at $100. But, let's say you were Long $100,000 of Stock, you will have received a credit of $1,150 by shorting a Covered Call on a $100,000 position to your account. You must work out with an average price calculator prior to entering the Position what your $ upside would be on using the Covered Call Strategy (above in point 1) if the call expires worthless and assess whether it is worth it or not. Then in your own spreadsheets you can amend the average price of the Long Stock Position or add into your spreadsheets your Options Trading Book as a separate Asset and the P/L of your Options Account. You will be able to keep a track record of how much value over time you add to your Long Stock Positions See Covered Call Video Download Resources.

3. Hedge against Long Stock Position in a Dividend paying Stock that is going ex-Dividend very soon and collect Premium.

This is a very simple and useful scenario / strategy especially for Retail Traders / Pensions investors who hold Long Stock positions in their Long Only Pensions especially in Mega Cap and / or Large Cap Stocks in the U.S. that have active liquid Options Markets. When a Stock goes ex dividend, theoretically (all things being equal), the day that it goes ex-dividend the Stock will fall by the amount of the Dividend. However, the Options price of both Calls and Puts does not re-adjust. The expectation of the Dividend is already in the Options prices. Options are valued taking into account the projected dividends receivable in the coming weeks and months up to the Option expiration date. Consequently, Options of high cash dividend stocks have lower premium calls and higher premium puts.

So, let's say you are Long a Stock that is at $100 and the Stock pays a $4 Dividend per year or $1 per quarter. We all know when the ex-dividend date is going to be. This is usually public information. Therefore, you know that in say 1 weeks' time the stock will automatically fall by $1. You will not lose money on your Long Stock Position in this scenario because you will actually be receiving the Dividend and the average price of your Long Stock position in your Retirement / Trading Account should adjust automatically. In this time, it might be worth considering a Covered Call Strategy if you believe the price will not rise prior to the ex-dividend date or straight after i.e. you believe that due to the ex-dividend date and price re-adjustment there will be a period of "indigestion" in the Stock so it will trade sideways overall during the period or fall slightly. In this scenario you can add value to your Stock Position by writing a Covered Call, because Options prices do not re-adjust for Dividends. So, for example. Let's say you are reasonably confident that the Stock will be sticky to $100 before the ex-Dividend date..., this means then that you believe that it will be sticky to $99.00 on the ex-dividend date and immediately after. Let's say you sell a Covered Call with a

Strike of $103 for $1.25 per share with an expiration that is a week after the ex-Dividend date. Your breakeven will be $97.75 (dividend adjusted) and $98.75 (non-Dividend Adjusted). Leading into the ex-dividend date your Call Option will likely fall in value and reprice to be worth around $0.25 as the Stock drops to $99.00 BUT your average price on the Short Option trade WILL NOT change down to $0.25. However, the Stock WILL reprice by $1 lower. However, the Stock WILL reprice by $1 lower. So, in this instance you will make a $1 Dividend and $1 on the Covered Call trade. What you are doing here is called "Dividend Protection." In reality you are not making $1 on the Dividend because the Stock reprices down $1 and your average price on the long reprices down by $1. But you are making $1 on the Options contract because your average price remains at $1.25 on the Option. So, you are adding $1 value to your Long Stock Position. Of course, you can get caught out on this transaction and nothing is ever this simple. This is a theoretical example of what you could do if you believe the stock will not go up before during or after an ex-Dividend date. You could easily get caught out by the Stock "going ex-dividend well" i.e. on the day the Stock goes ex dividend i.e. the day you think the Stock is "supposed to automatically drop $1 on the open" could be the day after Global markets had a massive 3% rally overnight or a competitor company somewhere in the world reports amazingly positive numbers..., the Stock might go ex-dividend but open at $102.00 and rally all day to $104.50. When we use the phrase "a Stock goes ex-dividend well" we mean that the Stock goes up on the day of the dividend price re-adjustment. Conversely, when we say "a Stock goes ex dividend badly" we mean that the Stock falls on the day of the re-adjustment by a larger amount than the dividend price re-adjustment. In reality, the closer we get to ex-dividend days the premium in Calls erodes quickly and the premium in Puts rises quickly because the whole world knows and so do Market Makers that the Dividend date is coming up., so Options get priced accordingly. Calls WILL BE low priced. You can however still add value to your Long Stock Position if your Stock view of being Neutral into, on and after the ex-dividend date is correct and you can still bank some meaningful premium.

The best way to familiarise yourself with this Covered Call Strategy is to monitor your Mega Cap and Large Cap Long Only Stock holdings in your Pension and watch the price action of the Stocks 1-2 weeks before the Stocks go ex-dividend, on the day the Stock goes ex-dividend and 1 week after the Stock goes ex-dividend and also watch the Call and Put Options Markets into, on and after the day of the Stock going ex-dividend. Familiarize yourself with the process and do some theoretical paper trades selling Out of the Money Call Options and see if you would have added value to your Stock position. This will help get you used to the risk of the trade and understanding of the dynamics of how it works. Plus, you will feel more confident in putting "dividend protection" trades on.

4. Getting a better execution price on an intended Long Stock Position.

This Covered Call scenario is very useful especially for Retail Traders who do not trade fulltime and who can recognise good medium to long term fundamental Long ideas but don't have the execution capability or expertise to time their trades very accurately or who don't want to necessarily spend hours and days trying to get a slightly better price on their execution i.e. you just want to get the Long Stock position on for the medium to long term but you want to get on with your day job. Let's say you have a fundamental pre-disposition that a $100 stock is going to go from $100 to $140 over the next year BUT, you really do not know whether it could be $98 or $102 two weeks from now. Let's just say you are not confident that you are going to buy "at the bottom." Well in the vast majority of cases you would be right to assume this. No-one ever picks the bottom (when buying) or the top (when selling). Someone obviously does BUT for it to be you and for it be you all the time is just totally unrealistic. The great thing about a Covered Call strategy is that it can be put on immediately from scratch. So, let's say when you go long the $100 Stock you decide at exactly the same time to Short the 4% Out of the Money $104 Call Options for $1 with a $105 break even with an expiry date 3 weeks from now. You are basically saying to yourself that you know your timing might not be perfect (and it usually isn't) so in the first few weeks because I know my timing is usually or probably going to be off, I might as well bank some premium in the near term and add value to my execution. This is a very effective way of building into a Long Only pensions position over time. If you are position building, especially in a bear market, putting on a Covered Call from scratch can obviously be a helpful strategy as an immediate Stock Repair strategy to eliminate bad timing on going Long the Stock. It works exactly the same way as the other hedge explanations of being either positive or negative P/L, except you are creating it from scratch to enhance execution from the outset of creating a new Long Stock position to add value to your timing. At the time your P/L is $0. So, you do not have to worry so much about trying to "pick the bottom." Retail Traders with full time jobs and / or who run businesses can't sit at a screen all day trying to bottom tick every stock they go long in their pension. Remember as a Retail Trader you have Opportunity Cost of time too. Every hour spent sitting at your screen trying to save 10c on execution is an hour lost at work doing something else i.e. making $50, $100, $200, $300 per hour.

Risks of the Covered Call Strategy - There are two main risks when using this strategy. First, it offers very little protection if the stock should fall in value. Any losses incurred from a drop in the value of the underlying stock will be offset only by the credit received for writing the options. If the Stock falls further than that you are not protected / hedged. This is why we have given the given the Covered Call strategy a "medium" rating in "Usefulness."

It could be argued, of course, that you would incur those losses just from owning the Stock anyway and the covered call does at least give you something in return. You should be very clear, though, that this isn't a suitable strategy if you think there's much chance that the Stock will drop significantly in value.

The second main risk is that you won't make any further profits if the stock should rise above the strike of the options written. Although this would still mean a profit is made, you would have made more if you had simply held on to the stock and not applied the covered call. As such, this isn't an ideal strategy if you think the price of the stock may increase by a significant amount, although you can always buy back the options written if at any point you believe the price is going to increase by more than originally expected.

Break Even

Break-even point is when **Price of Underlying Security = (Starting Point - Price of Option)**

Profit Calculations (Maximum Upside)

Maximum profit is made when **Price of Underlying Stock = Strike of Options**

Profit is also made when **Price of Underlying Stock > or = Starting Point but < Strike of Options**

Profit, per share owned/option written, is **(Price of Underlying Stock – Starting Point) + Price per Option**

The profit calculation does not apply when **Price of Underlying Stock > Strike of Options**

It should be noted that there's a school of thought that says that any profit made from an increase in the price of the underlying security would have been made even without applying the covered call, and it shouldn't be included in the profit calculations.

Risk Calculations (Maximum Downside)

Maximum loss on the Options is limited because you are supposed to be perfectly hedged with a Long Stock position. So, if the Stock goes to “infinity” your Profit on the Stock will too, but your loss on the Short Call Option will be the same.

Of course, if the Stock goes to Zero you will lose the value of the Long on the Stock side of the equation, however your $ upside in the Calls is limited to the Premium you collect.

Strategy Example

An example of establishing a covered call is as follows.

- You own 100 shares of Company X stock, which is currently trading at $50. We shall refer to this price as the Starting Point (See above).
- You believe that the price will not move over the next few weeks, and want to profit / bank some premium whilst your Long Stock position trades sideways / around $50.
- You notice that Out of The Money calls with a strike of $52 and the closest expiration date are trading at $1.
- You write 1 Call Option contract (each contract contains 100 options) and receive a credit of $100.

Profiting

The Max’ profit is made when, at the time of expiration, the price of the shares increases to the strike of the options written. In the above example, this would be when Company X stock is trading at $52. Should this scenario occur, the options written would expire worthless and you would keep the credit received for writing them and have no further obligation. Therefore, your profit would be $100. You would, of course, also profit from the shares that you own increasing in value, in this case $2 per share multiplied by 100 shares for a $200 profit. Your total Max’ profit would be $300.

The Covered Call strategy would also return a profit if the price didn't move at all, or increased to a price lower than the strike of the options written. Again, the written calls would expire worthless and you would keep the credit as your profit. You would also still profit from the increase in the value of the stock, if there was any.

5. Covered Call Collar

Quick Explanation

The Covered Call Collar Options Trading Strategy is a strategy that can be applied when you already have a Long Stock position, and you don't expect the price of those shares to move much over a period of time. It can potentially return a profit from a stable stock price in a similar way to the Covered Call strategy. However, the Covered Call Collar Strategy also offers additional protection against the stock price falling, because it involves buying Put Options as well as writing Call Options.

In effect the Covered Call Collar has all the same applications (benefits and drawbacks) as the Covered Call Strategy except you also get more protection on the downside on your Long Stock position than you would by simply writing a Covered Call if indeed the Stock you are long does go down. The Covered Call Collar Strategy is a direct extension of the Covered Call strategy, which is used the same purpose i.e. you are Long a Stock and you expect the Stock price to remain neutral (no material rise or fall), but sacrifices some of the profitability of that strategy to also hedge against the stock falling in value. Therefore, you would use it when you wanted to earn money from your neutral outlook, but you wanted some protection against potential losses if the stock price dropped.

You will notice in the usefulness ranking that we have ranked the Covered Call Strategy as high for Retail Traders versus Medium for the Covered Call Strategy. This is because although as a Long Stock holder you do give up some of the Net Credit you would receive from writing Call Options (one side of the trade) and although your $ upside is Limited on both sides of the trade, the $ upside on the second side of the trade (Long Put) is only limited because the Stock can only theoretically fall to Zero. In reality if the Stock fell by an amount that is meaningful i.e. through the Strike price of the Put you are long the P/L gain on the Long Put position is meaning full enough to warrant a substantially better Hedge than just simply being Short a Call against the Long Stock position. This in our estimation makes the Covered Call Collar Strategy more useful to Retail Traders, especially those with Long Stock positions in their Pension that they are seeking to Hedge effectively.

- **Non-Directional Bet**
- **Neutral Strategy**
- **Simple**
- **One Transaction**
- **Net Credit (Upfront Payment Received)**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

As explained above, the Covered Call Collar Strategy has the same benefits as the Covered Call Strategy in the previous section with the added benefit of downside protection by also being Long a Put Option. Remember the Covered Call Strategy had four main uses; -

Establishing a Covered Call has 4X main uses; -

1. Hedge against Long Stock Position that is positive P/L and collect Premium.
2. Hedge against Long Stock Position that is Negative P/L and collect Premium.
3. Hedge against Long Stock Position in a Dividend paying Stock that is going ex-Dividend very soon and collect Premium.
4. Getting a "better" execution price on an intended Long Stock Position.

In extension to each of these 4 benefits add on "Long Put" for downside protection. We will not repeat the 4X benefits here. Please at your own discretion remind yourself of these benefits from the Covered Call Strategy section and add on the benefit to each use a plus (+) "Long Put Option" to protect against a Stock Price fall. It is therefore a more complete strategy when being used for the purposes as a "Hedge" against a Long Stock position. The expectation is that if the Stock does indeed fall during the time period to expiration that the $ losses experienced by the Long Stock holder on the Long Stock position will be offset or more than offset by the $ gains experienced on the Long Put position. In each benefit above a Net Credit can still be received as long as the trade is structured in a way whereby the Credit received by writing Call Options exceeds the money spent (debit) on buying the Long Put position. It can therefore be a Debit or a Credit Trade however where possible you should seek to trade efficiently and spend less on the Long Put position than you gain from writing the Short Call position. After all, you are writing

the Call Option because you expect the Stock not to go up. You are not Writing the Call Option because you expect the Stock to go down. You are writing it because you think it will neither go up nor down in price but remain neutral for a period of time. You are buying the Put Option because you think there might be an off chance that it could go down for reasons that you may not be able to see right at this moment in time. That's why it's called a "Hedge." It is therefore a more useful Hedging strategy than simply writing a Covered Call because the strategy will protect against an unforeseen fall in the Stock Price and a Credit can still be received.

How to Use the Strategy

Putting the strategy into place is straightforward enough, with just two transactions required. You would write Calls on the relevant stock (enough to cover the amount of Long Stock owned) and buy the same number of Puts. You should use the same expiration date for both sets of options, which would typically be the nearest expiration date. You can, however, use a longer-term expiration date if you believe the stock will remain stable for a longer period of time.

The big decision you need to make when establishing the Covered Call Collar is which strikes to use. Generally speaking, you should write out of the money Calls at a strike that is only slightly higher than the current price of the stock you own. You can use an even higher strike if you wish, because this will enable you to potentially make more profits if the stock increases in price, but you will receive a lower credit and will make less if the price doesn't go up. The Puts that you buy should also be out of the money, and you should absolutely seek to spend less on them than you receive for writing the calls so you ensure that you receive a net Credit. Not receiving a Net Credit defeats the purpose of the Hedge and eliminates major advantage that the Covered Call Collar Strategy has over simply applying the Covered Call Strategy i.e. you are not only being paid to Hedge you are still being paid for a Hedge that is more effective than simply writing upside calls as a Covered Call Strategy against a Long Stock position. So, in effect you are being paid to receive the large $ upside saving if the stock does indeed fall for whatever / unforeseen circumstances. Once you step over the line of NOT receiving a Credit but actually paying for the Hedge (Debit), then a major advantage of placing the Covered Call Collar strategy versus the simple Covered Call Strategy is eliminated. Getting paid and getting a superior Hedge is the motivation here i.e. to obtain a better more efficient Risk Reward profile on the Hedge.

As with the above explanation of the Covered Call Strategy, the 4X main uses were explained on when to use the strategy. We will not repeat them in this section. Please remind yourself of these 4X main uses above and add into the outcome a Long-Put position that is purchased as an Out of The Money (OTM) Put Option to protect against a down move in the Stock and the price of that Long Put option is lower than the Credit received by writing the Out of The Money Call.

Break Even

Break-even point is when **Price of Underlying Security = Starting Point + (Net Premium)**

In the case of the Net Premium being a Credit in the above calculation Net Premium is a minus figure i.e. we must subtract the net credit received figure from the starting point (reference price) of the underlying stock when the Covered Call Collar was established.

In the case of the Net Premium being a Debit in the above calculation Net Premium is a plus figure i.e. we must add the net debit paid figure to the starting point (reference price) of the underlying stock when the Covered Call Collar was established.

