OIC The Options Industry Council

Options Strategies

QUICK GUIDE

ABOUT OIC

The Options Industry Council (OIC) was created to educate the investing public and brokers about the benefits and risks of exchange-traded options. In an effort to demystify this versatile but complex product, OIC conducts seminars, distributes educational software and brochures, and maintains a Web site focused on options education. OIC was formed in 1992. Today, its sponsors include the American Stock Exchange, Boston Options Exchange, the Chicago Board Options Exchange, the International Securities Exchange, NYSE Arca, the Philadelphia Stock Exchange and The Options Clearing Corporation. These participants have one goal in mind for the options investing public: to provide a financially sound and efficient marketplace where investors can hedge investment risk and find new opportunities for profiting from market participation. Education is one of many factors that assist in accomplishing that goal.

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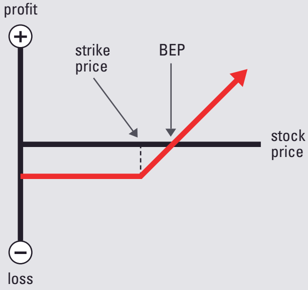
www.optionseducation.org

HOW TO USE THIS BOOK



Each strategy has an accompanying graph showing profit and loss at expiration.

- The vertical axis shows the profit/loss scale.
- When the strategy line is below the horizontal axis, it assumes you paid for the position or had a loss. When it is above the horizontal axis, it assumes you received a credit for the position or had a profit.
- The dotted line indicates the strike price.
- The intersection of the strategy line and the horizontal axis is the break-even point (BEP) not including transaction costs, commissions, or margin (borrowing) costs.
- These graphs are not drawn to any specific scale and are meant only for illustrative and educational purposes.
- The risks/rewards described are generalizations and may be lesser or greater than indicated.

bull strategy | LONG CALL

Example: Buy call

Market Outlook: Bullish

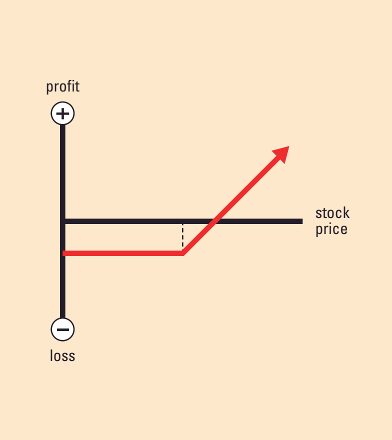
Risk: Limited

Reward: Unlimited

Increase in Volatility:
Helps position

Time Erosion: Hurts position

BEP: Strike price plus
premium paid



bull strategy | BULL CALL SPREAD

Example: Buy 1 call;
sell 1 call at higher strike

Market Outlook: Bullish

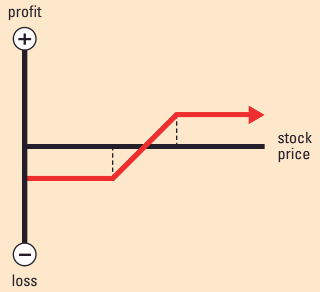
Risk: Limited

Reward: Limited

Increase in Volatility:
Helps or hurts depending
on strikes chosen

Time Erosion: Helps or hurts
depending on strikes chosen

BEP: Long call strike plus
net premium paid



bull strategy | CALL BACKSPREAD

Example: Sell 1 call;
buy 2 calls at higher strike

Market Outlook: Very bullish

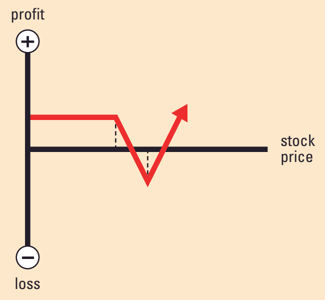
Risk: Limited

Reward: Unlimited

Increase in Volatility:
Typically helps position

Time Erosion:
Typically hurts position

BEP: Two BEPs
1. Short call strike plus premium received
2. Long call strike plus [(the difference between the long call strike and short call strike) minus credit received]



bull strategy | COVERED CALL/BUY WRITE

Example: Buy stock; sell calls on a share-for-share basis

Market Outlook: Neutral to slightly bullish

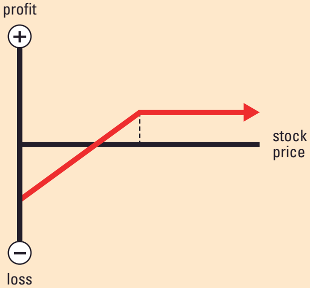
Risk: Limited, but substantial (risk is from a fall in stock price)

