Bull Call Spread

View : Bullish  
Risk : Low

The bull call option trading strategy is employed when one is of opinion that the price of the underlying asset will go up moderately in the near-term.

The Bull Call spread offers a limited profit potential if the underlying rises and a limited loss if the underlying falls. It is formed with a combination of buy ATM Call and sell OTM Call. The premium received from the selling of OTM call option reduces the cost incurred while paying premium for buying ATM Call option. Other advantage of this strategy is that it has a pre-defined risk-reward ratio.

Profit and loss (at expiry):

**Profit:** Limited to the difference between the two strikes minus net premium cost. Maximum profit occurs when the underlying rises to the level of the higher strike or above.

**Loss:** Limited to the net premium paid in establishing the position. Maximum loss occurs when the underlying falls to the level of the lower strike or below.

**Profitability level:** Strategy reaches the profitable level when the underlying is above the lower strike level by more than the amount equal to the net premium paid.

**Example:** On June 15, 2009, Nifty spot was at 4480. So one can establish this spread position by buying Nifty June 4500 Call Option at 105 and selling Nifty June 4600 Call Option at 80.

Max Profit = \([\text{difference between two strikes} - \text{premium difference}] \times \text{lot size}\]

\[= [(4600-4500) - (105-80)] \times 50 = Rs.3750\]

Maximum profits occur, if Nifty expires at or above 4600 level.

Strategy is profitable above \([\text{lower Call Strike} + \text{difference between the two premiums}]\)

i.e. \(4500 + (105 – 80) = 4525\) level

Maximum loss = Difference between two Premiums * Lot size

\[= (105-80) \times 50 = Rs.1250\]

Maximum losses occur, if Nifty expires at or below 4500 level.
The Covered Call trading strategy is also employed when one is of the opinion that the price of the underlying will go up moderately in the near-term.

The Covered Call spread has the advantage of reducing the cost of holding of a long futures position by selling an OTM Call option. The Covered Call offers a limited profit potential if the underlying rises and the limited downside protection if the underlying falls.

Profit and loss (at expiry):

**Profit:** Limited to the difference between the option strike and futures price plus premium received in selling a call. Maximum profit occurs when the underlying rises to the level of the higher strike or above.
**Loss:** Losses in the long futures position are protected till the premium received if the underlying falls.

**Downside protection till:** Strategy is protected on downsides till the level which is equivalent to the premium received while selling the call option.

**Time decay:** Time decay is the rate of decrease in option premium with the movement towards expiry. Strategy gains with time decay as the call option premium decreases as it approaches towards expiry.

**Example:** On June 15, 2009, Nifty June Futures was at 4490. So one can establish this strategy by buying Nifty June Futures at 4490 and selling Nifty June 4600 Call Option at 80.

Total inflow = Lot size * Premium received on selling the call
= 50 * 80 = Rs.4000

Maximum Profits = Lot Size * { (Difference between the call strike & Futures price) + (Premium received on selling the call)}
= 50 * {(4600-4490)+(80)} = Rs.9500

Strategy will have maximum profits at or above 4600 levels.

Downside is protected till (Futures Price – Premium received on selling call option)
i.e. 4490 – 80 = 4410 levels

Maximum Losses: Losses are unlimited in the strategy below Nifty level of 4410.

**Strategy Pay-off**
Scenario Analysis at various Levels

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Action</th>
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</tbody>
</table>

Profit/Loss per share: -60 0 40 90 190 190
Total Profit/Loss: -3000 0 2000 4500 9500 9500

Bear Put Spread

View: Bearish  
Risk: Low

The Bear Put option trading strategy is employed when one is of the view that the price of the underlying asset will go down moderately in the near-term.

The Bear Put spread offers a limited profit potential if the underlying falls and a limited loss if underlying rises. It is formed with a combination of buy ATM Put and sell OTM Put. The premium received from the selling of OTM Put option reduces the cost incurred while paying premium for buying ATM Put option. Other advantage of this strategy is that it has a pre-defined risk-reward ratio.

Profit and loss (at expiry):

Profit: Limited to the difference between the two strikes minus net premium cost. Maximum profit occurs when the underlying falls to the level of the lower strike or below.

Loss: Limited to the net premium paid in establishing the position. Maximum loss occurs when the underlying rises to the level of the higher strike or above.

Profitability level: Strategy reaches the profitable level when the underlying is below the upper strike level by more than the amount equal to the net premium paid.

Example: On June 15, 2009, Nifty Spot was at 4480. So one can establish this spread position by buying Nifty June 4400 Put option at Rs.70 and selling Nifty June 4300 Put option at Rs.45.

Max Profit = [(difference between two strikes) - (premium difference)] x lot size
= [(4400-4300) – (70-45)] * 50 = Rs.3750

Maximum profits occur, if Nifty expires at or below 4300 level.

Strategy is profitable below [higher Put Strike - (Difference between the two premiums)]
i.e. 4400 - (70-45) = 4375 levels.