It is therefore much more preferable to receive a Net Credit from the Covered Call Collar Strategy in order to have a break even that is lower than the reference price.

Profit Calculations (Maximum Upside)

Leg A = Write Call Option, Leg B = Long Put Option

Maximum profit is made when **Price of Underlying Stock = Strike of Options in Leg A**

Profit is also made when **Price of Underlying Stock > or = Starting Point but < Strike of Options in Leg A**

Profit, per share owned is **(Price of Underlying Stock – Starting Point) + (Price per Option Leg A – Less Price Per Option Leg B)**

It should be noted that there's a school of thought that says that any profit made from an increase in the price of the underlying security would have been made even without applying the covered call, and it shouldn't be included in the profit calculations.

Risk Calculations (Maximum Downside)

The biggest possible loss occurs if the price of the underlying security should drop to exactly the strike of the puts options bought in Leg B. The calls would expire worthless, and so would the puts. You would keep the net credit. However, the shares you own would have dropped in value and that loss wouldn't be completely covered by the net credit. If the shares drop even further, then the losses wouldn't get any greater. Although the stock would continue to fall in value, the puts would start to increase in value and offset that fall. The potential losses can be summarized as follows.

Maximum loss is made when **Price of Underlying Stock = Strike of Options Leg B**

Maximum loss, per share owned is **(Starting Point –Strike of Options in Leg B) - (Price per Option Leg A – Less Price Per Option Leg B)**

There's also the risk that the Covered Call Collar can potentially cost you profits, if the stock rises above the Strike of the Call Options written in Leg A. Should the stock rise above the Strike, then the Calls written in Leg A could be assigned. You could be obliged to sell the stock you own at the strike. This would still represent a profit, but you could have made a larger profit if you had just kept hold of your Stock and not used this strategy. Although you can always close the Short Call Options position created in Leg A. The Covered Call Collar or indeed the Covered Call Strategy is clearly NOT an ideal strategy to use if you think there is a chance that the underlying security will increase significantly in price.

Strategy Example

- You own 100 shares of Company X stock, which is currently trading at $50. We shall refer to this price as the Starting Point (Reference Price)
- You believe that the price will not move much, if at all, over the next few weeks and you want to try and profit from this / bank some Net Premium whilst also protecting your downside.
- You Write Out of The Money (OTM) Calls with a strike of $52 and the closest expiration date are trading at $1. You write 1 call options contract (each contract contains 100 options) and receive a credit of $100. This is Leg A.
- Out of The Money (OTM) Puts with a strike of $47 and the closest expiration date are trading at $.50. You buy 1 call options contract (each contract contains 100 options) at a cost of $50.
- You have created a Covered Call Collar and received a net credit of $50.

Profiting

The maximum possible profit will be returned when, at the time of expiration, the price of the stock has increased to the strike of the calls written ($52). When this happens, the Calls you have written will be At The Money, and will therefore expire worthless. The Puts you have bought will also expire worthless.

Therefore, you would keep the net credit made at the time of applying the strategy ($50) + the shares that you own have increased in value by $2 per share and you will have also made a profit of $200 on the Long Stock position. This would give you a total profit of $250.

There's also the risk that the Covered Call Collar can potentially cost you profits if the stock rises above the strike of the options written in Leg A. In the above example, should the stock rise above $52, then the Calls written in Leg A could be assigned. You could be obliged to sell the Stock you own at the strike of $52. This would still represent a profit, but you could have made a larger profit if you had just kept hold of your stock and not used this Covered Call Collar Strategy. Although you can always close the Short Call Options position created in Leg A.

Losses

The biggest possible loss occurs if the price of the underlying security should drop to exactly the strike of the Put Option bought in Leg B ($47). The Calls would expire worthless, and so would the Put, so you would keep the net credit. However, the Long Stock position you own would have dropped in value (by a total of $300), and that loss wouldn't be completely covered by the net credit received. If the shares drop even further the losses wouldn't get any greater. Although the stock would continue to fall in value, the Put Option Contract would start to increase in value and offset the $ losses incurred by the Long Stock position.

Please Note: One other key advantage of the Covered Call Collar is that, at the time of applying the strategy, you can calculate exactly what the maximum return and the maximum loss will be as both profits and losses are limited. However, the profits on the Leg B side of the trade (Long Put) are only limited in the sense that the Stock can only go to Zero. Meaning there is a major hedging advantage by using the Covered Call Collar Strategy versus simply using the Covered Call Strategy. This why we rate the strategy as High Usefulness for Retail Traders for the Covered Call Collar Strategy versus Medium for the Covered Call Strategy. It is also a simple strategy to deploy with only 2X very straight forward transactions.

6. Bull Call Spread

Quick Explanation

Buying a Call Option and Selling a Higher Strike Call Option where both contracts have the same time to expiration.

The Bull Call Spread is one of the most useful Options Trading Strategies for Retail Traders because it is relatively simple, requiring just two transactions to implement and the risk is limited to premium paid. It is primarily used when the outlook on an underlying Stock is Bullish, and the expectation is that the Stock will increase in price to a certain range in the time frame of the contracts traded, but no higher than a certain level. It's often considered a cheaper alternative to the Long Call Options Strategy, because it involves Writing Calls to offset some of the cost of Buying Calls. The trade-off with doing this is that the potential $ profits are capped on the upside (limited). The main reason why you would use this Strategy is to try and profit from a Stock increasing in price. You would typically use it when you expected the price of an asset to increase by a certain amount, but not dramatically (as the profit potential is limited). The strategy is basically designed to reduce the upfront costs of buying Calls so that less capital investment is required, and it can also reduce the effect of time decay.

- **Directional Bet**
- **Bullish Strategy**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

Buying a Call Option and Selling a Higher Strike Call Option where both contracts have the same time to expiration.

The main reason you would use a Bull Call Spread is because you are Bullish the underlying Stock and you expect it to rise in price but not above a certain level by the time of expiration of the two Call Option contracts you have bought and sold. The point of this is to get a marginal benefit of being Long the Call Option versus simply owning Stock and to reduce the upfront cost of the Long Call Option Contract by writing a higher Strike Call to the one you have bought. There will be a net Debit (premium) paid over the two transactions because the Long Call Option you have bought is nearer the Money than the one you have sold and is therefore more “expensive” / higher priced. However, the cost of a Bull Call Spread is lower than simply being Long a Call. You are paying for the Lower Strike Call (Debit) and receiving a Credit for writing the higher Strike Call. The net effect is still a net Debit but the cost is reduced. The trade-off here versus paying more for a simple Long Call Option Strategy is that your upside is capped. So, you need to be confident of the Call Option Strike that you sell that the Stock will not rally more than that Strike price by the time of expiration in order to maximise your gain. If the underlying stock rallies above the Strike you have sold, the Calls you have Sold will be In The Money (ITM) as to will your lower Strike Calls, but your Profit would be lower than if you had been just Long the Stock. It could then be argued that the Marginal benefit of putting the strategy on over simply buying Stock diminishes. However, it is still true that the downside of putting the Bull Call Spread on versus simply buying Stock still has a marginal benefit because the downside is limited to the net premium you pay for the spread. So, if the underlying stock falls and both contracts expire worthless you have only lost the premium you have paid for the spread (limited Downside), whereas if you were Long Stock, this may have required more capital and you could have lost a lot more. This is why the Bull Call Spread is ranked high in usefulness for Retail Traders. The $ upside may be limited but the $ risk is also limited. Additionally, it is a simple strategy and it is a Directional Bet. So, the Bull Call Spread Strategy has high usefulness in the specific situations that it can be used for.

How to Use the Strategy

There are two main ways to use the strategy. We can buy an At The Money (ATM) Call and sell a higher Strike Call or we could buy an Out of the Money (OTM) Call and Sell a Higher Strike Call. In both scenarios there needs to be a marginal benefit in doing so over simply being Long Stock. The marginal benefit comes from a Risk Reward analysis of the specific fundamentals you are

looking to expose yourself too and capital considerations. If you are expecting a moderate rise by the time of expiration of both contracts in the underlying Stock then it would better to either own Stock or buy an ATM Call and Sell a higher Strike Call. You must believe that the Strike you sell will be the price that the Stock will go to but no higher than that price. If you expect an explosive rise in the Stock price by the time of expiration of both contracts you may be better off (but not always) buying an OTM Call (say 3-5%) and selling a higher Strike that you believe even though you expect the Stock to rally aggressively, the Stock will settle as close to the higher Strike as possible by expiration but no higher. The biggest decision you need to make therefore when putting on the Bull Call Spread is the Strike that you choose for the Calls that you write.

With the Bull Call Spread you are making money in two ways. You are making profit on the Calls you are going Long as the underlying Stock Price goes up. But you are also making money on the Calls you have written due to time decay. The ideal scenario is that the price of the underlying security goes up to around the strike price of the written options contracts, because this is where the maximum profit is. If the underlying security continues to go up in price beyond that point, then the written contracts will move into a losing position. Although this won't cost you anything, because the options you own will continue to increase in price at the same rate. The spread will lose money if the underlying security doesn't increase in price. Although you will profit from the short position, as the contracts you have written will expire worthless, the options you own will also expire worthless. The potential losses are limited though, because you cannot lose any more than the cost of putting the spread on.

You have the chance to make a bigger Return On Investment (ROI) than you would by simply buying Calls, and also you will have reduced losses if the underlying security falls in value. This is a simple Risk Reward strategy and comparison to simply being Long Calls or being Long Stock, which appeals because you know exactly how much you stand to lose at the point of putting the spread on and exactly how much you stand to make. The disadvantages of are limited, which is perhaps why it's such a popular strategy. There are more commissions to pay than if you were simply buying calls, but the benefits mentioned above should more than offset that minor downside. The only other real disadvantage is that your profits are limited and if the price of the underlying security rises beyond the strike price of the short call options you won't make further gains.

Another use for a Bull Call Spread could be to Hedge a Short Stock Position. By Buying an ATM or slightly OTM Call Option and selling a higher Strike Call this would lower the cost of a simple Long Call Hedge against a Short Stock Position. However again the $ upside would be capped but at least if there is a Short squeeze in the Stock that was unexpected you would save losing money on your Short Stock position and will have increased ammunition to Short more into a technical squeeze (Fundamentals don’t change) if it made sense to do so. As the $ downside on a Short Stock position is theoretically unlimited, this is another reason why this Directional bet has high usefulness for Retail Traders as it can act as an effective hedge on Short Stock positions and add significant value to your overall portfolio.

Break Even

Leg A = Buy ATM or OTM Call Option, Leg B = Write Higher Strike Call Option

Break-even point is when Price of Underlying Security = Strike Price Leg A + (Price of Options Leg A – Price of Options Leg B)

Profit Calculations (Maximum Upside)

Maximum profit is limited

Maximum profit is made when **Price of Underlying Security > or = Strike Price Leg B**

Maximum profit per option owned is **(Strike Price Leg B – Strike Price Leg A) – (Price of Option Leg A – Price of Option Leg B)**

Risk Calculations (Maximum Downside)

Maximum loss is limited

Maximum loss is made when **Price of Underlying Security < or = Strike Price Leg A**

Maximum loss per option owned is **Price of Option Leg A – Price of Option Leg B**

Strategy Example

Here we have provided an example of the Bull Call Spread strategy, showing how it would be used and a few potential outcomes at the point of expiration. Please be aware this example is purely to provide a rough overview of how it can work and it doesn't necessarily use exact prices. For the purposes of this example we have ignored the commission costs.

- Company X stock is trading at $50, and you expect it to increase in price but by no higher than $53.

- At The Money (ATM) Calls on Company X stock (Strike Price $50) are trading at $2 and Out of The Money (OTM) calls on Company X stock (strike price $53) are trading at $0.50.
- You buy 1 Call contract with a Strike price of $50 and Expiration Date of Feb' 22nd (4 weeks from now) at a cost of $200 (One contract = 100 shares). This is Leg A.
- You write 1 Call contract with a Strike Price of $53 and Expiration Date of Feb 22nd for a credit of $50 (One contract = 100 shares). This is Leg B.
- You have created a Bull Call spread for a net debit of $150.

If Company X stock increases to $53 by expiration

The options you bought in Leg A will be In The Money and worth approximately $3 each for a total of $300. The ones you wrote in Leg B will be at the money and worthless. Taking into account your initial investment of $150, you have made a total profit of around $150.

If Company X stock rose even higher than $53, your profits wouldn't increase above the $150, because the short position would start to cost you money.

If Company X stock increases to $52 by expiration

The options you bought in Leg A will be In The Money and worth approximately $2 each for a total of $200. The ones you wrote in Leg B will be out of the money and worthless. Taking into account your initial investment of $150, you have made a total profit of around $50.

If Company X Stock stays at $50 or falls, by expiration date Feb 22nd.

Your contracts would both expire worthless, and you would lose your initial investment. You will have no further returns to come and no further liabilities, but you have lost your initial $150 investment. No matter how far Company X Stock fell, your loss would still be limited to the initial $150 investment.

Remember: You can close your positions at any time prior to expiration if you want to take your profits at a particular point, or cut your losses. Also, you can increase the profit potential of the spread by writing the options in Leg B with a higher strike price.

7. Bear Put Spread

Quick Explanation

The Bear Put Spread is very similar to the Bull Call Spread except it is a bearish directional bet using Put Options. It is one of the most useful Options Trading Strategies for Retail Traders because it is relatively simple, requiring just two transactions to implement and the risk is limited to premium paid. It is primarily used when the outlook on an underlying Stock is Bearish, and the expectation is that the Stock will decrease in price to a certain range in the time frame of the contracts traded, but no lower than a certain level. It's often considered a cheaper alternative to the Long Put Options Strategy, because it involves Writing Puts to offset some of the cost of Buying Puts. The trade-off with doing this is that the potential $ profits are capped on the upside (limited). The main reason why you would use this Strategy is to try and profit from a Stock decreasing in price. You would typically use it when you expected the price of an asset to decrease by a certain amount, but not dramatically (as the profit potential is limited). The strategy is basically designed to reduce the upfront costs of buying Puts so that less capital investment is required, and it can also reduce the effect of time decay.

- **Directional Bet**
- **Bearish Strategy**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

Buying a Put Option and Selling a Lower Strike Put Option where both contracts have the same time to expiration.

The main reason you would use a Bear Put Spread is because you are Bearish the underlying Stock and you expect it to fall in price but not below a certain level by the time of expiration of the two Put Option contracts you have bought and sold. The point

of this is to get a marginal benefit of being Long the Put Option versus simply being Short Stock and to reduce the upfront cost of the Long Put Option Contract by writing a lower Strike Put to the one you have bought. There will be a net Debit (premium) paid over the two transactions because the Long Put Option you have bought is nearer the Money than the one you have sold and is therefore more “expensive” / higher priced. However, the cost of a Bear Put Spread is lower than simply being Long a Put. You are paying for the Higher Strike Put (Debit) and receiving a Credit for writing the lower Strike Put. The net effect is still a net Debit but the cost is reduced. The trade-off here versus paying more for a simple Long Put Option Strategy is that your $ upside is capped. So, you need to be confident of the Put Option Strike that you sell that the Stock will not fall more than that Strike price by the time of expiration in order to maximise your gain. If the underlying stock falls below the Strike you have sold, the Puts you have Sold will be In The Money (ITM) as to will your higher Strike Puts, but your Profit would be lower than if you had just been short the Stock. It could then be argued that the Marginal benefit of putting the strategy on over simply Shorting Stock diminishes. However, it is still true that the downside of putting the Bear Put Spread on versus simply Shorting Stock still has a marginal benefit because the downside is limited to the net premium you pay for the spread. So, if the underlying stock rallies and both contracts expire worthless you have only lost the premium you have paid for the spread (limited $ Downside), whereas if you were Short Stock, this may have required more capital and you could have lost a lot more. This is why the Bear Put Spread is ranked high in usefulness for Retail Traders. The $ upside may be limited but the $ risk is also limited. Additionally, it is a simple strategy and it is a Directional Bet. So, the Bear Put Spread Strategy has high usefulness in the specific situations that it can be used for.