Reward: Limited

Increase in Volatility: Hurts position

Time Erosion: Helps position

BEP: Starting stock price minus premium received



bull strategy | **PROTECTIVE/MARRIED PUT**

Example: Own 100 shares of stock; buy 1 put

Market Outlook: Cautiously bullish

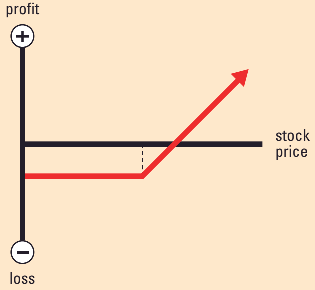
Risk: Limited

Reward: Unlimited

Increase in Volatility: Helps position

Time Erosion: Hurts position

BEP: Starting stock price plus premium paid



bull strategy | CASH-SECURED SHORT PUT

Example: Sell 1 put; hold cash equal to strike price x 100

Market Outlook: Neutral to slightly bullish

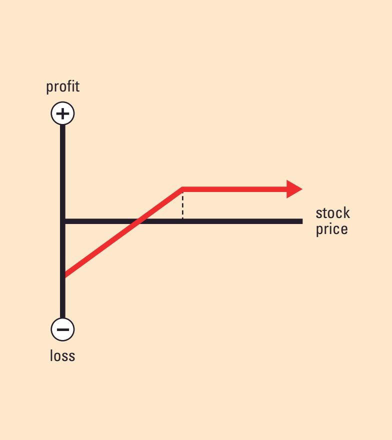
Risk: Limited, but substantial

Reward: Limited

Increase in Volatility: Hurts position

Time Erosion: Helps position

BEP: Strike price minus premium received



bull strategy | BULL SPLIT-STRIKE COMBO

Example: Buy 1 call;
sell 1 put at lower strike

Market Outlook: Bullish

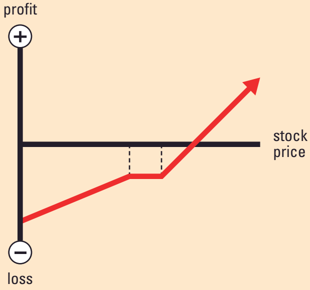
Risk: Limited, but substantial

Reward: Unlimited

Increase in Volatility: Typically helps position

Time Erosion: Typically hurts position

BEP: Two BEPs
1. Long call strike plus premium paid
2. If established at a credit, short put strike minus premium received



Note: This strategy is similar to a Synthetic Long Stock when the strikes are identical.

