Choosing the Best Option Strategy

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In order to simplify the computations, commissions have not been included in the examples used in these materials. Commission costs will impact the outcome of all stock and options transactions and must be considered prior to entering into any transactions. Multiple-leg strategies involve multiple commission charges.

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Presentation Outline

- Quiz - Pick the best option
- Buy Call vs Bull Call Spread
- Straddle vs Strangle
- Protective Put vs Collar

Pick the Best Option

50 days to expiration

Stock   92.80   →   96.50

Days to Exp.   50 →   40

(50-day options)

    91 Call   4.10 →

    93 Call   2.90 →

    95 Call   1.95 →

    97 Call   1.20 →

Which option would you buy?

Quiz – Pick the Best Option

50 days to expiration

Stock	92.80 →	96.50
Days to Exp.	50 →	40

Estimated results in $

(50-day options)

91 Call	4.10 →	6.40	+2.30
93 Call	2.90 →	4.95	+2.05
95 Call	1.95 →	3.70	+1.75
97 Call	1.20 →	2.70	+1.50

Quiz – Pick the Best Option

50 days to expiration

|			Estimated results in %	
Stock	92.80 → 96.50			
Days to Exp.	50 → 40			
(50-day options)				
91 Call	4.10 → 6.40	+2.30	+ 56%	
93 Call	2.90 → 4.95	+2.05	+ 70%	
95 Call	1.95 → 3.70	+1.75	+ 90%	
97 Call	1.20 → 2.70	+1.50	+125%	

ATM Call Option

Option premium erodes with the passage of time

° only time value affected – not intrinsic value

° erosion accelerates as expiration approaches
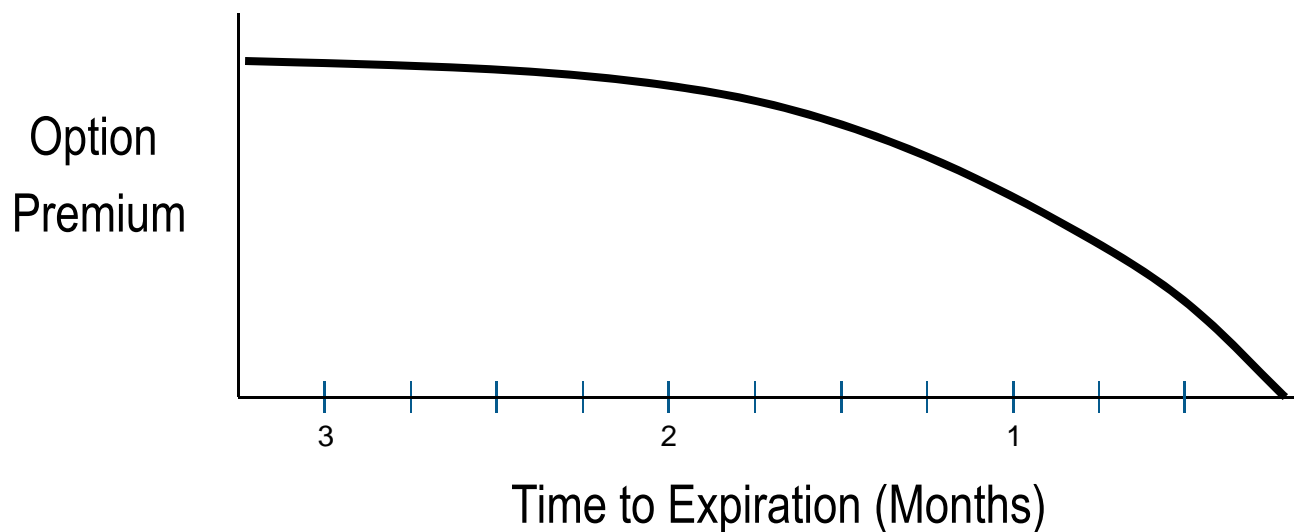
Effects of Changing Volatility

Change in Volatility (Implied or Assumed)	Call Prices	Put Prices
Volatility ↑	↑	↑
Volatility ↓	↓	↓