How to Use the Strategy

There are two main ways to use the strategy. We can buy an At The Money (ATM) Put and sell a Lower Strike Put or we could buy an Out of the Money (OTM) Put and Sell a Lower Strike Put. In both scenarios there needs to be a marginal benefit in doing so over simply being Short Stock. The marginal benefit comes from a Risk Reward analysis of the specific fundamentals you are looking to expose yourself too and capital considerations. If you are expecting a moderate fall by the time of expiration of both contracts in the underlying Stock then it would better to either Short Stock or buy an ATM Put and Sell a Lower Strike Put. You must believe that the Strike you sell will be the price that the Stock will go to but no higher than that price. If you expect an aggressive fall in the Stock price by the time of expiration of both contracts you may be better off (but not always) buying an OTM Put (say 3-5%) and selling a Lower Strike that you believe even though you expect the Stock to fall aggressively, the Stock will settle as close to the Lower Strike as possible by expiration but no lower. The biggest decision you need to make therefore when putting on the Bear Put Spread is the Strike that you choose for the Puts that you write.

With the Bear Put Spread you are making money in two ways. You are making profit on the Puts you are going Long as the underlying Stock Price goes down. But you are also making money on the Puts you have written due to time decay. The ideal scenario is that the price of the underlying security goes down to around the strike price of the written options contracts, because this is where the maximum profit is. If the underlying security continues to go down in price beyond that point, then the written contracts will move into a losing position. Although this won't cost you anything, because the options you own will continue to increase in price at the same rate. The spread will lose money if the underlying security doesn't fall in price. Although you will profit from the short position, as the contracts you have written will expire worthless, the options you own will also expire worthless. The potential losses are limited though, because you cannot lose any more than the cost of putting the spread on.

You have the chance to make a bigger Return On Investment (ROI) than you would by simply buying Puts, and also you will have reduced losses if the underlying security rises in value. This is a simple Risk Reward strategy and comparison to simply being Long Puts or being Short Stock, which appeals because you know exactly how much you stand to lose at the point of putting the spread on and exactly how much you stand to make. The disadvantages are limited, which is perhaps why it's such a popular strategy. There are more commissions to pay than if you were simply buying Puts, but the benefits mentioned above should more than offset that minor downside. The only other real disadvantage is that your profits are limited and if the price of the underlying security falls beyond the strike price of the short Put Options you won't make further gains.

Another use for a Bear Put Spread could be to Hedge a Long Stock Position. By Buying an ATM or slightly OTM Put Option and selling a Lower Strike Put this would lower the cost of a simple Long Put Hedge against a Long Stock Position. However, again the $ upside would be capped but at least if there is a fall in the Stock that was unexpected you would save losing money on your Long Stock position and will have increased ammunition to Buy more into a technical sell off (Fundamentals don’t change), if it made sense to do so. As the $ downside on a Long Stock position is theoretically limited as a Stock can only go to Zero, it is still highly desirable especially for Long Term holders of Stocks like Pension Fund holders to Hedge against their Stocks selling off for prolonged periods and to not lose money if Stock Holdings in a pension fall. This is another reason why this Directional bet has high usefulness for Retail Traders as it can act as an effective hedge on Long Stock positions and add significant value to your overall portfolio.

Break Even

Leg A = Buy ATM or OTM Put Option, Leg B = Write Lower Strike Put Option

Break-even point is when **Price of Underlying Security = Strike Price Leg A – (Price of Options Leg A – Price of Options Leg B)**

Profit Calculations (Maximum Upside)

Maximum Profit is Limited

Maximum profit is made when **Price of Underlying Security < or = Strike Price Leg B**

Maximum profit, per option owned is **(Strike Price Leg A – Strike Price Leg B) – (Price of Option Leg A – Price of Option Leg B)**

Risk Calculations (Maximum Downside)

Maximum loss is limited.

Maximum loss is made when **Price of Underlying Security > or = Strike Price Leg A**

Maximum loss per option owned is **Price of Option in Leg A – Price of Option Leg B**

Strategy Example

Here we have provided an example of the Bear Put Spread strategy, showing how it would be used and a few potential outcomes at the point of expiration. Please be aware this example is purely to provide a rough overview of how it can work and it doesn't necessarily use exact prices. For the purposes of this example we have ignored the commission costs.

- Company X stock is trading at $50 and you expect it to fall in price but not any lower than $47.
- At The Money Puts on Company X stock (Strike price $50) are trading at $2 and Out of The Money Puts on Company X stock (strike price $47) are trading at $0.50.
- You buy 1 At The Money Put Option contract with a Strike Price of $50 and Expiration date of Feb 22nd (4 weeks from now) at a cost of $200 (One contract = 100 shares). This is Leg A.
- You write 1 Out The Money Put Option contract with a strike price of $47 and Expiration date of Feb 22nd (4 Weeks from now) for a credit of $50 (One contract = 100 shares) This is Leg B.
- You have now constructed a Bear Put Spread and incurred a net debit of $150.

If Company X stock decreases to $47 by expiration

The Put Options you bought in Leg A will be In The Money and worth around $3 each, and the ones written in Leg B will be At The Money and worthless. The ones owned will be worth around $300 in total which means a profit of $150 after accounting for your initial Debit of $150.

If Company X stock decreases to $48 by expiration

The Put Options you bought in Leg A will be In The Money and worth approximately $2 each, while the ones you wrote in Leg B will be Out of The Money and worthless. The ones you hold will be worth $200 in total, giving you a net profit of $50 after taking your initial Debit of $150 into account.

If Company X stock stays at $50, or increases, by expiration

The Put Options in both Leg A and Leg B will expire worthless. With no returns to come and no liabilities, you have simply lost your initial $150 investment.

If Company X stock increased dramatically, you still wouldn't lose any more than your initial $150 investment. Equally, if Company X stock fell even lower than $47, your profits wouldn't increase above the $150, because the position in Leg B would start to lose you money at the same rate the position in Leg A would make you money.

Remember: You can close your positions at any time prior to expiration if you want to take your profits at a particular point, or cut your losses. Also, you can increase the profit potential of the spread by writing the options in Leg B with a lower strike price.

8. Short Bull Ratio Spread

Quick Explanation

Buy Long Call Option and Write a Call Option with a Lower Strike with the same Expiration date.

The Short Bull Ratio Spread is an Options trading strategy that is used to profit from a security increasing in price in a similar way to simply buying Calls. Specifically, it's designed to reduce the upfront costs of taking a simple Long Call Position while still allowing for unlimited profits. It is a straightforward strategy to apply because it only requires two transactions, but there are some complexities involved, such as choosing an appropriate ratio and knowing which Strike Prices to use. This strategy is best used when you are expecting a security to make a strong rise. It's very similar to the simple long call in that the potential for profits is unlimited; however, while it does not make quite the same level of returns as the long call, it significantly reduces the upfront costs. It's an ideal strategy to use if you are reasonably confident of a security going up, but have some concerns that it may fall in price and don't want to invest too much capital upfront.

The Short Bull Ratio spread requires two simultaneous transactions. Buying Calls and Writing Calls with a lower Strike, but with the same expiration date. You need to buy a greater number of Call Options than you Write, and the idea is to keep the upfront cost as low as possible by buying ones that are cheaper than those that you write.

- **Directional Bet**
- **Bullish Strategy**
- **Simple**
- **Two Transactions**
- **Debit or Credit (As close to Zero as possible or Credit)**
- **Max Risk (Limited)**
- **Max Gain (Unlimited)**

When to Use the Strategy

Buy a Long Call Option and Write a Call Option with a Lower Strike with the same Expiration date.

The Short Bull Ratio Spread strategy will return a profit if, by the time of expiration, the price of the underlying Stock rises sufficiently so that the price of the Calls you own is high enough to make them worth more than the ones you have written, bearing in mind the ones you have written have a Lower Strike and a higher price. As an example (assuming you have applied a 3 to 1 ratio), if the Calls you own are worth $1 each and the ones you have written are worth $2.50 each, the higher the price of the underlying security goes up, the more profit you will make.

The Maximum loss occurs when the price of the underlying security is equal to the Strike of the Calls bought at the time of expiration. This would mean the Calls you own expire worthless, but you will have a liability on the ones you have written with the Lower Strike. Unusually for a Bullish strategy, you will actually be better off if the price of the underlying security falls dramatically than you will be if it only falls a little bit. If the price does drop far enough to be below the Strike of the Call Options you have written, then they will expire worthless too and you will only lose any upfront cost you incurred on the overall Strategy. This is why you should try and make the upfront cost as close to zero as possible.

In assessing the usefulness of the Short Bull Ratio Spread strategy we assess it as High usefulness because of its Unlimited Gain, Limited Risk AND because it costs very little, Zero or you can actually receive a Credit for putting it on. Due to the payoff nature of the Strategy in that it pays for the Stock to move either up aggressively or down and not be Neutral, the best times to use the Short Bull Ratio Spread is if you are Fundamentally Bullish on a Stock Long Term but you believe it might take a fair amount of time for the Stock to go up by a long way and the Stock might have a fair chance of going lower. If you didn't think it had a fair chance of going lower (for whatever reason) then you would just put on a Long Call or Bull Call Spread.

Different Strategies lend themselves to different Fundamental Scenarios. You can be Bullish on a Stock and it could be down 70% in the last 2 years due to real Fundamentally bad reasons but now you assess that the Fundamental turnaround for the Company is beginning. Typically, in these "Turnaround" stories simply buying Stock or Buying Calls or Buying a Bull Call Spread can either be dangerous or wasted money spent on premium, because it might take a long time or longer than expected for them to "Turnaround" the Fundamentals. A Short Bull Ratio Spread can help in this situation, because if its put on with a long time till expiration, it is improbable that over the Long Term that the Stock will still be roughly the same price as when you put it on, if a Fundamental Turnaround in the company's earnings happens or doesn't happen. It will either go up massively (genuine fundamental turnaround) or continue to go down (the fundamental bleed continues). It may also be a takeover target. The Short Bull Ratio Spread can also be useful with growth / momentum plays where you have a Bullish fundamental pre-disposition BUT when you have assessed buying Long Calls or doing a Call Spread it just seems too "expensive" to do so. If you put on a Long

Dated Short Bull Ratio Spread, you can get it on for close to Zero cost, at Zero Cost or even at a Credit and play the momentum of a stock not just in the short term but over the Long term. Remember you are writing In The Money Calls so the Longer-term expiration that you write the more expensive the Options will be and the more money you will take upfront. You will make money on this side of the trade through time decay.

You could also use the Short Bull Ratio Spread as a Hedge against a Short Stock position. Let's say you are Short a Stock that you think might go up for a short period of time but the fundamentals of the Stock will not change. So, you still want to be fundamentally Short the Stock because the fundamentals are so bad that you think it could just collapse at any moment BUT in the short term you want to defend against a potential technical Short Squeeze in the stock. You could create a Short Bull Ratio Spread at Zero Cost and get yourself a "Free Hedge" so if the Stock does rise in price aggressively you do lose on the capital value of the Short Stock position but you make the same amount on the Short Bull Ratio Spread as a Hedge. You can then unwind the Spread when you believe the Stock has topped out leaving yourself Short the Stock at higher prices BUT having lost no money when it rallied. This adds a significant advantage to simply buying a Call as a Hedge or buying a Call Spread as a Hedge because you don't pay anything for it. You will make a proportionately less amount of money on the Ratio Spread versus being Long a Call or a Call Spread but you payed nothing for it.

It is worth mentioning here so we do not get carried away thinking the Short Bull Ratio Spread is the "Ultimate" Options Strategy. You still have to get the Strikes and the Ratios right for the trade to be worthwhile, which on many occasions can be difficult. If you can't get it on for a Ratio at prices and strikes that make sense then it has no incremental value to being Long a Call or Long a Call Spread.

How to Use the Strategy

Perhaps the biggest advantage of this strategy is the fact that you technically have the best of both worlds. Providing the price of the underlying Stock goes up by at least a fair amount then there is no limit to the profits you can make, but you don't stand to lose anything (or at least very little) if the price of the underlying Stock goes down by a fair amount.

The only risk is that the security doesn't move much in price at all and you lose the money spent on the options bought, but you still have a liability on the ones written. You will just have to unwind the Options positions and claw back as much as you can if it becomes obvious prior to expiration that the underlying Stock is not going to move by much either way before expiry. The fact that you can implement the spread without any upfront cost is also obviously appealing.

The only major hurdle you have to overcome is that you do need to get the calculations right in terms of the ratio of the strikes for the strategy to work properly. This might seem simple enough once you know what you are doing, but it can be difficult when you are starting out. The only minor drawback is that you won't make profits at quite the same rate as just buying Options, but that's the trade-off for reducing the upfront costs.

As mentioned in the previous section "When to Use the Strategy" it is best to give yourself a Long-dated shot at making money on the trade in either Fundamental Turnaround stories or Longer-Term Momentum plays. Getting in for free but also giving it enough time to work is the best way to play this Strategy. This is when its most useful versus simply owning Stock, buying a Long Call (which has an upfront cost & can suffer from time decay) or buying a Bull Call Spread (which has an upfront cost too). However, where the Short Bull Ratio Spread is most optimal is in the "Fundamental Turnaround" situation because with a "Momentum Play" it is difficult to justify over simply buying a Call because there is less doubt that the stock will go down in the near to medium term due to a continuation of poor company earnings. Additionally, you won't make as much money on the upside with a Short Bull Ratio Spread versus just being Long a Call Option. You won't have to pay for it BUT you won't make a s much. So, the incremental advantage of the Short Bull Ratio Spread as a Strategy for a Trader is in these "Fundamental Turnaround" stories in Stocks, where upside can be explosive but downside could still occur. You may want to look 6-12 months out in the calendar to play these turnaround stories that have had 1 or 2 bad years of fundamental decline. This gives the company a few more quarters to get the turnaround in place and for investors to wake up to the turnaround and start buying the stock again.

Break Even

Leg A = Buy 3X ATM or slightly OTM Calls, Leg B = Write 1X Lower Strike OTM Call Option

The break-even points of the Short Bull Ratio spread will depend on the ratio used, the upfront costs (if any) and the strike prices used. Here we have used a 3-1 Ratio. It could be 2-1, 4-1 etc etc and you could get in for a cost (Debit) at Zero cost or for a Credit. You need to carry out your own calculations when applying the Short Bull Ratio Spread to determine where the break-even points are.

Profit Calculations (Maximum Upside)

Maximum profit is unlimited.

Profit = **((Price of Underlying Security – Strike Price Leg A) x Number of Options in Leg A) – ((Price of Underlying Security – Strike Price Leg B) x Number of Options in Leg B).**

If you incurred a net debit when creating the spread, then that would have to be deducted from your profits.

Risk Calculations (Maximum Downside)

Maximum loss is limited

Maximum loss is made when **Price of Underlying Security = Strike Price of Leg A**

Maximum loss is **(Price of Underlying Security - Strike Price Leg B) x Number of Options Leg B**

If you incurred a net debit when creating the spread, then that would have to be added to your losses.

Strategy Example

Please note this is just a rough guide to how the strategy works, and it doesn't take into account commission costs. The options prices are obviously hypothetical.

- Company X stock is trading at $50, and you expect a strong increase in price.
- At The Money calls on Company X stock (Strike Price $50) are trading at $2 and In The Money calls on Company X stock (strike price $45) are trading at $6.
- You buy 3 Call Contracts with a Strike Price of $50 (3X contract = 300 shares) at a cost of $600. This is Leg A
- You write 1 call contract with a Strike Price of $45 (1X contract = 100 shares) for a credit of $600. This is Leg B
- You have created a Short Bull Ratio spread for zero upfront cost.

If Company X stock increases to $53 by expiration

The Calls you have bought in Leg A will be worth around $3 each, for a total of $900. The ones you have written in Leg B will have a liability of around $8 each for a total of $800. You will have made a profit of approximately $100.

If Company X stock increases to $55 by expiration

The Calls you have bought in Leg A will be worth approximately $5 each, with a total of $1,500. The ones you have written in Leg B will be worth approximately $10 each, and a total of $1,000. Your profit will be around $500.

If Company X stock remains at $50 by expiration.