Bear Strategies

bear strategy | LONG PUT

Example: Buy put

Market Outlook: Bearish

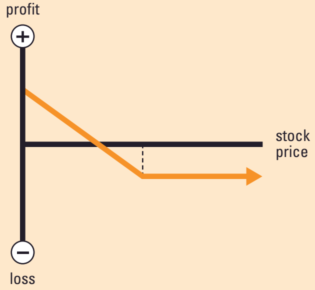
Risk: Limited

Reward: Limited, but substantial

Increase in Volatility:
Helps position

Time Erosion: Hurts position

BEP: Strike price minus
premium paid



bear strategy | BEAR PUT SPREAD

Example: Sell 1 put;
buy 1 put at higher strike

Market Outlook: Bearish

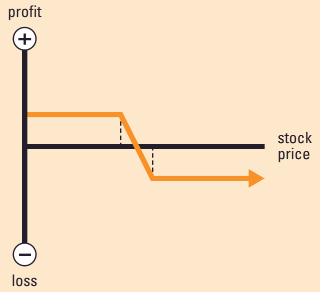
Risk: Limited

Reward: Limited

Increase in Volatility:
Helps or hurts depending on strikes chosen

Time Erosion: Helps or hurts depending on strikes chosen

BEP: Long put strike minus net premium paid



bear strategy | PUT BACKSPREAD

Example: Sell 1 put;
buy 2 puts at lower strike

Market Outlook: Bearish

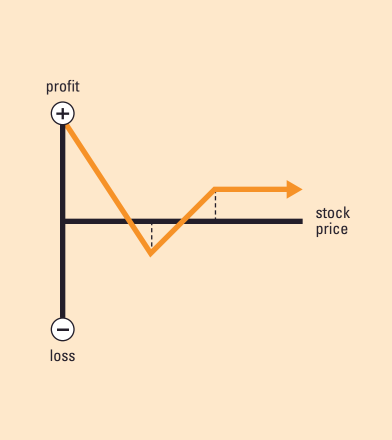
Risk: Limited

Reward: Limited, but substantial

Increase in Volatility: Typically helps position

Time Erosion: Typically hurts position

BEP: Two BEPs
1. Short put strike minus premium received
2. Long put strike minus [(difference between long put strike and short put strike) minus credit received]



bear strategy | **BEAR SPLIT-STRIKE COMBO**

Example: Buy 1 put;
sell 1 call at higher strike

Market Outlook: Bearish

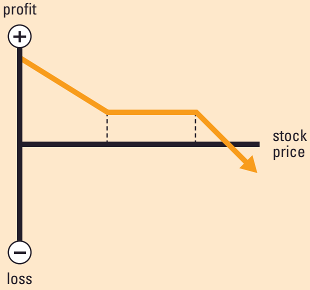
Risk: Unlimited

Reward: Limited, but substantial

Increase in Volatility: Neutral

Time Erosion: Neutral

BEP: Two BEPs
1. Short call strike plus premium received
2. If established at a debit, long put strike minus premium paid



Note: This strategy is similar to a Synthetic Short Stock, if established at a debit.

Neutral Strategies

neutral strategy | COLLAR

Example: Own stock, protect by purchasing 1 put and selling 1 call with a higher strike

Market Outlook: Neutral

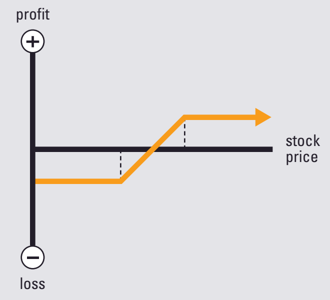
Risk: Limited

Reward: Limited

Increase in Volatility: Effect varies, none in most cases

Time Erosion: Effect varies

BEP: In principle, breaks even if, at expiration, the stock is above/(below) its initial level by the amount of the debit/(credit)



neutral strategy | SHORT STRADDLE

Example: Sell 1 call; sell 1 put at same strike

Market Outlook: Neutral

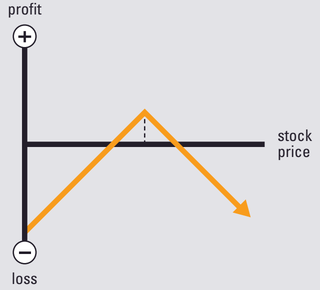
Risk: Unlimited

Reward: Limited

Increase in Volatility: Hurts position

Time Erosion: Helps position

BEP: Two BEPs
1. Call strike plus premium received
2. Put strike minus premium received