Volatility
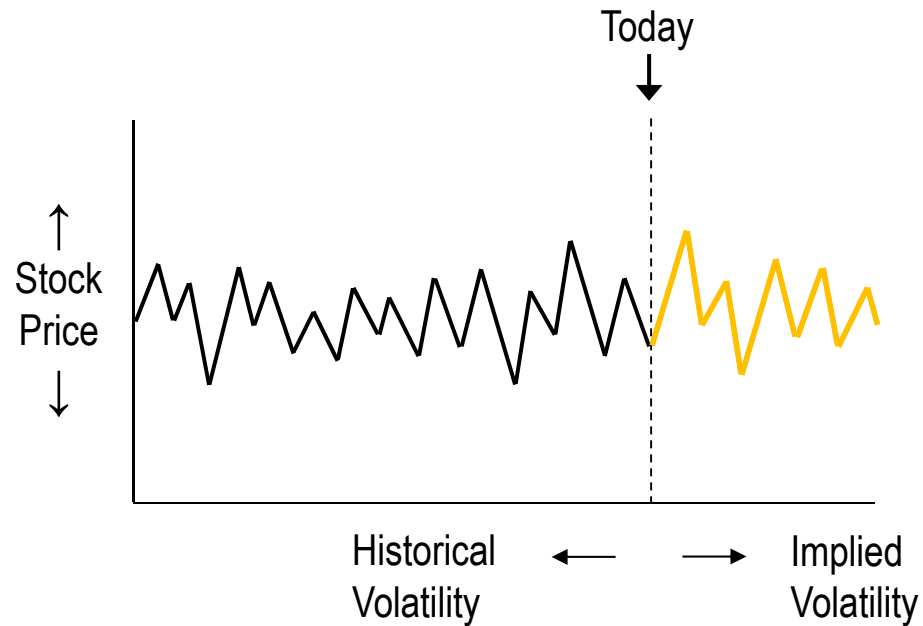
- Only options have implied volatility
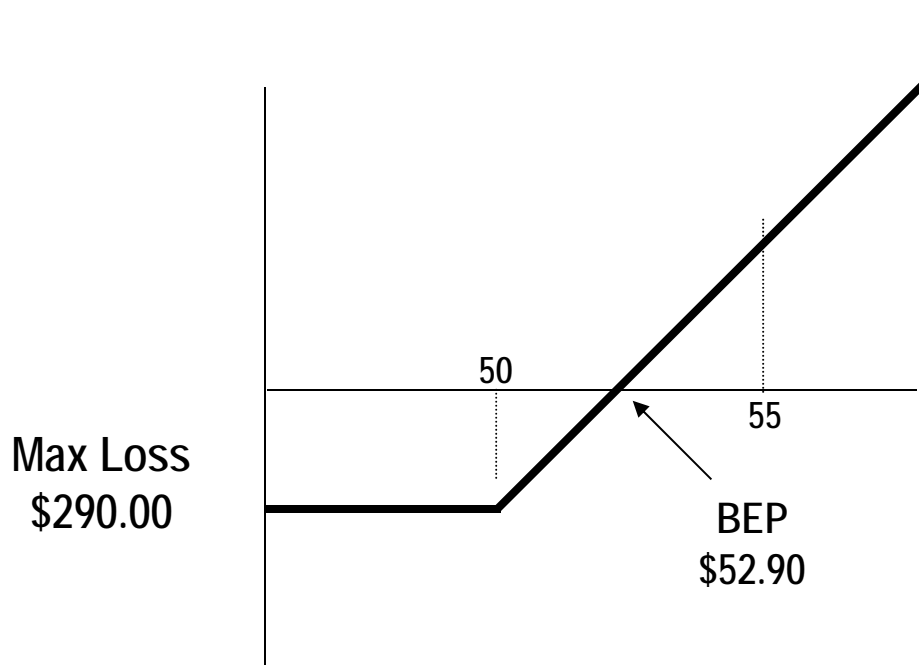- IV predicts a stocks future volatility

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Buy Call vs Bull Call Spread

Planning a Trade

Three-Part Forecast

1) What will the stock do?