The Calls you have bought in Leg A will be At The Money and worthless. The ones you have written in Leg B will have a liability of around $5 each for a total of $500. You will have lost approximately $500.

If Company X stock falls to $45 by expiration.

The Calls you have bought in Leg A will be worthless, and so will the ones you have written in Leg B. You will have roughly broken even on the trade.

The higher the price of Company X stock by expiration, the more profit you would make. If the stock fell any lower than $45, then nothing would change and you would be about break even.

9. Short Bear Ratio Spread

Quick Explanation

Buy Long Put Option and Write a Put Option with a Higher Strike with the same Expiration date.

The Short Bear Ratio Spread Strategy is established to generate profits from the price of a security falling in value. It's essentially an extension of just buying puts (the long put), in that it can provide a high return on investment if a security does fall in price, but it allows you to reduce the amount of capital you need to invest. It is a fairly simple strategy that only requires you to make

two transactions and similar to the Short Bull Ratio Spread it is a ratio trade which means one leg is created at a higher ratio to the other leg. In this case, it involves buying more puts than you write. The Short Bear Ratio Spread is a good choice of strategy when you are expecting the price of a security to drop sharply, but want to reduce the upfront cost of establishing a position. The potential for profits are limited only by how much the security can fall in price (just like the Long Put), but the cost of buying Puts is greatly reduced by also Writing Puts.

The trade-off is simply that you make returns at a proportionately lower rate as the price of the security falls. It's a strategy that you should probably use if you are expecting a security to go down in price, but have some concerns that it may in fact go up in price and want some protection against that happening.

In terms of its usefulness as an Options Trading Strategy for Retail traders, we have to compare it to being simply short a Stock and it must have a Marginal Benefit both in capital requirement terms and risk reward. Additionally, the strategy must have a Marginal Benefit to simply being Long Puts or a Bear Put Spread. We have ranked the Short Bear Ratio Spread as Medium in Usefulness only due to 2X factors. Firstly, the maximum gain is limited BUT only limited to the amount that the underlying Stock can fall i.e. to Zero. When compared to the Short Bull Ratio Spread that has unlimited $ upside the Short Bear Ratio Spread does have limited $ upside so it is not as 'useful" theoretically. Secondly, like the Short Bull Ratio Spread it can be a little complex to get the ratio of Options you buy to Options you write correct and the Strikes you choose correct. Only in this sense is it ranked as Medium in usefulness. In reality there are many situations where if you do get the Ratio's and Strikes right it has high usefulness. So, we are probably being a little bit mean by ranking this Options strategy as "Medium" usefulness. If you get it right, the Risk reward is still awesome because if you get it right you will get the position on for either a small debit, at zero cost or even a credit AND the $ upside on the trade although "Limited" is only limited to how much the stock can fall i.e. Zero can still be huge!

- **Directional Bet**
- **Bearish Strategy**
- **Simple**
- **Two Transactions**
- **Debit or Credit (As close to Zero as possible or Credit)**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

Buy Long Put Option and Write a Put Option with a Higher Strike with the same Expiration date.

The Short Bear Ratio Spread strategy will return a profit if, by the time of expiration, the price of the underlying Stock falls sufficiently so that the price of the Puts you own is high enough to make them worth more than the ones you have written, bearing in mind the ones you have written have a higher Strike and a higher price. As an example (assuming you have applied a 3 to 1 ratio), if the Puts you own are worth $1 each and the ones you have written are worth $2.50 each, the lower the price of the underlying security, the more profit you will make.

The Maximum loss occurs when the price of the underlying security is equal to the Strike of the Puts bought at the time of expiration. This would mean the Puts you own expire worthless, but you will have a liability on the ones you have written with the Higher Strike. Unusually for a Bearish strategy, you will actually be better off if the price of the underlying security rises dramatically than you will be if it only rises a little bit. If the price does rise far enough to be above the Strike of the Put Options you have written, then they will expire worthless too and you will only lose any upfront cost you incurred on the overall Strategy. This is why you should try and make the upfront cost as close to zero as possible.

In assessing the usefulness of the Short Bear Ratio Spread strategy we assess it as Medium in usefulness because of its Limited Gain, Limited Risk AND because it costs very little, Zero or you can actually receive a Credit for putting it on. In reality the "Limited Gain" is only because the underlying Stock can only go to Zero. So, it's just slightly less preferable to the Short Bull Spread Strategy that has Unlimited Gains. Due to the payoff nature of the Strategy in that it Pays for the Stock to move either up aggressively or down and not be Neutral, the best times to use the Short Bear Ratio Spread is if you are Fundamentally Bearish on a Stock Long Term but you believe it might take a fair amount of time for the Stock to break an uptrend, break a technical level and fall by a long way AND the Stock might have a fair chance of going higher. If you didn't think it had a fair chance of going higher (for whatever reason) then you would just put on a Short Stock position Long Put or Bear Put Spread.

Different Strategies lend themselves to different Fundamental Scenarios. You can be Bearish on a Stock and it could be up 200% in the last 2 years due to real Fundamentally good reasons but now you assess that there is going to be a Fundamentally bearish turnaround for the Company soon but you can't time it exactly. Typically, in these "turnaround" stories simply shorting Stock or

Buying Puts or Buying a Bear Put Spread can either be dangerous or wasted money spent on premium, because it might take a long time or longer than expected for the "turnaround" of the Fundamentals to occur. A Short Bear Ratio Spread can help in this situation, because if its put on with a long time till expiration, it is improbable that over the Long Term that the Stock will still be roughly the same price as when you put it on, if a Fundamental turnaround in the company's earnings happens or doesn't happen. It will either go down massively (genuine fundamental turnaround) or continue to go up (the strong bullish fundamentals remain). So, if you shorted stock in this scenario you may have to put up a lot of capital do so and you may get short squeezed with infinite downside. If you put on a Long Put or Long Put Spread only it could be wasted premium. Remember the market can stay irrational longer than you can stay solvent! This is where the incremental usefulness of the Bear Put Ratio Spread strategy comes from.

The Short Bull Ratio Spread can also be useful with Stocks that are in big fundamental trouble and collapsing to zero / going bankrupt i.e. where you have a bearish / terminal view i.e. you believe the company is going to go bust BUT when you have assessed buying Long Puts or doing a Put Spread it just seems too "expensive" to do so. If you put on a Long Dated Short Bear Ratio Spread, you can get it on for close to Zero cost, at Zero Cost or even at a Credit and play the momentum of a stock not just in the short term but over the Long term. You will essentially almost have a "free Option" on the bet that the Company will go bust. Stocks that are heading to Zero also have a lot of takeover risk. You have to assume that there is always some company out there with access to capital who is ready to pay what THEY THINK the company is worth! Remember you are writing In The Money Puts so the Longer-term expiration that you write the more expensive the Options will be and the more money you will take upfront. You will make money on this side of the trade through time decay. Its also worth noting that Stocks historically when they go up go up in a trending manner. When Stocks fall because there is a fundamental turnaround they fall a lot faster than they generally go up. If you have ever heard the phrase "Stocks take the escalator up and the elevator down" this is exactly what we mean. When a company's fundamentals change for the worse, volatility will spike aggressively and every shareholder will be running for the exit. This means Stock Borrow on a Short Stock position will be higher (higher chance of a Stock short squeeze) and Options will be more expensive, so Buying a Long Put or Long Put Spread will be more expensive. A Short Bear Ratio Spread is a good strategy to consider in this scenario because you are writing ITM Puts at higher vol' and buying OTM Puts at higher vol and you are doing it at a small cost or at Zero cost or credit. This is why its incrementally useful.

You could also use the Short Bear Ratio Spread as a Hedge against a Long Stock position. Let's say you are long a Stock that you think might go down for a short period of time but the fundamentals of the Stock will not change. So, you still want to be fundamentally long the Stock and perhaps collect dividends even if the Stock is falling because you want to keep it for the Long Term. You could create a Short Bear Ratio Spread at little or Zero Cost and get yourself a close to free or totally "Free Hedge" so if the Stock does fall in price you lose on the Capital value of your Long Stock position but you make money out of Bear Ratio Put Spread. You can then unwind the Spread when you believe the Stock has bottomed out leaving yourself Long the Stock at lower prices BUT having lost no money when it had fallen. This adds a significant advantage to simply buying a Put as a Hedge or buying a Put Spread as a Hedge because you can pay very little for it or don't pay anything for it. You will make a proportionately less amount of money on the Ratio Spread versus being Long a Put or a Put Spread but you pay nothing for it.

It is worth mentioning here so we do not get carried away thinking the Short Bear Ratio Spread is the "Ultimate" Options Strategy. You still have to get the Strikes and the Ratios right for the trade to be worthwhile, which on many occasions can be difficult. If you can't get it on for a Ratio at prices and strikes that make sense then it has no incremental value to being Long a Put or Long a Put Spread.

How to Use the Strategy

Perhaps the biggest advantage of this strategy is the fact that you technically have the best of both worlds. Providing the price of the underlying Stock goes down by at least a fair amount then you can make fantastic profits and get fantastic reward, but you don't stand to lose anything (or at least very little) if the price of the underlying Stock goes up by a fair amount i.e. the risk reward can be very good.

The only risk is that the security doesn't move much in price at all and you lose the money spent on the options bought, but you still have a liability on the ones written. You will just have to unwind the Options positions and claw back as much as you can if it becomes obvious prior to expiration that the underlying Stock is not going to move by much either way before expiry. The fact that you can implement the spread without any upfront cost is also obviously appealing.

The only major hurdle you have to overcome is that you do need to get the calculations right in terms of the ratio of the strikes for the strategy to work properly. This might seem simple enough once you know what you are doing, but it can be difficult when you are starting out. The other minor drawback is that you won't make profits at quite the same rate as just buying Put Options, but that's the trade-off for reducing the upfront costs.

As mentioned in the previous section "When to Use the Strategy" it is best to give yourself either a Long-dated shot at making money on the trade in either a Stock that has had bullish fundamentals and the fundamentals are now turning bearish (Fundamental Turnaround stories) or Stocks that have experienced a big negative shock and are falling rapidly i.e. "Going to Zero" trades. Getting in for a very low price or for free but also giving it enough time to work is the best way to play this Strategy. This is when its most useful versus simply shorting Stock, buying a Long Put (which has an upfront cost & can suffer from time decay) or buying a Bear Put Spread (which has an upfront cost too). As long as you get the Strikes and the ratios correct, the Short Bear Ratio Spread is a good strategy for both these scenarios. You won't make as much money on the downside with a Short Bear Ratio Spread versus just being Long a Put Option. You won't have to pay for it BUT you won't make as much. So, the incremental advantage of the Short Bear Ratio Spread as a Strategy for a Trader is in these "Fundamental Turnaround" stories in Stocks, where fundamentals are still bullish but deteriorating and the stock is still trending up or sideways and it might take a while for the bearish fundamentals to worsen and the stock to break to the downside aggressively. You may want to look 6-12 months out in the calendar to play these turnaround stories that have had several years of bullish fundamentals and uptrend. This gives you a few more quarters to allow the bearish turnaround to take hold and for investors to wake up to the turnaround and start heading for the exits and aggressively selling the Stock.

Break Even

Leg A = Buy 3X ATM or slightly OTM Puts, Leg B = Write 1X Higher Strike OTM Put Option

The break-even points of the Short Bear Ratio spread will depend on the ratio used, the upfront costs (if any) and the strike prices used. Here we have used a 3-1 Ratio. It could be 2-1, 4-1 etc etc and you could get in for a cost (Debit) at Zero cost or for a Credit. You need to carry out your own calculations when applying the Short Bull Ratio Spread to determine where the break-even points are.

Profit Calculations (Maximum Upside)

Maximum profit is limited only by the amount the security can fall in price.

Profit made is **((Strike Price Leg A – Price of Underlying Security) x Number of Options Leg A) – ((Strike Price Leg B – Price of Underlying Security) x Number of Options Leg B).**

If you incurred a net debit when creating the spread, you would have to deduct that from your profits.

Risk Calculations (Maximum Downside)

Maximum loss is limited

Maximum loss is made when **Price of Underlying Security = Strike Price of Leg A**

Maximum loss is **(Strike Price in Leg B – Price of Underlying Security) x Number of Options in Leg B**

If you incurred a net debit when creating the spread, then that would have to be added to your losses.

Strategy Example

Please note this is just a rough guide to how the strategy works, and it doesn't take into account commission costs. The options prices are obviously hypothetical.

Initial Trade

- Company X Stock is trading at $50 and you expect a strong decrease in the price.
- At The Money Puts on Company X stock (strike of $50) are trading at $2 and In The Money Puts on Company X stock (strike of $55) are trading at $6.
- You buy 3 Put Options contracts with a strike of $50 (3X Contracts = 300 shares) at a cost of $600. This is Leg A.
- You write 1 Put Options contract with a strike of $55 (1X Contract = 100 shares) for a credit of $600. This is Leg B.
- You have created a Short Bear Ratio spread and the upfront cost is zero.

If Company X stock decreases to $47 by expiration

The Puts you own (those in Leg A), will be worth approximately $3 per option, for a total of $900. The ones you have written (those in Leg B) will be worth approximately $8 per option for total of $800. Your profit will be approximately $100.

If Company X stock decreases to $45 by expiration

The Puts you bought in Leg A will be worth around $5 each (a total of $1,500). The ones you wrote in Leg B will be worth around $10 each (a total of $1,000). Your profit will be roughly $500.

If Company X stock remains at $50 by expiration

The puts you bought in Leg A will be worthless. The ones you wrote in Leg B will be worth around $5 each for a total liability of $500. Your loss on the trade will be around $500.

If Company X stock increases to $55 by expiration

The puts you bought in Leg A will be worthless, as will the ones you wrote in Leg B. With no initial cost, you will have roughly broken even on the trade.

If the stock rose any higher than $55, then the result would be the same and you would be about break even. If the stock fell any lower than $45, then your profits would increase further.

10. Bull Call Ladder Spread

Quick Explanation

Buy 1X At The Money or Slightly Out of The Money Call Option and Write 2X higher Strike Calls (with differing Strikes) for the same expiration.

The Bull Call Ladder Spread Strategy as the name suggests is a Bullish Directional Strategy. It is very similar to the Bull Call Spread in which the aim is to profit from a move higher in the underlying Stock price by owning Call Options but at the same time doing this in a less costlier way than simply owning Call options, by writing a higher Strike Call Option at a Strike price that you believe the Stock will not go higher than by the time of expiration of the 2X Call Option contracts. The only difference between the Bull Call Spread and the Bull Call Ladder Spread is the amount of transactions that are required to establish the trade, the ratio by which Call Options are written and the cost of doing so. In the Bull Call Spread the amount of transactions is 2X i.e. Buy 1X Call Option and Sell 1X higher Strike Call Option with the same expiration. With the Bull Call Ladder Spread, there are 3X transactions. Buy 1X Call Option and Sell 2X Higher Strike Calls at different Strikes. The Strategy can be put on for a small Debit or even a Credit.

- **Directional Bet**
- **Bullish Strategy**
- **Simple**
- **Three Transactions**
- **Debit or Credit**
- **Max Risk (Medium-Unlimited)**
- **Max Gain (Limited)**

When to Use the Strategy

Buy 1X At The Money or Slightly Out of The Money Call Option and Write 2X higher Strike Calls (with differing Strikes) for the same expiration.

Putting on a Bull Call Ladder Spread versus establishing a Bull Call Spread, a Long Call Option or simply owning Stock is essentially a trade off between upfront cost (Debit or Credit) and forgone profit opportunity. It is a useful strategy incrementally for Retail Traders because if you can get it on at good prices and you have a very high degree of certainty that the underlying Stock will not rise by expiration above a certain price, it will be a lower priced strategy (Debit or Credit) than simply buying a Bull Call Spread (Debit) or owning an outright Long Call Option position (Debit). The only problem is if the underlying Stock does go higher than both the higher Strikes of the Calls you have written, you will still make money (if the underlying stock doesn't rally too much), but less than simply owning a Bull Call Spread or a Long Call Option or simply owning Stock. If the underlying Stock does rally too much you can actually lose money on the trade. So even though the profits here are limited the risk is theoretically unlimited. Though, only unlimited in the sense that it would have to be in extraordinary circumstances that you lose a lot of money on the trade, which is why we rank this strategy as High as it can be used in many circumstances for

incremental added portfolio value by Retail Traders as the cost of the strategy is low or even beneficial in the receipt of a Credit. You can also always buy back one or both Call Options you have written if you believe the Stock is going to rally higher than the Strikes you have written by expiration. So, there is a degree of flexibility here.