Total Cost = Lot Size * (difference between the two premiums)
= 50 * (70 – 45) = Rs.1250

Maximum loss = Difference between the two premiums * Lot size
= (70-45) * 50 = Rs.1250

Maximum losses occur, if Nifty expires at or above 4400 levels.

**Strategy Pay-off**

<table>
<thead>
<tr>
<th>Spot closing at expiry</th>
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<td>75</td>
<td>75</td>
<td>25</td>
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<tr>
<td>Total Profit/Loss</td>
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<td>3750</td>
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</table>
Covered Put

View : Bearish  
Risk : Moderate

The Covered Put trading strategy is employed when one is of opinion that the price of the underlying asset will go down moderately in the near-term.

The Covered Put spread has the advantage of reducing the cost of holding of a short futures position by selling a Put option. The Covered Put offers a limited profit potential if the underlying falls and the limited upside protection if the underlying rises.

Profit and loss (at expiry):

**Profit:** Limited to the difference between the option strike and futures price plus premium received in selling a put. Maximum profit occurs when the underlying falls to the level of the lower strike or below.

**Loss:** Losses in the short futures position are protected till the premium received if the underlying rises.

**Upside protection till:** Strategy is protected on upsides till the level which is equivalent to the premium received while selling the put option.

**Time decay:** Time decay is the rate of decrease in option premium with the movement towards expiry. Strategy gains with time decay as the put option premium decreases as it approaches towards expiry.

**Example:** On June 15, 2009, Nifty June Futures was at 4490. So one can establish this position by Selling Nifty June Futures at 4490 and selling Nifty June 4400 Put Option at 70.

Total Inflow = Lot size * Premium received on selling the put option  
= 50 * 70 = Rs.3500

Maximum Profit = Lot Size * { (Difference between the put strike & futures price) + (Premium received on selling the put)}  
= 50 * {(4490-4400) + (70)} = Rs.8000

Strategy will have maximum profits at or below 4400 levels.

Upside protection till (Futures Price + Premium received on selling put option)  
i.e. 4490 + 70 = 4560 levels.

Maximum losses : Losses are unlimited in the strategy above Nifty level of 4560.
Strategy Pay-off

Scenario Analysis at various Levels

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<tr>
<th>Instrument</th>
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Short Straddle

View : Rangebound

The Short Straddle is employed when one is of opinion that there will be no sharp directional move and the market will trade in the limited range in the near-term.

The Short straddle offers a limited profit potential if the underlying remains in the limited range but can have unlimited losses, if the market moves out of the range. It is formed with a combination of short ATM Call and short ATM Put strikes.

Profit and loss (at expiry):

Profit: Limited to the premium received. Profits will be highest if the underlying remains exactly between the profitable range.

Loss: Unlimited for a sharp move in the underlying in either direction beyond the profitable range.
Profitability: Strategy remains profitable in the range of (Lower strike - total premium received) and (Upper strike + Total premium received).

Increase in Volatility: The option premium increases due to increase in volatility. Hence the strategy may result in losses if the volatility increases.

Time decay: Time decay is the rate of decrease in option premium with the movement towards expiry. Strategy gains with time decay as the option premium decreases as it approaches towards expiry.

Example: On June 15, 2009, Nifty spot was at 4480. So one can establish this position by Selling Nifty June 4500 Call option at Rs. 105 and Selling Nifty June 4500 Put option at Rs.110.

Strategy is profitable below = Higher strike + total premium received  
= 4500 + 215 = 4715 levels

Strategy is profitable above = Lower strike – total premium received  
= 4500 – 215 = 4285 levels

Hence, strategy is profitable in the range of 4285-4715 Nifty levels.

Total Inflow = Lot Size * total premium received  
= 50 * 215 = Rs.10750

Max Profit = Total inflow as computed above.

Strategy Pay-off
Scenario Analysis at various Levels

<table>
<thead>
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<th>Instrument</th>
<th>Action</th>
<th>Strike</th>
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**Short Strangle**

**View : Rangebound**

The Short Strangle is employed when one is of opinion that there will be no sharp directional move and market will trade in the broad range in the near-term. The advantage of Short strangle over short straddle is that short strangle can be profitable in a broad range however, short straddle is profitable in a limited range.

The Short strangle offers a limited profit potential if the underlying remains in the broad range but can have unlimited losses, if the market moves out out of the range. It is a combination of short OTM Call and short OTM Put strikes.

**Profit and loss (at expiry):**

**Profit:** Limited to the premium received. Profits will be highest if the underlying closes exactly between the profitable range.

**Loss:** Unlimited for a sharp move in the underlying in either direction beyond the profitable range.

**Profitability:** Strategy remains profitable in the range of (Lower strike - total premium received) and (Upper strike + Total premium received).

**Increase in Volatility:** The option premium increases due to increase in volatility. Hence the strategy may result in losses if the volatility increases.

**Time decay:** Time decay is the rate of decrease in option premium with the movement towards expiry. Strategy gains with time decay as the option premium decreases as it approaches towards expiry.