2) How long will it take?

3) What about volatility?

Forecasts are the foundation of all option trades

Buy Call Example

Max Profit
Unlimited

50

55

Max Loss
$290.00

BEP
$52.90

Break-even point
lower strike + debit paid
$50.00 + $2.90 = $52.90

Long 50 strike call $2.90

Not including commissions

Two Greeks

Buy Call

	Vega	Theta
Long 50 Call 2.90	+.10	−0.03

Bull Call Spread Example

Max Profit
$330.00

Max Loss
$170.00

50

55

BEP
$51.70
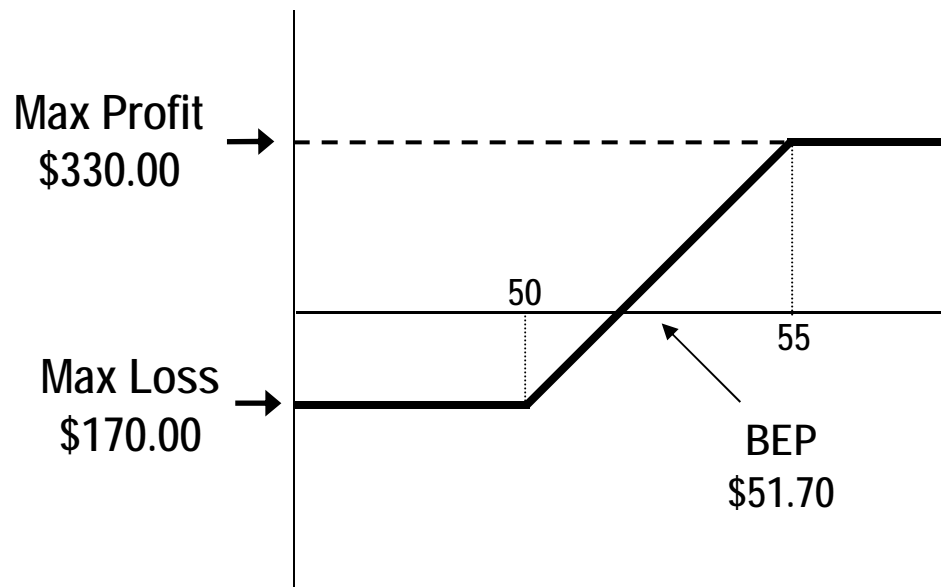
Break-even point
lower strike + debit paid
$50.00 + $1.70 = $51.70

Long 50 Call	2.90
Short 55 Call	1.20
Net Debit	1.70

Not including commissions

Two Greeks

Bull Call Spread

		Vega	Theta
Long 50 Call	2.90	+.10	–0.03
Short 55 Call	1.20	–.08	+0.02
Net Debit	1.70	+.02	-.01

Long Straddle Example

Maximum Loss:
$6.20 Debit Paid
$620.00 Total

Break-even at Expiration:
Upside = Strike + Debit Paid
$50.00 + $6.20 = $56.20
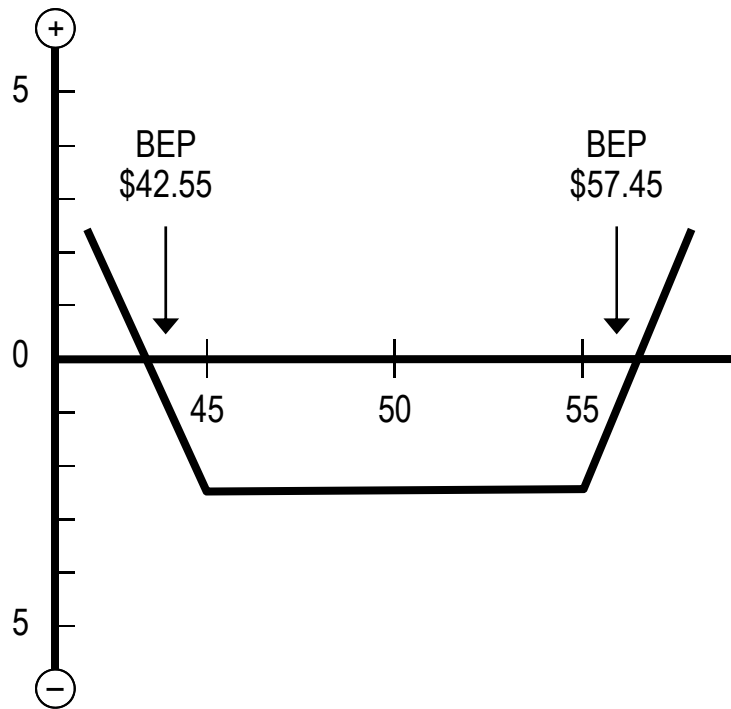
Downside = Strike – Debit Paid
$50.00 – $6.20 = $43.80