How to Use the Strategy

There are two main ways to use the strategy. We can buy an At The Money (ATM) Call and sell 2X higher Strike Calls at differing Strikes or we could buy a slightly Out of the Money (OTM) Call and Sell 2X Higher Strike Calls at differing Strikes. In both scenarios there needs to be a Marginal Benefit in doing so over simply putting on a Bull Call Spread, a Long Call or simply owning Stock. The marginal benefit comes from a Risk Reward analysis of the specific fundamentals you are looking to expose yourself to and capital considerations. The Capital consideration is fairly straight forward as it would be a lot lower capital (margin) requirement to put on a Long Call, Bull Call Spread or Bull Call Ladder Spread than to simply own Stock. The opportunity cost of doing so is where the real value add to your portfolio (or not) arises i.e. the risk reward versus other Options Strategies. If you are expecting a moderate rise in the underlying Stock by the time of expiration of both legs of the trade then it would be better to either own Stock or buy an At The Money (ATM) Call and Sell a higher Strike Call as a Bull Call Spread or buy an At The Money Call and writing 2X differing higher Strikes thus establishing a Bull Call Ladder Spread rather than buying an Out of The Money Call and writing a higher Strike Call establishing a Bull Call Spread or an Out of the Money Call and establishing a Bull Call Ladder Spread by writing 2X higher strike calls. This is because your view is that the stock is not going to move much higher, so why buy an Out of the Money Call and lower your chances of maximizing profitability? It doesn't make any sense to do so. As with the Bull Call Spread really the most important thing for a Bull Call Ladder Spread to add incremental value to your portfolio and hence to maximize "usefulness" and profitability, you must believe with the Bull Call Ladder Spread that the Strike of the lower Strike Call you sell will be the price that the Stock will go to but no higher than that price. If you expect an explosive rise in the Stock price by the time of expiration of both contracts you may be better off (but not always) buying an OTM Call and selling the 2X higher Strikes that you believe the underlying Stock will not rally beyond in the case of the lower Strike Call you sell. It is the same principle as before when you expected a moderate rise in the stock, except now you're expecting an aggressive rally in the stock. The point is, regardless of your view on how aggressive or moderate the rally will be, profit is maximized when the underlying stock settles at or as close to the Strike price of the lower Strike Call you sell by the time of expiration. The biggest decision you need to make therefore when putting on the Bull Call Ladder Spread is the Strikes that you choose for the Calls that you write. The lower Strike Call needs to be the level that you genuinely believe the Stock can not rally beyond and the second higher Strike Call you sell must be even higher than this.

With the Bull Call Ladder Spread you are making money in two ways. You are making profit on the Calls you are going Long as the underlying Stock Price goes up. But you are also making money on the Calls you have written due to time decay. The ideal scenario is that the price of the underlying security goes up to around the strike price of the Lower Strike written Call options contract, because this is where the maximum profit is. If the underlying security continues to go up in price beyond that point, then the Lower Strike written Call contract will move into a losing position. If the underlying Stock price continues to go even higher beyond the higher Strike Call Option contract you have written, both Call Option Contracts you have written will be losing Money. Remember you have only bought 1X ATM or slightly OTM Call Option at the Lower Strike level and sold 2X Call Options at 2X Higher Strikes. You will still make money by the time of expiration if the underlying Stock settles below the lower Strike Calls you have Written and if it settles between the 2X Strikes you have written. However, if the underlying Stock settles at the time of expiration above both the Strikes you have written your profit will diminish quickly and you could end up losing money because the options you own will NOT continue to increase in price at the same rate as the 2X Call Options contracts you are short. Additionally, the spread will lose money if the underlying security doesn't increase in price. Although you will profit from the short position, as the contracts you have written will expire worthless, the options you own will also expire worthless. The problem you have here is Gap Risk. If the market is closed and a materially positive announcement occurs like a Revenue or profit guidance increase from the company or a merger or takeover of the company and the stock opens say 30% higher than the higher Strike you have sold you are going to be in a big hole. Remember though in continuous markets, even if materially positive news comes out, in terms of risk of losing money due to an aggressive rally in the Stock, there is always the flexibility of buying one or both of the Call Option legs you have written back, if you believe the Stock price will settle higher than the lower Strike or higher than both Strikes you have sold. So, there is some degree of flexibility here. If you buy one of them back you will be left with a Bull Call Spread. If you buy both back you will be left with a Long Call position.

With the Bull Call Ladder Spread you have the chance to make a bigger Return On Investment (ROI) than you would by simply buying Calls or a Bull Call Spread, and also you will have reduced losses if the underlying security falls in value. This is a simple Risk Reward strategy and comparison to simply having a Bull Call Spread, Long Calls or being Long Stock, which appeals because you know exactly how much you stand to lose at the point of putting the spread on. However, you cannot know exactly how much you stand to make or lose if the Stock rallies aggressively through both Strikes of the Call Options you have written, although you will have the ability to know roughly, so it's a moot point.

The disadvantages are limited. There are more commissions to pay than if you were simply buying a Bull Call Spread or going Long Calls. Another disadvantage is that your profits are limited and if the price of the underlying security rises beyond the strike prices of Calls you have written, you won't make further gains and you could end up losing money if it rallies aggressively higher. Lastly this strategy does require a larger amount of margin in your Options trading account versus establishing a Bull Call Spread because you are writing 2X as many Calls as you are buying.

Another use for a Bull Call Ladder Spread could be to Hedge a Short Stock Position. By Buying an ATM or slightly OTM Call Option and selling 2X higher Strike Calls..., this would lower the cost of a simple Long Call Hedge or Bull Call Spread against a Short Stock Position and you may even get a Credit for doing so i.e. you get paid to get a Hedge! However again the $ upside would be capped, but at least if there is a Short squeeze in the Stock that was unexpected you would save losing money on your Short Stock position and will have increased ammunition to Short more Stock into a technical squeeze (Fundamentals don't change) if it made sense to do so. As the $ downside on a Short Stock position is theoretically unlimited, this is another reason why this Directional bet has high usefulness for Retail Traders as it can act as an effective low cost hedge on Short Stock positions and can add significant value to your overall portfolio.

Strategy Example

Due to the complex nature of the 3X transactions and the variability in the Debit / Credit payment, breakeven, profit / loss calculations it is better to use an example than to use a formulaic process in explaining how the Strategy works.

The first thing you need to do before you use this strategy is to determine what strikes you are going to use. You should probably simply buy at the money calls for the long leg of the spread, but you need to put some thought into the strikes for the two short legs. It is best to write one batch of options with a strike equal to approximately what price you think the underlying security will rise to, but not exceed, and write another batch of options with the next highest strike.

You can use higher strikes if you choose, but these will be a cheaper price, and you won't receive as much credit to offset the upfront cost of the long leg. The advantages of using higher strikes though is that the strategy will require less margin and you can potentially make more profits.

Warning! Do not choose Strikes based on whether you will pay a Debit or receive a net Credit. The Stock wont settle at a particular price at expiration simply because you paid out or received money on the strategy. The Stock doesn't care whether you paid a debit or received a Credit. Choose the Strikes you sell based purely on your view of where the Stock is capped near term NOT based on whether you receive a Credit or not. If it so happens that you receive a net Credit then of course that's a bonus. But if it's a small debit then its still OK!

Remember all three legs should use contracts with the same expiration date.

Let's assume that Company X stock is trading at $30, and you believe its price will increase up to around $35, but it will go no higher. You would make the following three transactions.

- Buy At The Money Calls based on Company X stock, with a Strike Price of $30.
- Write the same number of Calls, with a strike of $35.
- Write the same number of Calls again, with a strike of $36.

Now let's look at the sums of money involved in creating this spread. Please note, we haven't accounted for any commission costs.

- At The Money Calls (strike $30) are trading at $1. You buy 2X contracts, (1 contract = 100 shares), for a total cost of $200.
- The Calls with a $35 strike price are trading at $.30. You write 2X contracts, (1 contract = 100 shares), and receive a credit of $60.
- The Calls with a $36 strike price are trading at $.20. You write 2X contracts, (1 contract = 100 shares), and receive a further credit of $40.

The upfront cost of $200 for buying the options is offset by $100 because of writing the options with a higher strike. In this example, you have created a Bull Call Ladder Spread for a cost of $100 (Debit). If you received a Credit you would add this onto your Breakeven and Max Profit calculations.

The spread will start to move towards profit as the underlying security (Company X stock in this example) increases in price. The maximum profit will be if the price of the security increases to at least the lowest strike of the Call options written ($35 in this case) but no higher than the higher strike of the Call options written ($36 in this case).

If the underlying security increases in price beyond that point, the position will start to reverse and you can lose money if the price goes too high. If the underlying security fails to increase in price, or even falls in price, the maximum loss is the initial investment ($100).

Company X stock remains at $30 by expiry

- The Options in the long leg will be At The Money, and will therefore expire worthless. The ones in both the short legs will be out of the money and will also expire worthless. Therefore, you will eat the loss of your initial investment, $100.

Company X stock increases to $33 by expiry

- The Options in the long leg will be in the money, and worth around $3 each. You implicitly own a total of 200 shares, meaning the Options contracts are worth $600.
- The Options in both the short legs will be Out of The Money and they will expire worthless
- Your profit will be the $600, minus your initial $100 investment, for a total of $500

Company X stock increases to $35 by expiry

- The Options in the long leg will be In The Money, and worth around $5 each. You implicitly own a total of 200 shares, meaning the Options contracts are worth $1,000.
- The Options with a Strike of $35 will be At The Money, and will expire worthless.
- The Options with a Strike of $36 will be Out of The Money, and will expire worthless.
- Your profit will be the $1,000, less your initial $100 investment, for a total of $900.
- This is the maximum profit you can make, and it would be the same if the price of Company X stock is anywhere between $35 and $36 at the time of expiration.

Company X stock increases to $40 by expiry

- The Options in the long leg will be In The Money, and worth around $10 each. Your total holding will be worth $2,000
- The Options with a Strike of $35 will be In The Money, and will give you a liability of around $5 each, for a total of $1,000
- The Options with a Strike Price of $36 will be In The Money, and will give you a liability of around $4 each, for a total of $800
- Your profit is the value of the options you own minus your liabilities and your initial investment. This would give you a total of $100 profit.
- If the price of Company X stock increased above $40, your position would turn into a losing one. Of course, you could always close your position early if the security looked like it would rise by that much. The issue is you have Gap Risk!

11. Bear Put Ladder Spread

Quick Explanation

Buy 1X At The Money or Slightly Out of The Money Put Option and Write 2X Lower Strike Puts (with differing Strikes) for the same expiration.

The Bear Put Ladder Spread Strategy as the name suggests is a Bearish Directional Strategy. It is very similar to the Bear Put Spread in which the aim is to profit from a move lower in the underlying Stock price by owning Put Options but at the same time doing this in a less costlier way than simply owning Put options, by writing a lower Strike Put Option at a Strike price that you believe the Stock will not go below by the time of expiration of the 2X Put Option contracts. The only difference between the Bear Put Spread and the Bear Put Ladder Spread is the amount of transactions that are required to establish the trade, the ratio by which Put Options are written and the cost of doing so. In the Bear Put Spread the amount of transactions is 2X i.e. Buy 1X Put Option and Sell 1X lower Strike Put Option with the same expiration. With the Bear Put Ladder Spread, there are 3X transactions. Buy 1X Put Option and Sell 2X Lower Strike Puts at different Strikes. The Strategy can be put on for a small Debit or even a Credit.

- **Directional Bet**
- **Bearish Strategy**
- **Simple**
- **Three Transactions**
- **Debit or Credit**
- **Max Risk (Limited)**
- **Max Gain (Limited)**

When to Use the Strategy

Putting on a Bear Put Ladder Spread versus establishing a Bear Put Spread, a Long-Put Option or simply shorting Stock is essentially a trade-off between upfront cost (Debit or Credit) and forgone profit opportunity. It is a useful strategy incrementally for Retail Traders because if you can get it on at good prices and you have a very high degree of certainty that the underlying Stock will not fall by expiration below a certain price, it will be a lower priced strategy (Debit or Credit) than simply buying a Bear Put Spread (Debit) or owning an outright Long Put Option position (Debit). The only problem is if the underlying Stock does go down more than both the lower Strikes of the Puts you have written, you will still make money (if the underlying stock doesn't fall too much), but less than simply owning a Bear Put Spread or a Long-Put Option or simply shorting Stock. If the underlying Stock does fall a lot you can actually lose money on the trade. We have marked the risk as Medium-Unlimited in the Usefulness stakes. Even though the theoretical loss is limited by the fact that a Stock can only fall to Zero, losses can be high if a Stock does fall by a lot. So even though the profits here are limited and the risk is "limited" we assume large losses can occur as this is just prudent. In reality however, losses should not be big if you are prudent enough to choose the right Strikes to sell and the Stock does crater. You can always buy back Puts in continuous markets which is why we rank this strategy as High. So, there is a degree of flexibility here. It can be used in many circumstances for incremental added portfolio value by Retail Traders as the cost of the strategy is low or even beneficial in the receipt of a Credit.

How to Use the Strategy

There are two main ways to use the strategy. We can buy an At The Money (ATM) Put and sell 2X lower Strike Puts at differing Strikes or we could buy a slightly Out of the Money (OTM) Put and Sell 2X lower Strike Puts at differing Strikes. In both scenarios there needs to be a marginal benefit in doing so over simply putting on a Bear Put Spread, a Long Put or simply shorting Stock. The marginal benefit comes from a Risk Reward analysis of the specific fundamentals you are looking to expose yourself to and capital considerations. The Capital consideration is fairly straight forward as it would be a lot lower capital (margin) requirement to put on a Long Put, Bear Put Spread or Bear Put Ladder Spread than to simply own Stock. The opportunity cost of doing so is where the real value add to your portfolio (or not) arises i.e. the risk reward. If you are expecting a moderate fall in the underlying Stock by the time of expiration of both legs of the trade then it would be better to either be short Stock or buy an At The Money (ATM) Put and Sell a lower Strike Put as a Bear Put Spread or buying an At The Money Put and writing 2X differing lower Strikes thus establishing a Bear Put Ladder Spread rather than buying an Out of The Money Put and writing a lower Strike Put establishing a Bear Put Spread or an Out of the Money Put and establishing a Bear Put Ladder Spread by writing 2X lower strike calls. This is because your view is that the stock is not going to move much lower, so why buy an Out of the Money Put and lower your chances of maximizing profitability? It doesn't make any sense to do so. As with the Bear Put Spread the most important thing for a Bear Put Ladder Spread to add incremental value to your portfolio and hence to maximize "usefulness" and profitability, you must believe with the Bear Put Ladder Spread that the Strike of the higher Strike Put that you sell will be the price that the Stock will go to but no lower than that price. If you expect a dramatic collapse in the Stock price by the time of expiration of both contracts you may be better off (but not always) buying an OTM Put and selling the 2X lower Strikes that you believe the underlying Stock will not fall beyond the higher Strike Put you sell. It is the same principle as before when you expected a moderate fall in the stock, except now you're expecting big fall in the stock. The point is, regardless of your view on how aggressive or moderate the fall will be, profit is maximized when the underlying stock settles at or as close to the Strike price of the higher Strike Put you sell by the time of expiration. The biggest decision you need to make therefore when putting on the Bear Put Ladder Spread is the Strikes that you choose for the Puts that you write. The higher Strike Put that you write needs to be the level that you genuinely believe the Stock cannot fall below and the second lower Strike Put you sell must be even lower than this.