neutral strategy | LONG STRADDLE

Example: Buy 1 call;
buy 1 put at same strike

Market Outlook: Large move in either direction

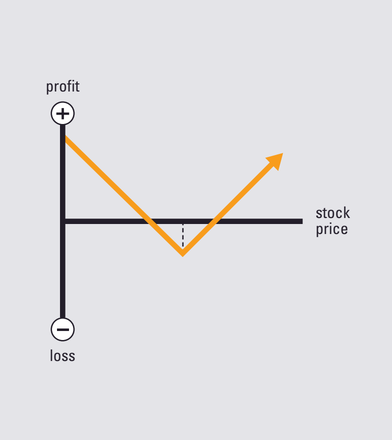
Risk: Limited

Reward: Unlimited

Increase in Volatility: Helps position

Time Erosion: Hurts position

BEP: Two BEPs
1. Call strike plus premium paid
2. Put strike minus premium paid



neutral strategy | LONG STRANGLE

Example: Buy 1 call;
buy 1 put at lower strike

Market Outlook: Large move in either direction

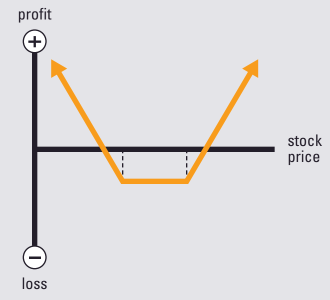
Risk: Limited

Reward: Unlimited

Increase in Volatility: Helps position

Time Erosion: Hurts position

BEP: Two BEPs
1. Call strike plus premium paid
2. Put strike minus premium paid



neutral strategy | SHORT STRANGLE

Example: Sell 1 call;
sell 1 put at lower strike

Market Outlook: Neutral

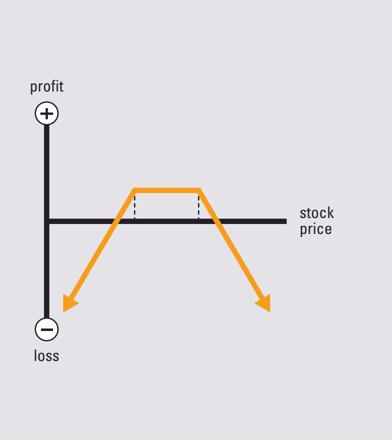
Risk: Unlimited

Reward: Limited

Increase in Volatility:
Hurts position

Time Erosion: Helps position

BEP: Two BEPs
1. Call strike plus premium received
2. Put strike minus premium received



neutral strategy | RATIO SPREAD WITH CALLS

Example: Buy 1 call;
sell 2 calls at higher strike

Market Outlook: Neutral to slightly bullish

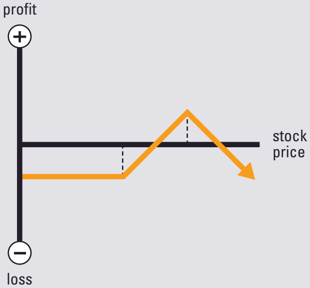
Risk: Unlimited

Reward: Limited

Increase in Volatility: Typically hurts position

Time Erosion: Typically helps position

BEP: Two BEPs
1. Long call strike plus premium paid
2. Short call strike plus [(the difference between the long call strike and short call strike) minus premium paid]



The maximum profit potential is limited to the difference between the strikes plus/(minus) the premium received/(paid).

neutral strategy | LONG CALL BUTTERFLY

Example: Sell 2 calls;
buy 1 call at next lower strike;
buy 1 call at next higher strike
(the strikes are equidistant)

Market Outlook: Neutral around strike

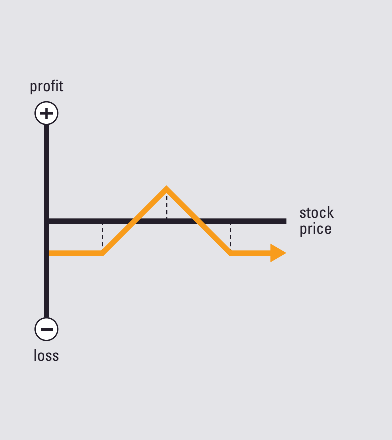
Risk: Limited

Reward: Limited

Increase in Volatility:
Typically hurts position

Time Erosion: Typically helps position

BEP: Two BEPs
1. Lower long call strike plus net premium paid
2. Higher long call strike minus net premium paid



Break-Even Point (BEP): The stock price(s) at which an option strategy results in neither a profit nor loss.

Call: An option contract that gives the holder the right to buy the underlying security at a specified price for a certain, fixed period of time.

In-the-money: A call option is in-the-money if the strike price is less than the market price of the underlying security. A put option is in-the-money if the strike price is greater than the market price of the underlying security.

Long position: A position wherein an investor is a net holder in a particular options series.

Out-of-the-money: A call option is out-of-the-money if the strike price is greater than the market price of the underlying security. A put option is out-of-the-money if the strike price is less than the market price of the underlying security.

Premium: The price a put or call buyer must pay to a put or call seller (writer) for an option contract. Market supply and demand forces determine the premium.

Put: An option contract that gives the holder the right to sell the underlying security at a specified price for a certain, fixed period of time.

Short position: A position wherein the investor is a net writer (seller) of a particular options series.

Strike price or exercise price: The stated price per share for which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

Synthetic position: A strategy involving two or more instruments that has the same risk/reward profile as a strategy involving only one instrument.

Time decay or erosion: A term used to describe how the time value of an option can "decay" or reduce with the passage of time.

Volatility: A measure of the fluctuation in the market price of the underlying security. Mathematically, volatility is the annualized standard deviation of returns.

FOR MORE INFORMATION

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