Not including commissions

BEP
$43.80

BEP
$56.20

+

5

0

5

−

45   50   55
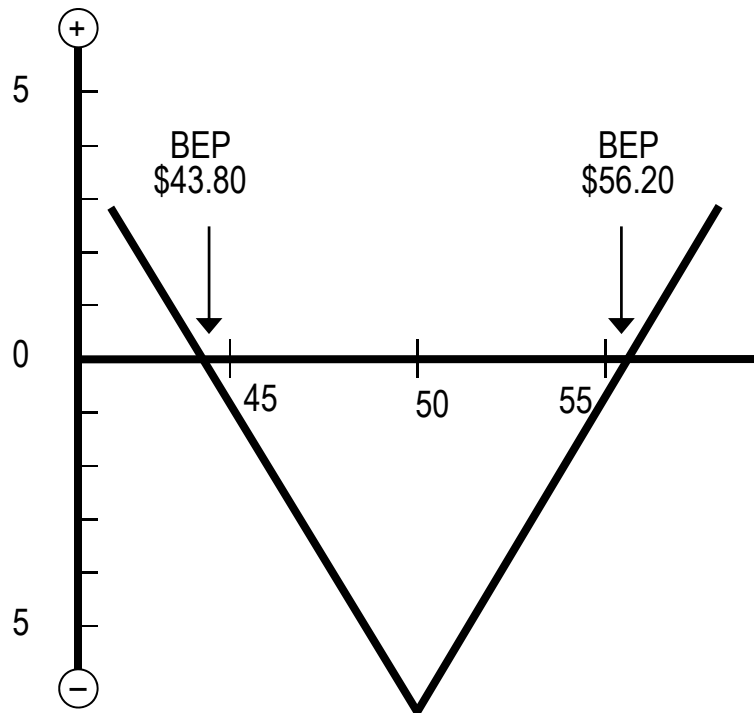
Long 50 ATM call $3.20
Long 50 ATM put $3.00
Net debit $6.20

Two Greeks

Long Straddle

		Vega	Theta
Long 50 Call	3.20	+.10	− 0.03
Long 50 Put	3.00	+.10	− 0.03
Net Debit	6.20	+.20	− .06

Long Strangle Example

BEP $42.55

BEP $57.45

5

0

45   50   55

5

Long 55.00 call $1.40
Long 45.00 put $1.05
        net cost: $2.45

Maximum Loss:
$2.45 Debit Paid
$245.00 Total

Break-even at Expiration:
Upside = Call Strike + Debit Paid
$55.00 + $2.45 = $57.45

Downside = Put Strike – Debit Paid
$45.00 – $2.45 = $42.55

Not including commissions

Two Greeks

Long Strangle

		Vega	Theta
Long 55 Call	1.40	+.06	− 0.02
Long 45 Put	1.05	+.06	− 0.02
Net Debit	2.45	+.12	− .04