With the Bear Put Ladder Spread you are making money in two ways. You are making profit on the Puts you are going Long as the underlying Stock Price goes down. But you are also making money on the Puts you have written due to time decay. The ideal scenario is that the price of the underlying security goes down to around the strike price of the higher Strike written Put options contracts, because this is where the maximum profit is. If the underlying security continues to go down in price beyond that point, then the higher Strike written Put contract will move into a losing position. If the underlying Stock price continues to go

even lower beyond the lower Strike Put Option contract you have written, both Put Option Contracts you have written will be losing Money. Remember you have only bought 1X ATM or slightly OTM Put Option at the higher Strike level and sold 2X Put Options at 2X lower Strikes. You will still make money by the time of expiration if the underlying Stock settles above the higher Strike Put you have Written and if it settles between the 2X Strikes you have written. However, if the underlying Stock settles at the time of expiration below both the Strikes you have written your profit will diminish quickly and you could end up losing money because the options you own will NOT continue to increase in price at the same rate as the 2X Put Options contracts you are short. Additionally, the spread will lose money if the underlying security doesn't fall in price. Although you will profit from the short position, as the contracts you have written will expire worthless, the options you own will also expire worthless. The potential losses are limited though, because you cannot lose any more than the cost of putting the spread on or if you receive a credit the number should be subtracted from your breakeven calculations from the Strikes of the Puts you have sold as you have received this money upfront. Remember as well in terms of risk of losing money due to an aggressive fall in the Stock, there is always the flexibility of buying one or both of the Put Options you have written back if you believe the Stock price will settle lower than the higher Strike or both Strikes you have sold. So, there is some degree of flexibility here. If you buy one of them back you will be left with a Bear Put Spread. If you buy both back you will be left with a Long-Put position.

With the Bear Put Ladder Spread you have the chance to make a bigger Return On Investment (ROI) than you would by simply buying Puts or a Bear Put Spread, and also you will have reduced losses if the underlying security rises in value. This is a simple Risk Reward strategy and comparison to simply having a Bear Put Spread, Long Puts or being Short Stock, which appeals because you know exactly how much you stand to lose at the point of putting the spread on. However, you cannot know exactly how much you stand to make or lose if the Stock falls aggressively through both Strikes of the Put Options you have written, although you will have the ability to know roughly, so it’s a moot point.

The disadvantages are limited. There are more commissions to pay than if you were simply buying a Bear Put Spread or going Long Puts. Another disadvantage is that your profits are limited and if the price of the underlying security falls beyond the strike prices of Puts you have written, you won't make further gains and you could end up losing money if it falls aggressively lower. Lastly this strategy does require a larger amount of margin in your Options trading account versus establishing a Bear Put Spread because you are writing 2X as many Puts as you are buying.

Another use for a Bear Put Ladder Spread could be to Hedge a Long Stock Position. By Buying an ATM or slightly OTM Put Option and selling 2X lower Strike Puts..., this would lower the cost of a simple Long Put Hedge against a Long Stock Position and you may even get a Credit for doing so i.e. you get paid to get a Hedge! However again the $ upside would be capped, but at least if there is a decent fall in the Stock that was unexpected you would save losing money on your Long Stock position and will have increased ammunition to buy more into a technical fall (Fundamentals don’t change) if it made sense to do so. This is another reason why this Directional bet has high usefulness for Retail Traders as it can act as an effective low-cost hedge on Long Stock positions and can add significant value to your overall portfolio.

Strategy Example

Due to the complex nature of the 3X transactions and the variability in the Debit / Credit payment, breakeven, profit / loss calculations it is better to use an example than to use a formulaic process in explaining how the Strategy works.

The first thing you need to do before use this strategy is to determine what strikes you are going to use. You should probably simply buy at the money Puts for the long leg of the spread, but you need to put some thought into the strikes for the two short legs. It is best to write one batch of options with a strike equal to approximately what price you think the underlying security will fall to, but not go lower than, and write another batch of options with the next lowest strike.

You can use lower strikes if you choose, but these will be a cheaper price, and you won't receive as much credit to offset the upfront cost of the long leg. The advantages of using lower strikes though, is that the strategy will require less margin and you can potentially make more profits.

Warning! Do not choose Strikes based on whether you will pay a Debit or a receive a Credit. The Stock won’t settle at a particular price at expiration simply because you paid out or received money on the strategy. The Stock doesn’t care whether you paid a debit or received a Credit. Choose the Strikes you sell based purely on your view of where you estimate the Stocks floor is near term NOT based on whether you receive a Credit or not. If it so happens that you receive a net Credit then of course that’s a bonus. But if it’s a small debit then it’s still OK!

Now let’s look at the sums of money involved in creating this spread. Please note, we haven't accounted for any commission costs.

- Puts with the $50 strike are trading at $2. You buy 1 contract, containing 100 options, for a total cost of $200.

- Puts with the $45 strike are trading at $.40. You write 1 contract, containing 100 options, for a credit of $40.
- Puts with the $44 strike price are trading at $.30. You write 1 contract, containing 100 options, for a further credit of $30.

The $200 spent on the long leg is partially offset by the $70 credit received for writing contracts in the second leg. The net result is you have created a debit spread, and the total cost is $130. We can now look at the potential profits, and losses, this strategy could return.

The potential profit is limited, and the maximum profit is made when the underlying security (in this case Company X stock) falls in price to the Strike Price of the higher Strike Put written or somewhere between the strikes of the Puts written (in this case between $44 and $45).

If the security falls lower than the lowest strike ($44), then the profits will start to diminish and the position can even move into a loss if the price goes low enough. If the security doesn't fall in price at all, or goes up in price, then the initial investment ($130) will be lost. We have provided some examples of what would happen in a few different scenarios.

Company X stock remains at $50 by expiry

- The options bought will be at the money, and worthless, while the ones written will be out of the money and also worthless. With no further returns or liability, the loss is the amount of the initial debit investment - $130.
-

Company X stock falls to $47 by expiry

- The options bought will be in the money and worth roughly $3 each for a total of $300.
- The options written will all be out of the money and therefore worthless.
- Your profit will be the $300 less your initial $130 investment. You will have made a total profit of $170.

Company X stock falls to $45 by expiry

- The options bought will be in the money, and worth roughly $5 each for a total of $500.
- The options written will all be out of the money and therefore worthless.
- You profit will be the $500, less your initial $130 investment for a total of $370.
- This is the maximum profit you can make, and it's made when Company X stock price is at $45 or anywhere between $44 and $45.

Company X stock falls to $40 by expiry

- The options bought will be in the money and worth around $10 each for a total of $1,000.
- The options written (strike $45) will be in the money and worth around $5 each for a total liability of $500.
- The options written (strike $44) will be in the money and worth around $4 each for a total liability of $400.
- The value of the options owned ($1,000), minus the liabilities ($900) and the initial investment ($130), gives you a total loss of $30.
- The further the price of Company X stock falls, the more you would lose. Remember, though, you can close the position early at any time by selling the options owned and buying back the ones written.

WARNING! Please do remember that with the Bull Call Ladder Spread and with the Bear Put Ladder Spread that there is no such thing as zero “Gap Risk” in Stocks or publicly traded assets. For example, if you have a Bull Call Ladder Spread position on and a company reports or pre-reports and guides to significantly higher Earnings than the market is expecting and while the market is closed, if the Stock opens the next day +20%, +30% or even higher, you will not have a chance to buy back the 2X Calls you have Written at favourable prices and losses can be high. The same goes for a Bear Put Ladder Spread. If a company reports or pre-reports and guides to significantly lower Earnings than the market is expecting i.e. the company announces a “Revenue Warning” and / or “Profit Warning” while the market is closed and the Stock opens the next day -20%, -30% or even lower, you will not have a chance to buy back the 2X Puts you have written at favourable prices and losses can be high. Obviously if you are using the Bull Ladder Spread as a Hedge to a Short Stock Position and the Stock Gaps much higher, you will lose money on your short stock position and you would not make money on your hedge but you would lose even more money overall because of the Hedge. Likewise, if you are using the Bear Put Ladder Spread as a Hedge to a Long Stock Position and the Stock Gaps down much lower you will lose money on your Long Stock position and you would not make money on your Hedge, you would lose even more money overall because of the Hedge. This is why it so important to get the Strikes that you sell right and to get the time to expiration right. Remember with trading Options versus simply trading Stock you are adding timing risk to every trade.

12. Long Straddle

Quick Explanation

Buy 1X At The Money (ATM) Call Option and Buy 1X At The Money (ATM) Put Option with the same Strike and expiration

The Long Straddle is a Non-Directional Strategy and is a bet on Volatility. It is therefore not a bet on whether the underlying Stock will go up or down. It is a bet that the Stock will go up and / or down in a big way. We have marked the Long Straddle Strategy as "Medium Usefulness" for Retail Traders i.e. the Retail Trader Mandate. In reality it should be marked as "Low" usefulness however we have marked it as medium because it helps us to understand more Optimal strategies. We assume throughout the POTM Video Series that you either already have a position in a Stock (Long or Short) or you do not but you already have a Fundamental predisposition in the Stock of either Bullish or Bearish. In either of these cases what is the use of buying a Call and buying a Put at the same time? It neither acts as a Marginal Benefit to owning or shorting stock, nor does it act as an effective Hedge against a Long or Short Stock position i.e. there are better strategies as Hedges using Options to apply. However, we are explaining the Long Straddle Strategy here in the "Useful" PDF because its essential to understand its construction so we can look later at the Strap Straddle and Strip Straddle Strategies that are Directional in nature and are more useful. The only real use that the Long Straddle Strategy has is if you are a Market Maker in Options and you end up getting caught out being Short Volatility in an Asset and you don't want to be Short Volatility in the Asset. In this instance it adds value to a Market Maker BUT it doesn't add any value for those with a Directional predisposition or someone who already has a Stock position and is looking for optimal Hedging strategies i.e. The Retail Trader mandate.

- **Non-Directional Bet**
- **Volatility Bet**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Low Defined)**
- **Max Gain (Unlimited)**

When to Use the Strategy

The Long Straddle is actually a very simple strategy to deploy. You buy an ATM Call Option Contract and simultaneously buy an ATM Put Option Contract with the same expiration. It is clearly a debit strategy so risk is limited to the premium you pay. The $ upside is unlimited due the Long Call nature of the positioning. However, in what instance would you put it on as a Retail Trader? Would you put the position on when you are Fundamentally Bullish on the underlying Stock? Would you put it on when you are Fundamentally Bearish? Would you put it on when you already have a Long Stock or Short Stock Position in order to Hedge or to get more leverage to the upside or downside respectively? No! Why? .., because there are multiple strategies that fit this mandate better mentioned previously in this PDF and that will be mentioned. When you put the Long Straddle on you are not expressing a Directional or even Neutral bias. You are expressing a bias of Volatility and basically saying "no matter which Direction the underlying Stock goes I believe it will just be volatile and either go big up or big down." If the Stock just stayed where it is or Near The Money by the time of expiration then the debit would be lost and it is not worth doing. If it goes up big then you make less money on the upside than if you would have spent the same amount of money on Long double the amount of Calls or double the amount of $ Debit on another Bullish Strategy. If the underlying goes down big then you make less money on the downside than if you would have spent the same amount of money on being Long double the amount of Puts or double the amount of $ Debit on another bearish strategy. Also, we have looked at strategies where if you have a directional bias regardless of the $ amount invested as a Debit or received as a Credit..., there can be much higher % ROI i.e. using alternative strategies to the Long Straddle. The Long Straddle is a large debit because you are buying both Calls and Puts at the same time with the same expiration. You are basically paying a large amount out as a debit for the "I don't have a clue where it's going, but I know its going somewhere" trade. Which is pointless! Unless you are a Market Maker. This to a Retail Trader or anyone with a Directional Fundamental predisposition or who already has a Long / Short position is essentially a "boredom trade." The most likely scenario in the vast majority of cases is that the Stock won't move by as much as you thought and by the time of expiration your premium will have eroded to zero due to time decay and both the Call and the Put option you are long will expire worthless.

How to Use the Strategy

As mentioned above the best time to use the Long Straddle strategy is if you are on the defensive as a Market Maker or if you are a Market Maker and you see an Opportunity to buy Volatility "cheaply" because it is mispriced in the very short term. So, for example let's say you are a U.S. Listed Options Market Maker and you are working on the U.S. Equity Options Market Making

Desk at one of the large U.S. Investment Banks / Brokers and you are using a Black Scholes Options Pricing Model or a similar Options Pricing Model or derivative thereof and multiple clients like Hedge Funds come to you and start buying across multiple Stocks lots of Call Options and Put Options across multiple expirations. What Happens? You now have a "negative selection portfolio" of lots of positions you do not necessarily want to have and you are now short Volatility. A "negative selection portfolio" is one in which the positions were chosen for you NOT chosen by yourself. You have ended up with these positions because you have done business with clients with the intention of being involved in the order flow of the Options market and to make commissions. Maybe you have even sold Implied Volatility in all the names at what you consider at the time to be favourable prices. However, now you have Short Volatility risk. If a big event occurs overnight and Volatility goes through the roof and is out of your control, then as the Market Maker you could lose all your Money and more and even blow up your trading book. So, you decide to Hedge your short Volatility position by buying multiple Long Straddle Positions across the whole market. You may even do this at the market level in Index Options to negate the risk. Then you would slowly unwind both sides of the trade i.e. both the long side or the short side by trading out of the positions intraday and legging out of both sides or you could just let everything expire or a mixture of both.

The point here is that the Long Straddle Strategy has its uses BUT not for a Retail Trader mandate. Retail Traders need Directional, high Reward versus Risk / high ROI Options Trading Strategies because they either already have Stock positions or they already have a Fundamental Bullish or Bearish predisposition on a Stock that has been generated by a systematic Idea Generation process like the systematic process we teach in the PTM Video Series. Retail Traders are looking for an edge from the Options Trading Strategy and for it to add value to either current Long or Short Positions in the stock OR their Fundamental Predisposition by it adding a Marginal Benefit to trade structure. Retail Traders are not competing with Market Makers to hedge negative selection portfolios or indeed in order to "nickel and dime" (arbitrage) Market Makers on Options Prices that they believe are either too high due to the market maker models pricing higher implied volatility or too low due to the market maker models pricing lower implied volatility. If you have a fundamental predisposition of Bullish and you believe a Long Call Options trade for example will provide a higher ROI than simply being Long Stock then if Implied Volatility is priced lower than you expected, this will be reflected in the price of the Option and in your risk reward calculations already. This may present an opportunity. But simply buying a Long Straddle because you are bullish the underlying would be foolish because now the $ debit is twice the size and this will change the risk reward and ROI metrics drastically making the trade in the vast vast majority of cases not worth doing. It would also be counterintuitive to your view i.e. if you are Bullish, why bet the same amount of $ on a downside bet as you would on an upside bet and forego all other Bullish strategies? It simply makes no logical sense.

If you have experienced Trading Educators and Brokers that advocate this strategy as a viable and useful strategy for Retail Traders please question their motives for doing so. There may be a conflict of interest somewhere. Most likely it will be commission and / or volume based. Either that or they are just really genuinely dumb and they do not understand the Retail Trader mandate. Which probably means they don't even have their own trading accounts. Otherwise they would know it's a low usefulness strategy and / or they would have the integrity to tell you not to do it!

We do however have to understand the parameters of the Long Straddle here in order to provide perspective on what "Low Usefulness" means at a bare minimum and so we can understand more Optimal Strategies that are Directional in nature.

Break Even

Leg A = Buy 1X ATM Call, Leg B = Buy 1X ATM Put with the same expiration.

There is an upper break-even point and a lower break-even point.

Upper Break-Even Point = **Strike of Leg A + Price of Each Option in Leg A + Price of Each Option in Leg B)**

Lower Break-Even Point = **Strike of Leg B – (Price of Each Option in Leg A + Price of Each Option in Leg B)**

Profit Calculations (Maximum Upside)

Maximum profit is unlimited

Profit is made when **Price of Underlying Security > (Strike of Leg A + Price of Each Option in Leg A + Price of Each Option in Leg B)** or when **Price of Underlying Security < (Strike of Leg B – (Price of Each Option in Leg A + Price of Each Option in Leg B))**

Risk Calculations (Maximum Downside)

Maximum loss is limited to the initial net Debit

The Long Straddle will return a loss any time **Price of Underlying Security < Upper Break-Even Point and > Lower Break-Even Point**

Strategy Example

The longer term the Options contracts the more time the holder of a Call and a Put with the same expiration has to be right. However, this will already be reflected in the Options prices versus shorter term contracts. Longer term Long Straddles cost more than shorter term Long Straddles and Break evens will be higher. So, it is a fallacy to say that because someone puts on a Longer Term Long Straddle that they have a higher chance of making money than buying a shorter term Long Straddle.