**Example:** On June 15, 2009, Nifty spot was at 4480. So one can establish this strategy by Selling Nifty June 4500 Call option at Rs. 105 and Selling Nifty June 4400 Put option at Rs.70.

Strategy is profitable below = Higher strike + total premium received

= 4500 + 175 = 4675 levels
Strategy is profitable above = Lower strike – total premium received
\[= 4400 – 175 = 4225 \text{ levels}\]

Hence, strategy is profitable in the range of 4225-4675 Nifty levels.

Total Inflow = Lot Size * total premium received
\[= 50 * 175 = \text{Rs.8750}\]

Max Profit = Total Inflow as computed above.

**Strategy Pay-off**

![Strategy Payoff Graph]

**Scenario Analysis at various Levels**

<table>
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<th>Instrument</th>
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<td>-105</td>
<td>70</td>
<td>70</td>
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</table>

Profit/Loss per share
-25  0  175  175  0  -25

Total Profit/Loss
-1250  0  8750  8750  0  -1250
**Long Strangle**

**View : Volatile**

The Long Strangle is employed when one is of opinion that there will be a sharp directional move and market will be highly volatile and may move beyond a broad range in the near-term.

The Long strangle offers a unlimited profit potential if the market moves beyond a broad range. However, the long strangle will have a limited loss if the market stagnates and doesn't have a major move. It is formed with a combination of long OTM Call and long OTM Put strikes.

**Profit & loss (at expiry):**

**Profit:** The profit potential is unlimited although a substantial directional movement is necessary to yield a profit in either direction of the underlying.

**Loss:** Loss occurs if the market remains in the range; limited to the premium paid in establishing the position.

**Profitability:** It is reached if the market rises above the higher strike price or falls below the lower strike price by more than the premium paid while establishing the strategy.

**Decrease in Volatility:** The option premium decreases due to decrease in volatility. Hence the strategy may result in losses if the volatility decreases.

**Time decay:** Time decay is the rate of decrease in option premium with the movement towards expiry. Strategy loses with time decay as the option premium decreases as it approaches towards expiry.

**Example:** On June 15, 2009, Nifty spot was at 4480. So one can establish this position by Buying Nifty June 4500 Call option at Rs. 105 and Buying Nifty June 4400 Put option at Rs.70.

Profitable above = Higher strike + total premium received

= 4500 + 175 = 4675 level

Profitable below = Lower strike – total premium received

= 4400 – 175 = 4225 level

Hence, strategy is profitable below 4225 and above 4675 Nifty levels.

Total Outflow = Lot Size * total premium received

= 50 * 175 = Rs.8750

Max Loss = Total outflow as computed above.

Max Profit = Unlimited
Strategy Pay-off

Scenario Analysis at various Levels

<table>
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<th>Instrument</th>
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**Long Straddle**

View : Volatile

The Long Straddle is employed when one is of opinion that there will be a sharp directional move and the market will be highly volatile and may move beyond a limited range in the near-term.

The Long straddle offers an unlimited profit potential if there is major market movement beyond a limited range. However, the long straddle will have a limited loss if the market stagnates and doesn't have a major move. It is formed with a combination of long ATM Call and long ATM Put strikes.

**Profit & Loss (at expiry)**

**Profit:** The profit potential is unlimited although a substantial directional movement is necessary to yield a profit in either direction of the underlying.
**Loss:** Loss occurs if the market remains in the range; limited to the premium paid in establishing the position.

**Profitability:** It is reached if the market rises above the higher strike price or falls below the lower strike price by more than the premium paid while establishing the strategy.

**Decrease in Volatility:** The option premium decreases due to decrease in volatility. Hence the strategy may result in losses if the volatility decreases.

**Time decay:** Time decay is the rate of decrease in option premium with the movement towards expiry. Strategy loses with time decay as the option premium decreases as it approaches towards expiry.

**Example:** On June 15, 2009, Nifty spot was at 4480. So one can establish this position by Buying Nifty June 4500 Call option at Rs. 105 and buying Nifty June 4500 Put option at Rs.110.

Profitable above = Higher strike + total premium received  
= 4500 + 215 = 4715 level

Profitable below = Lower strike – total premium received  
= 4400 – 215 = 4185 level

Hence, strategy is profitable below 4185 and above 4715 Nifty levels.

Total out flow = Lot Size * total premium received  
= 50 * 215 =Rs.10750

Max Loss = Total outflow as computed above.

Max Profit = Unlimited

**Strategy Pay-off**
### Scenario Analysis at various Levels

<table>
<thead>
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<th>Instrument</th>
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### Definitions:

**ATM:**

An option is ATM (at the money) when the strike price of the option is equal to the market price of the underlying security.

**OTM:**

For Call options, strike is OTM (out of the money) when the strike price of the option is higher than the market price of the underlying security.

For Put options, strike is OTM when the strike price of the option is lower than the market price of the underlying security.

**ITM:**

For Call options, strike is ITM (in the money) when the strike price of the option is lower than the market price of the underlying security.

For Put options, strike is ITM when the strike price of the option is higher than the market price of the underlying security.

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