Protective Put vs Collar

Protective Put

Own 100 shares XYZ at $42.00

Buy 1 60-day XYZ 40 put at $1.55

Long stock at $42.00

35   40   45

BEP $43.55
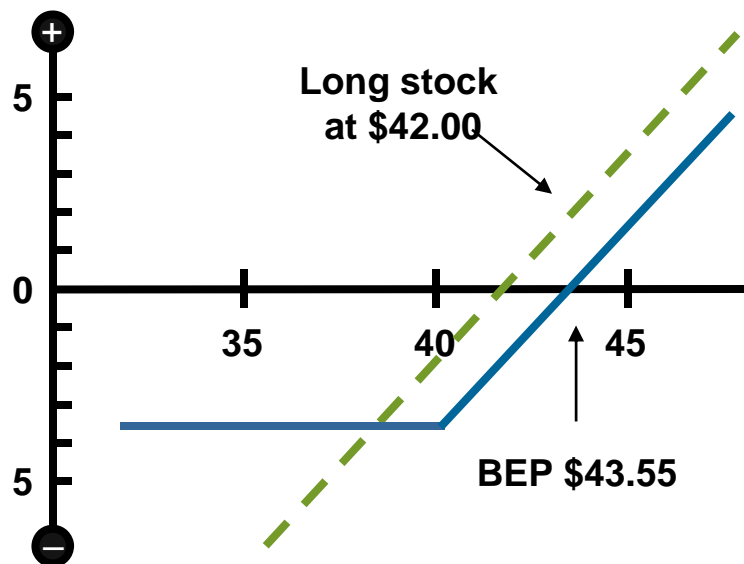
Break-even at Expiration:

Stock Price Paid + Put Premium Paid

$42.00 + $1.55 = $43.55

Maximum Loss:

Stock Price – Break-even for Put

$42.00 – ($40.00 – $1.55) = $3.55

$355.00 Total

The Collar

Own 100 XYZ shares at $42

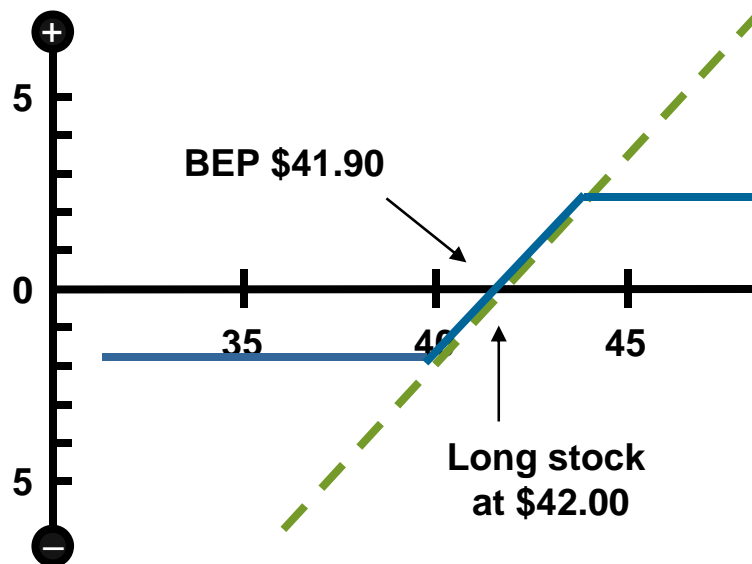| 60-day	Calls	Puts
39	$4.20	$1.15
40	$3.55	$1.55
41	$3.00	$1.95
42	$2.50	$2.45
43	$2.05	$3.00
44	$1.65	$3.65
45	$1.35	$4.30

Buy 1 60-day XYZ 40 put at $1.55

Sell 1 60-day XYZ 44 Call at $1.65

Net Credit $.10

The Collar

Own 100 shares XYZ at $42.00

Buy 1 60-day XYZ 40 put at $1.55

Sell 1 60-day XYZ 44 Call at $1.65

Net Credit $.10

BEP $41.90

**Long stock
at $42.00**

Break-even at Expiration:

Stock Price – Net Credit

$42.00 - $.10 = $41.90

Maximum Loss:

Stock Price – Put Strike – Net Credit

($42.00 – 40.00) – $.10) = $1.90

$190.00 Total

Summary

What is the plan to make money?

- Market direction?
- Time erosion?
- Change in volatility?

Set realistic expectations

Get familiar with all possible strategies

Don't overtrade

Thank you for attending!