However, here is an example of how it would work; -

- Company X stock is trading at $50, and you believe the price will make a significant move, but you are unsure in which direction.
- At The Money Calls (strike $50) are trading at $2. You buy 1 contract of these (1X Contract = 100 shares), at a cost of $200. This is Leg A.
- At The Money Puts (strike $50) are trading at $2. You also buy 1 contract of these (1X Contract = 100 shares), at a further cost of $200. This is Leg B.
- You have created a Long Straddle for a net debit of $400.

If Company X stock is still trading at $50 by the time of expiration

The options in both legs will expire worthless. You will lose your initial investment of $400.

If Company X stock is trading at $52 by the time of expiration

The Calls in Leg A will be worth $2 each ($200 total) while the Puts in Leg B will expire worthless. The $200 value of the Calls will partially offset the $400 initial investment and you'll lose a total of $200.

If Company X stock is trading at $56 by the time of expiration

The Calls in Leg A will be worth $6 each ($600 total) while the Puts in Leg B will expire worthless. The $600 value of the calls will cover the $400 initial investment and return a $200 profit overall.

If Company X stock is trading at $47 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be worth $3 each ($300 total). The $300 value of the Puts will partially offset the $400 initial investment and you will lose a total of $100.

If Company X stock is trading at $42 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be around $8 each ($800 total). The $800 value of the Puts will cover the $400 initial investment and return a $400 profit overall.

13. Long Strangle

Quick Explanation

Buy 1X Out of The Money (OTM) Call Option and Buy 1X Out of The Money (OTM) Put Option with the same expiration

The Long Strangle Options Strategy has exactly the same dynamics as the Long Straddle Options Trading Strategy except instead of buying At The Money Options the buyer buys Out of The Money Options. The Long Strangle therefore may cost less as a debit given the same time to expiration versus a Long Straddle Strategy, but the chances / probability of it paying off are lower i.e. the underlying Stock would have to move by a lot more in order for it to payoff. However, if the underlying Stock does move more the ROI will be higher. This does not mean however that its usefulness is “High.” It is of low usefulness to the Retail Trader mandate as it is for the Long Straddle. We only characterise it as Medium usefulness here like the Long Straddle because it helps us to understand at the bare minimum what Low usefulness means (perspective) when analysing Options Trading Strategies given the Retail Trader mandate and helps us to understand Directional variations of the strategy which we will come to later i.e. the Strap Strangle and the Strip Strangle.

We will not be repeating How to Use the Strategy or When to use the Strategy information as this is outlined in the Long Straddle explanation. All of the same information applies to the Long Strangle. The only difference are the Strikes of the Call and the Put you buy i.e. they are Out of The Money not At The Money.

- **Non-Directional Bet**
- **Volatility Bet**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Low Defined)**
- **Max Gain (Unlimited)**

We will however outline the Break Even, Profit and Risk of the trade (as a reminder) along with a Strategy Example for your consideration.

Break Even

Break Even

Leg A = Buy 1X OTM Call, Leg B = Buy 1X OTM Put with the same expiration.

There is an upper break-even point and a lower break-even point.

Upper Break-Even Point = **Strike of Leg A + (Price of Each Option in Leg A + Price of Each Option in Leg B)**

Lower Break-Even Point = **Strike of Leg B – (Price of Each Option in Leg A + Price of Each Option in Leg B)**

Profit Calculations (Maximum Upside)

Maximum profit is unlimited

Profit is made when **Price of Underlying Security > (Strike of Leg A + Price of Each Option in Leg A + Price of Each Option in Leg B)** or when **Price of Underlying Security < (Strike of Leg B – (Price of Each Option in Leg A + Price of Each Option in Leg B))**

Risk Calculations (Maximum Downside)

Maximum loss is limited to the initial net Debit

The Long Strangle will return a loss any time the **Price of Underlying Security < Upper Break-Even Point and > Lower Break-Even Point**

Strategy Example

The strategy example given here of a Long Strangle is pretty much exactly the same as the Long Straddle. As you can see above from the break even, profit and risk calculation formulae it is exactly the same calculation. Here we are simply using a slight variation in $ numbers with OTM options for observational and educational purposes.

- Company X stock is trading at $50, and you believe the price will move significantly, but you don't know which direction it will move in.
- Out of The Money Calls (strike $51) are trading at $1.50. You buy 1 contract (1X Contract = 100 Shares), at a cost of $150. This is Leg A.
- Out of The Money Puts (strike $49) are trading at $1.50. You buy 1 contract (1X Contract = 100 Shares), at a further cost of $150. This is Leg B.
- You have now created a Long Straddle for a net debit of $300.

If the price of Company X stock is still $50 by the time of expiration

The Options in both legs will expire worthless and you'll lose your initial investment of $300.

If the price of Company X stock is $52 by the time of expiration

The Calls in Leg A will be worth $1 each ($100 total) while the Puts in Leg B will expire worthless. The $100 value of the Calls will partially offset the $300 initial investment and you will lose a total of $200.

If the price of Company X stock is at $56 by the time of expiration

The Call Options in Leg A will be worth $5 each ($500 total) while the puts in Leg B will expire worthless. The $500 value of the Calls will cover the $300 initial investment and return a $100 profit overall.

If the price of Company X stock is at $47 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be worth $2 each ($200 total). The $200 value of the Puts will partially offset the $300 initial investment and you will lose a total of $100.

If the price of Company X stock is at $42 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be around $7 each ($700 total). The $700 value of the Puts will cover the $300 initial investment and return a $400 profit overall.

14. Strap Straddle

Quick Explanation

Buy 2X At The Money (ATM) Call Options and Buy 1X At The Money (ATM) Put Option with the same expiration

Or in any ratio / combination you prefer i.e. 3-1, 4-1 etc etc.

The Strap Straddle is essentially a modified version of the Long Straddle Options Strategy except instead of buying 1X At The Money Call Option and 1X At The Money Put Option you are placing a Directional bias in the trade of Bullish by buying more ATM Call Options than Put Options at the same expiration. We have marked the Strap Straddle as high in usefulness because it has a Directional Bias and it has minimal risk and unlimited upside. Unlike the Long Straddle Strategy where you are explicitly stating that you have no idea which way the underlying Stock is going to go, with the Strap Straddle you are implicitly stating you are Bullish as you make more money when the Stock Price goes up versus going down. As with all Long Options Strategies you are Long Volatility as well as having a Bullish Directional bias but it is worth pointing out here explicitly because you are also Long Volatility if the underlying stock goes down too.

- **Directional Bet**
- **Bullish and / or Volatility Bet**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Limited)**
- **Max Gain (Unlimited)**

So why would you put on a Strap Straddle?

How to Use the Strategy

If you are looking to enter a new Bullish position you have multiple choices of Strategies as previously mentioned in the “Useful” PDF document. You could buy Stock, you could Buy ATM Calls, OTM Calls, put on a Bull Call Spread, a Short Bull Ratio Spread, a Bull Call Ladder Spread. However, with the Strap Straddle you are choosing not to cap your upside and / or looking to express your view by getting a “cheaper” exposure to the upside. You want ALL the upside and don’t mind paying for it. So, the best way to think of this is that you are actually going Long ATM Calls but you also want a bit of protection on the downside if the underlying Stock goes down during the time to expiration. So, if you are putting on a Strap Straddle that is twice as many Calls as Puts another way to look at it is that you have a 1-2 Hedge against your Long Call position. You are explicitly stating therefore that you are confident that there will be explosive upside in the underlying Stock however you don’t mind spending a bit more premium on Puts as a Hedge in-case you are wrong in the short term / in the time to expiration. It is not like a Long Straddle

position where you are stating that you basically have no idea on the Direction of the underlying and you just want to be Long Volatility. Therefore, for a trader with a Fundamental Predisposition the Long Straddle is pretty useless. What you are stating is that you want to be long volatility but you believe the volatility will be explosive and the direction of the underlying will be to the upside.

When to Use the Strategy

There is one main use to the Strap Straddle. Getting a higher ROI than simply owning Stock and getting some protection to the downside versus simply being Long Call Options. For example. Let's say you have a Fundamental Bullish Pre-disposition, but you think there is a potentially very Bullish catalyst coming up in a Stock, you may instead of say buying $15,000 of Stock or on CFD, or buying $400 of Long Calls you might decide to put a $600 Strap Straddle on because if you are not right on the "very Bullish Catalyst" the Stock could go down by quite a lot especially if by the time the catalyst happens there is a lot of expectation in the market that the catalyst will be Bullish. So, if ATM Calls are trading at $2.00 and ATM Puts are Trading at $2.00, you buy 2X Calls and 1X Put. You have now established a Strap Straddle. Your downside is $600 and your Max Gain is unlimited. The max loss would only occur if the Stock settled on the day of expiration between the reference price of the Stock at the time you placed the trade and +/- the cost of the Options. So why is it useful? Well if the Stock did indeed go down and you were wrong, then you actually stand a chance of making money rather than owning Stock or owning 1X or 2X Call Options. If you are right and the Stock rallies hard then you would have a similar but lower ROI than a 2X Long Calls strategy but you would still be up by a lot. You can then look to trade out of the Options opportunistically and switch your position to a Long Stock position when you believe Volatility has peaked and would be more preferable to own Stock.

So, in this transaction you have put up less capital than buying Stock outright and you have significantly less risk. You have put up more capital than simply buying Calls but you still get a similar $ payoff / profile on the upside (the break even is just higher) and you have some protection or a chance of making money if you are spectacularly wrong and the stock goes down through the lower break even bound. If it works and then you decide to replace the Strap Straddle with a Long Stock position, then you can use the money you have made from the Strap Straddle position as a buffer / stop loss on the Long Stock Position. So, for example if the Strap Straddle trade cost $600 and you made a gain of $1,600 i.e. net profit of $1,000, you could trade out of the Strap Straddle position and use the $1,000 profit as a Stop Loss once you buy $15,000 of Stock. So, you would have a Stop Loss of ($1,000 / $15,000) X 100 = 6.66% on the Stock Position. Meaning after the positive catalyst has caused Volatility to spike and the stock to spike, you cash in on the Options trade opportunistically then you replace your Options position with a "Free" Stock position. If you are spectacularly wrong and the catalyst is not massively positive and the stock settles around the reference price when you put the Strap Straddle on you would lose your premium paid. If you had a stock position on you would be flat but you would have taken a lot more capital risk than the debit you had paid for the Strap Straddle. If the Stock goes lower through the lower Break Even bound you will lose money on the calls but make money on the Put. You would have also saved a lot of money NOT being Long the Stock. You could now seek to buy the Stock at lower levels having preserved Capital if your longer-term view remains the same as before. If the catalyst now changes your Fundamental predisposition in the Stock then you have saved yourself a lot of heartache and Capital lost by choosing the Strap Straddle versus a Long Stock Position or a Long Call Position.

Break Even

Leg A = Buy 2X ATM Calls, Leg B = Buy 1X ATM Put with the same expiration.

The Strap Straddle has an upper break- even point and a lower break-even point.

Upper Break-Even Point = **Strike of Call + (Total Premium Paid / Number of Share Options in Call Contracts)**

Lower Break-Even Point = **Strike of Puts – (Total Premium Paid / Number of Share Options in Put Contracts**

Profit Calculations (Maximum Upside)

Maximum profit is unlimited

Profit is made **when Price of Underlying Security > (Total Premium Paid / Number of share options in Call Contracts)** or when **Price of Underlying Security < Strike of Puts – (Total Premium Paid / Number of share options in Call Contracts)**

Risk Calculations (Maximum Downside)

The Strap Straddle will return a loss if **Price of Underlying Security < Upper Break-Even Point and > Lower Break-Even Point**

Maximum loss is limited to the initial investment and occurs when **Price of Underlying Security = Strike Price**

Strategy Example

As we have mentioned above, the strap straddle is designed specifically to be used when you have a volatile outlook with a bullish inclination. This means that you should use it if your expectation is that the underlying security will make a significant price movement in either direction, with an upward price movement being the most likely direction. It can return a profit from either direction, but the profits will be greater if the underlying security does indeed go up substantially.

- Company X stock is trading at $50 and you believe the price will make a significant move but you think that an upward movement is most likely.
- At The Money Calls (Strike $50) are trading at $2. You buy 2 contracts of these (2X Contracts = 200 shares), at a cost of $400. This is Leg A.
- At The Money Puts (Strike $50) are trading at $2. You buy 1 contract of these, at a cost of $200. This is Leg B.
- You have created a Strap Straddle for a net debit of $600.

If Company X stock is trading at $53 by the time of expiration

The Calls in Leg A will be worth $3 each ($600 total) while the Puts in Leg B will expire worthless. You will have broken even, as the value of the Calls is equal to the initial investment.

If Company X stock is trading at $57 by the time of expiration

The Calls in Leg A will be worth $7 each ($1400 total) while the puts in Leg B will expire worthless. Taking into account the initial investment of $600, you will have made a profit of $800.

If Company X stock is trading at $47 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be worth $3 each ($300 total). You will have made a loss of $300, as the value of the Puts is less than the $600 initial investment.

If Company X stock is trading at $43 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be around $7 each ($700 total). You will have made a total profit of $100, taking into account the initial investment.

15. Strip Straddle

Quick Explanation

Buy 1X At The Money (ATM) Call Option and Buy 2X At The Money (ATM) Put Options with the same expiration

Or in any ratio / combination you prefer i.e. 3-1, 4-1 etc etc.

The Strip Straddle is essentially a modified version of the Long Straddle Options Strategy except instead of buying 1X At The Money Call Option and 1X At The Money Put Option you are placing a Directional bias in the trade of Bearish by buying more ATM Put Options than Call Options with the same expiration. We have marked the Strip Straddle as high in usefulness because it has a Directional Bias and it has minimal risk and unlimited upside. Unlike the Long Straddle Strategy where you are explicitly stating that you have no idea which way the underlying Stock is going to go, with the Strip Straddle you are implicitly stating you are Bearish as you make more money when the Stock Price goes down versus going up. As with all Long Options Strategies you are Long Volatility as well as having a Bearish Directional bias but it is worth pointing out here explicitly because you are also Long Volatility if the underlying stock goes up too.

- **Directional Bet**
- **Bearish and / or Volatility Bet**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Limited)**
- **Max Gain (Unlimited)**

So why would you put on a Strip Straddle?

How to Use the Strip Straddle

If you are looking to enter a new Bearish position you have multiple choices of Strategies as previously mentioned in the "Useful" PDF document. You could Short Stock, you could Buy ATM Puts, OTM Put, put on a Bear Put Spread, a Short Bear Ratio Spread, a Bear Put Ladder Spread. However, with the Strip Straddle you are choosing not to cap your $ upside when the stock falls and / or looking to express your view by getting a "cheaper" exposure to a fall in the underlying Stock. You want ALL the $ upside if the Stock falls and you and don't mind paying for it. So, the best way to think of this is that you are actually going Long ATM Puts but you also want a bit of protection on the upside if the underlying Stock goes up during the time to expiration. So, if you are putting on a Strip Straddle that is twice as many Puts as Calls, another way to look at it is that you have a 1-2 Hedge against your Long-Put position. You are explicitly stating therefore that you are confident that there will be a dramatic collapse in the underlying Stock however you don't mind spending a bit more premium on Calls as a Hedge in-case you are wrong in the short term / in the time to expiration. It is not like a Long Straddle position where you are stating that you basically have no idea on the Direction of the underlying and you just want to be Long Volatility. Therefore, for a trader with a Fundamental Predisposition the Long Straddle is pretty useless. What you are stating is that you want to be long volatility but you believe the volatility will be explosive and the direction of the underlying will be to the downside.

When to Use the Strip Straddle

There is one main use to the Strip Straddle. Getting a higher ROI than simply shorting Stock and getting some protection to the upside versus simply being Long Put Options. For example. Let's say you have a Fundamental Bearish Pre-disposition and you think there is a potentially very Bearish catalyst coming up in a Stock, you may instead of say shorting $15,000 of Stock or on CFD, or buying $400 of Long Puts, decide to put a $600 Strip Straddle on because if you are not right on the "very Bearish Catalyst" the Stock could go up by quite a lot, especially if by the time the catalyst happens there is a lot of expectation in the market that the catalyst will be Bearish. So, if ATM Puts are trading at $2.00 and ATM Calls are Trading at $2.00, you buy 2X Puts and 1X Call. You have now established a Strip Straddle. Your downside is $600 and your Max Gain is unlimited due to the Long Call element of the trade. The max loss would only occur if the Stock settled on the day of expiration between the reference price of the Stock at the time you placed the trade and +/- the cost of the Options. So why is it useful? Well, if the Stock did indeed go up and you were wrong, then you actually stand a chance of making money rather than shorting Stock or owning 1X or 2X Put Options. If you are right and the Stock sells off hard then you would have a similar but lower ROI than a 2X Long Puts strategy but you would still be up by a lot. You can then look to trade out of the Options opportunistically and switch your position to a Short Stock position when you believe it would be more preferable to short Stock.

So, in this transaction you have put up less capital than shorting Stock outright would require and you have significantly less risk. You have put up more capital than simply buying Puts but you still get a similar $ payoff / profile on the upside (the breakeven is just higher) and you have some protection or a chance of making money if you are spectacularly wrong and the stock goes up through the upper break even bound. If it works and then you decide to replace the Strip Straddle with a Short Stock position, then you can use the money you have made from the Strip Straddle position as a buffer / stop loss on the short Stock Position. So, for example if the Strip Straddle trade costs $600 and you made a gain of $1,600 i.e. net profit of $1,000, you could trade out of the Strip Straddle position and use the $1,000 profit as a Stop Loss once you short $15,000 of Stock. So, you would have a Stop Loss of ($1,000 / $15,000) X 100 = 6.66% on the Stock Position. Meaning after the negative catalyst has caused Volatility to spike and the stock to collapse, you cash in on the Options trade opportunistically then you replace your Options position with a "Free" Short Stock position. If you are spectacularly wrong and the catalyst is not massively negative and the stock settles around the reference price when you put the Strip Straddle on, you would lose your premium paid. If you had a short stock position on you would be flat but you would have taken a lot more capital risk than the debit you had paid for the Strip Straddle. If the Stock goes higher through the higher Break Even bound, you will lose money on the Puts but make money on the Call. You would have also saved a lot of money NOT being Short the Stock. You could now seek to Short the Stock at higher levels having preserved Capital, if your longer-term view remains the same as before. If the catalyst now changes your Fundamental predisposition in the Stock then you have saved yourself a lot of heartache and Capital lost by choosing the Strip Straddle versus a Short Stock Position or a Long-Put Position.

Break Even

Leg A = Buy 1X ATM Call, Leg B = Buy 2X ATM Puts with the same expiration.

The Strip Straddle has an upper break- even point and a lower break-even point.

Upper Break-Even Point = **Strike of Call + (Total Premium Paid / Number of share options in Call Contracts)**
Lower Break-Even Point = **Strike of Puts – (Total Premium Paid / Number of share options in Put Contracts)**

Profit Calculations (Maximum Upside)

Maximum profit is unlimited

Profit is made **when Price of Underlying Security > Strike + (Total Premium Paid / Number of share options in Call Contracts)** or when **Price of Underlying Security < Strike of Puts – (Total Premium Paid / Number of share options in Put Contracts)**

Risk Calculations (Maximum Downside)

The Strip Straddle will return a loss if **Price of Underlying Security < Upper Break-Even Point and > Lower Break-Even Point**

Maximum loss is limited to the initial investment and occurs when **Price of Underlying Security = Strike Price**

Strategy Example

The Strip Straddle is an options trading strategy designed to be used when your outlook is volatile with a bearish inclination. Therefore, you would use it when you are expecting a big movement in the price of the underlying security and you think a downward movement is more likely than upward one. It can profit from a big movement in either direction, but will make higher profits from a downward movement.

Applying the Strip Straddle is very similar to applying the Long Straddle, in that you buy At The Money Puts and At The Money Calls. The only real difference is that you need to buy a higher number of Puts than Calls. You still need to use the same expiration date for both the calls and the puts.

The main decision you need to make is what ratio of Puts to Calls you use. In this example we are using a 2-1 ratio

- Company X stock is trading at $50, and you believe the price will make a significant move in a downward direction.
- At The Money Calls (Strike $50) are trading at $2. You buy 1 contract (1X Contract = 100 Shares), at a cost of $200. This is Leg A.
- At The Money Puts (Strike $50) are trading at $2. You buy 2 contracts (2X Contracts = 200 Shares) at a cost of $400. This is Leg B.
- You have created a Strip Straddle at a cost of $600.

If Company X stock is still trading at $50 by the time of expiration

The Options in both legs will expire worthless and you will lose your initial investment of $600.

If Company X stock is trading at $53 by the time of expiration

The Calls in Leg A will be worth $3 each ($300 total) while the Puts in Leg B will expire worthless. The $300 value of the Calls will partially offset the $600 initial investment for a total loss of $300.

If Company X stock is trading at $57 by the time of expiration

The Calls in Leg A will be worth $7 each ($700 total) while the puts in Leg B will expire worthless. The $700 value of the Calls is greater than the $600 initial investment and you will have made a $100 profit overall.

If Company X stock is trading at $47 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be worth $3 each ($600 total). The $600 value of the Puts will offset the $600 initial investment and you will break even.

If Company X stock is trading at $43 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be around $7 each ($1400 total). The $1400 value of the Puts is greater than the $600 initial investment and you will have made an $800 profit overall.

16. Strap Strangle

Quick Explanation

Buy 2X Out of The Money (OTM) Call Options and Buy 1X Out of The Money (OTM) Put Option with the same expiration

Or in any ratio / combination you prefer i.e. 3-1, 4-1 etc etc.

The Strap Strangle is exactly the same trade structure and payoff as the Strap Straddle except instead of buying a higher amount of ATM Calls versus Puts (Strap Straddle) a trader would buy a higher amount of OTM Calls than OTM Puts. Or put another way it is an extension of the Long Strangle Strategy but with a Ratio of higher Calls bought versus Puts bought OTM. The decisions you need to make are what Strikes to use and what Ratio of Calls to Puts to use. Neither of these decisions have a defined correct way to go. It's ultimately down to you to decide what is best for the circumstances and your own expectations of the underlying Catalyst. Whether you go for a Strap Straddle or Strap Strangle will depend on the risk reward and the underlying fundamental catalysts of the Stock you are expecting. The further Out of The Money you go when going long Options for a given Time to Expiration the lower the Options Prices will be, however the chances of getting paid will be lower.

> We have marked its usefulness as High Usefulness as an Options Strategy for the Retail Trader mandate because it has the same usefulness and payoff metrics as the Strap Straddle i.e. a Directional (Bullish) bet and on Volatility, with Limited Risk and unlimited gain. It has all the same uses as the Strap Straddle except a potentially higher ROI if the stock has an explosive move to the upside.

- **Directional Bet**
- **Bullish and / or Volatility Bet**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Limited)**
- **Max Gain (Unlimited)**

For the sake of repetition, we will not be repeating here How and When to Use the Strap Strangle Strategy because it is the same as the Strap Straddle strategy just using OTM Calls and Puts with different Strikes and the same expiration versus ATM Calls and Puts with the same Strike and expiration. However, we will document here the formulas for Break Evens, Profit and Loss and a Strategy Example in order to clarify its usefulness. For our $ payoff formulas and Strategy example, for ease of understanding we will assume that we use Strike Prices that are equidistant from the reference price of the Stock when the position is established.

Break Even

Leg A = Buy 2X OTM Calls, Leg B = Buy 1X OTM Put with the same expiration.

The Strap Strangle has an upper break- even point and a lower break-even point.

Upper Break-Even Point = **Strike of Call + (Total Premium Paid / Number of share options in Call Contracts)**
Lower Break-Even Point = **Strike of Puts – (Total Premium Paid / Number of share options in Put Contracts)**

Profit Calculations (Maximum Upside)

Maximum profit is unlimited

Profit is made **when Price of Underlying Security > Strike + (Total Premium Paid / Number of share options in Call Contracts)** or when **Price of Underlying Security < Strike of Puts – (Total Premium Paid / Number of share options in Put Contracts)**

Risk Calculations (Maximum Downside)

The Strap Strangle will result in a loss if **Price of Underlying Security < Upper Break-Even Point and > Lower Break-Even Point**

Maximum Loss is limited to the initial investment and occurs when **Price of Underlying Security < Strike Price of Leg A and > Strike Price of Leg B**

Strategy Example

Applying a Strap Strangle is simple with just two transactions involved. You need to buy a larger amount of Out of The Money Calls versus Out of The Money Puts, and then you have two main decisions to make. First, you must decide what ratio of Calls to Puts to use. Second, you must decide how far Out of The Money you want the Options to be. For ease of understanding here we have used a Ratio of 2-1 for Calls to Puts and Strikes that are equidistant from the reference price of when the trade is put on.

The Strap Strangle is exactly the same trade structure and payoff as the Strap Straddle except instead of buying a higher amount of ATM Calls versus Puts (Strap Straddle) a trader would buy a higher amount of OTM Calls than OTM Puts. Or put another way it is an extension of the Long Strangle Strategy but with a Ratio of higher Calls bought versus Puts bought.

- Company X stock is trading at $50 and you believe the price will make a significant move in an upward direction.
- Out of The Money Calls (Strike $51) are trading at $1.50. You buy 2X contracts (2X Contracts = 200 Shares) at a cost of $300. This is Leg A.
- Out of The Money Puts (Strike $49) are trading at $1.50. You buy 1X contract (1X Contract = 100 Shares) at a cost of $150. This is Leg B.
- You have created a Strap Strangle for a net debit of $450.

If Company X stock is still trading at $50 by the time of expiration

The Options in both legs will expire worthless and you will lose the $450 upfront Debit.

If Company X stock is trading at $52 by the time of expiration

The Calls in Leg A will be worth $1 each ($200 total) while the Puts in Leg B will expire worthless. The $200 value of the Calls is lower than the $450 net debit, so you will make a loss of $250.

If Company X stock is trading at $58 by the time of expiration

The Calls in Leg A will be worth $7 each ($1400 total) while the Puts in Leg B will expire worthless. The $1400 value of the Calls is greater than the $450 net debit and you will have made a $950 profit overall.

If Company X stock is trading at $48 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be worth $1 each ($100 total). The $100 value of the Puts is lower than the $450 net debit, so you will make a loss of $350.

If Company X stock is trading at $42 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be around $7 each ($700 total). The $700 value of the Puts is greater than the $450 net debit, so your profit will be $250.

17. Strip Strangle

Buy 1X Out of The Money (OTM) Call Option and Buy 2X Out of The Money (OTM) Put Options with the same expiration

Or in any ratio / combination you prefer i.e. 3-1, 4-1 etc etc.

The Strip Strangle is exactly the same trade structure and payoff as the Strip Straddle except instead of buying a higher amount of ATM Puts versus ATM Calls (Strip Straddle) a trader would buy a higher amount of OTM Puts than OTM Calls. Or put another way it is an extension of the Long Strangle Strategy but with a Ratio of higher OTM Puts bought versus OTM Calls bought. The decisions you need to make are what Strikes to use and what Ratio of Puts to Calls to use. Neither of these decisions have a defined correct way to go. It's ultimately down to you to decide what is best for the circumstances and your own expectations of the underlying Catalyst. Whether you go for a Strip Straddle or Strip Strangle will depend on the risk reward and the underlying fundamental catalysts of the Stock you are expecting. The further Out of The Money you go when going long Options for a given Time to Expiration the lower the Options Prices will be, however the chances of getting paid will be lower.

We have marked its usefulness as High Usefulness as an Options Strategy for the Retail Trader mandate because it has the same usefulness and payoff metrics as the Strip Straddle i.e. a Directional (Bearish) bet and on Volatility, with Limited Risk and

unlimited gain. It has all the same uses as the Strip Straddle except a potentially higher ROI if the stock has an explosive move to the downside.

- **Directional Bet**
- **Bearish and / or Volatility Bet**
- **Simple**
- **Two Transactions**
- **Debit**
- **Max Risk (Limited)**
- **Max Gain (Unlimited)**

For the sake of repetition, we will not be repeating here How and When to Use the Strip Strangle Strategy because it is the same as the Strip Straddle strategy just using OTM Calls and Puts with different Strikes and the same expiration versus ATM Calls and Puts with the same Strike and expiration. However, we will document here the formulas for Break Evens, Profit and Loss and a Strategy Example in order to clarify its usefulness. For our $ payoff formulas and Strategy example, for ease of understanding we will assume that we use Strike Prices that are equidistant from the reference price of the Stock when the position is established.

Break Even

Leg A = Buy 1X OTM Call, Leg B = Buy 2X OTM Puts with the same expiration.

The Strip Strangle has an upper break- even point and a lower break-even point.

Upper Break-Even Point = **Strike of Call + (Total Premium Paid / Number of share options in Call Contracts)**
Lower Break-Even Point = **Strike of Puts – (Total Premium Paid / Number of share options in Put Contracts)**

Profit Calculations (Maximum Upside)

Maximum profit is unlimited

Profit is made **when Price of Underlying Security > Strike + (Total Premium Paid / Number of share options in Call Contracts)** or when **Price of Underlying Security < Strike of Puts – (Total Premium Paid / Number of share options in Put Contracts)**

Risk Calculations (Maximum Downside)

The Strip Strangle will return a loss if **Price of Underlying Security < Upper Break-Even Point and > Lower Break-Even Point**

Maximum loss is limited to the initial investment and occurs when **Price of Underlying Security < Strike of Leg A and > Strike of Leg B**

Strategy Example

Applying a Strip Strangle is simple with just two transactions involved. You need to buy Out of The Money Calls and a larger amount of Out of The Money Puts, and then you have two main decisions to make. First, you must decide what ratio of Puts to Calls to use. Second, you must decide how far out of the money you want the Options to be. For ease of understanding here we have used a Ratio of 2-1 for Puts to Calls and Strikes that are equidistant from the reference price of when the trade is put on.

The Strip Strangle is exactly the same trade structure and payoff as the Strip Straddle except instead of buying a higher amount of ATM Puts versus Calls (Strip Straddle) a trader would buy a higher amount of OTM Puts than OTM Calls. Or put another way it is an extension of the Long Strangle Strategy but with a Ratio of higher Puts bought versus Calls bought.

- Company X stock is trading at $50, and you believe the price will make a significant move downward.
- Out of The Money Call (Strike $51) are trading at $1.50. You buy 1 contract (1X Contract = 100 Shares) at a cost of $150. This is Leg A.
- Out of The Money Puts (Strike $49) are trading at $1.50. You buy 2 contracts (2X Contracts = 200 Shares) at a cost of $300. This is Leg B.
- You have created a Strip Strangle for a net debit of $450.

If Company X stock is still trading at $50 by the time of expiration

The Options in both legs will expire worthless and you will lose your initial investment of $600.

If Company X stock is trading at $52 by the time of expiration

The Calls in Leg A will be worth $1 each ($100 total) while the Puts in Leg B will expire worthless. The $100 value of the Calls will partially offset the $450 net debit for a total loss of $350.

If Company X stock is trading at $56 by the time of expiration

The Calls in Leg A will be worth $5 each ($500 total) while the Puts in Leg B will expire worthless. The $500 value of the Calls is greater than the $450 net debit and you will have made a $50 profit overall.

If Company X stock is trading at $48 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be worth $1 each ($200 total). The $200 value of the Puts will partially offset the $450 net debit and you will lose $250.

If Company X stock is trading at $44 by the time of expiration

The Calls in Leg A will expire worthless while the Puts in Leg B will be around $5 each ($1000 total). The $1000 value of the Puts is greater than the $450 net debit, and you'll have made a $550 profit overall.