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Network 18

F&O TRADING STRATEGIES

Table of Contents

Bullish Strategies

Neutral Strategies

Bearish Strategies

Introduction to Options

An Option is a financial derivative instrument which gives the right but not the obligation to the option holder to either sell or buy an underlying asset at a pre-specified date i.e. expiry date and at a pre-specific price i.e. the strike price. The option seller has the obligation to fulfill the transaction as and when the option holder demands (exercise or not to exercise decision rests with the option holder). The option writer receives a reward, for sale of this right to the option buyer, known as 'Premium'.

2 types of Option:

1. **Call Option**

   A Call Option gives an option buyer (then holder) the right but not the obligation to buy the underlying asset (stock, commodity, currency, etc.) at a pre-specific price (strike price) and at a pre-specified date (expiry date).

2. **Put Option**

   A Put Option gives an option buyer (then holder) the right but not the obligation to sell the underlying asset (stock, commodity, currency, etc.) at a pre-specific price (strike price) and at a pre-specified date (expiry date).

Duration of an Option:

In India, options can be traded for 3 months:

1. **Near Month**

   January (current on-going month)

2. **Next Month**

   February (next month)

3. **Far Month**

   March (next to next month)

Moneyness of an Option:

Comparing the spot price with the strike price at expiry date, Options will be classified under 3 categories:

Call Option	Moneyness	Put Option
Strike Price < Spot Price	**In The Money**	Strike Price > Spot Price
Strike Price = Spot Price	**At The Money**	Strike Price = Spot Price
Strike Price > Spot Price	**Out of the Money**	Strike Price < Spot Price

Disclaimer

The strategies mentioned in this e-book are only for learning purpose and cannot be construed as recommendations. Please consult your broker/financial adviser before executing a trade.

BULLISH STRATEGIES

Strategy 1: Long Call

Explanation

This is one of the basic strategies as it involves entering into one position i.e. buying the Call Option only. Any investor who buys the Call Option will be bullish in nature and would be expecting the market to give decent returns in the near future.

Risk: The risk of the buyer is the amount paid by him to buy the Call Option i.e. the premium value.

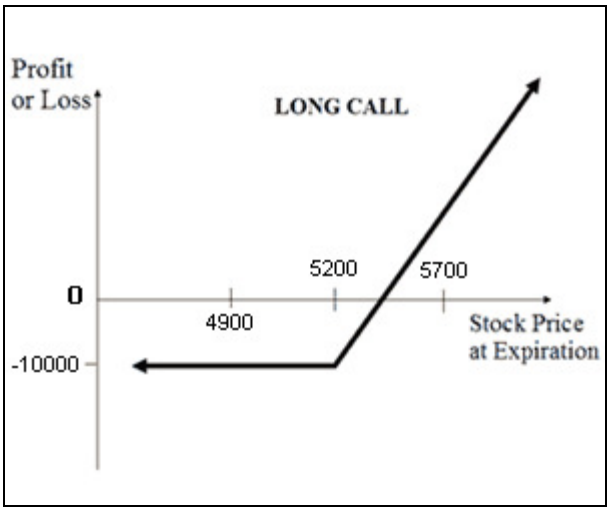
Reward: The reward will be unlimited as the underlying asset value can rise up to any value until the expiry.

Break-Even Point: The break-even point for the Call Option Holder will be 'Strike Price + Premium.'

Construction

Buy 1 Call Option

Payoff Chart



Example

Currently NIFTY is trading around 5300 levels, and Mr. X is bullish on NIFTY and buys one 5200 Call Option (ITM) for Rs. 200 premium. Lot size is 50. The investment amount will be Rs. 10000. (200*50)

Case 1: NIFTY closes at 5500 levels; Mr. X will make a profit of Rs. 5000. [(300-200)*50]

Case 2: NIFTY dips to 5100 levels; Mr. X will incur a loss of Rs. 10000 (200*50) which is the premium he paid for buying one lot of 5200 Call Option.

Strategy 2: Synthetic Long Call

Explanation

A trader is bullish in nature for short term, but also fearful about the downside risk associated with it.

Here, a trader wants to hold an underlying asset either in physical form like in case of commodities or demat (electronic) form in case of stocks. But he is always exposed to downside risk and in order to mitigate his losses, he will buy 1 ATM or OTM Put Option since ITM Put option will carry more premium than ATM & OTM Put options which are relatively cheap.

Case 1: If the prices rise as per his calculations, he will make unlimited profits on his long position in spot/cash market.

Case 2: If the prices fall, then his loss is covered by the Put Option. The loss incurred will be the premium amount paid to buy Put option.

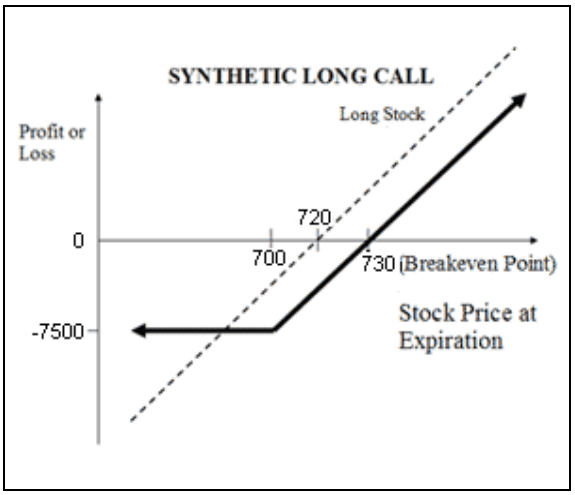
The net position created from Synthetic Call strategy is similar to Call Option buy strategy.

A major difference exists between buying a Call Option and Synthetic Call strategy. In a plain Vanilla Call Option you do not hold the underlying asset, whereas in Synthetic Call you will hold the underlying asset and reap the benefits of dividends, bonus issues, etc. (only in case if the underlying asset is a stock)

Construction

Buy 250 RIL Shares
Buy 1 Put Option of RIL

Payoff Chart



Example

RIL is trading at Rs. 720 levels, Mr. X is bullish in the long term, but wants to hedge himself from the fall in cash strategy goes wrong. He will buy 250 shares of RIL from the cash market @ Rs. 720 and buy 1 700 Put Option @ Rs. 10 as premium. The lot size of RIL is 250.

His net investment will be Rs. 180000. [(250*720) + Rs. 2500(250*10) = Rs. 182500]

Reward: The gains will be unlimited since it's a long position. His maximum loss will be Rs. 2500 assuming he will hold his cash position irrespective of the price. Break-Even Point for the net position will be Rs. 730. (720+10)

Case 1: If RIL dips to Rs. 690, then his net loss payoff will be Rs. 7500. [{(690-720) + (10-10)}*250]

Case 2: If RIL closes at Rs. 720, then his net loss payoff will be Rs. 2500. [{(720-720)-(10)}*250]

Case 3: If RIL rises up to Rs. 750, then his net profit payoff will be Rs. 5000. [{(750-720)-(10)}*250]

Strategy 3: Short Put

Explanation

A trader will short put if he is bullish in nature and expects the underlying asset not to fall below a certain level.

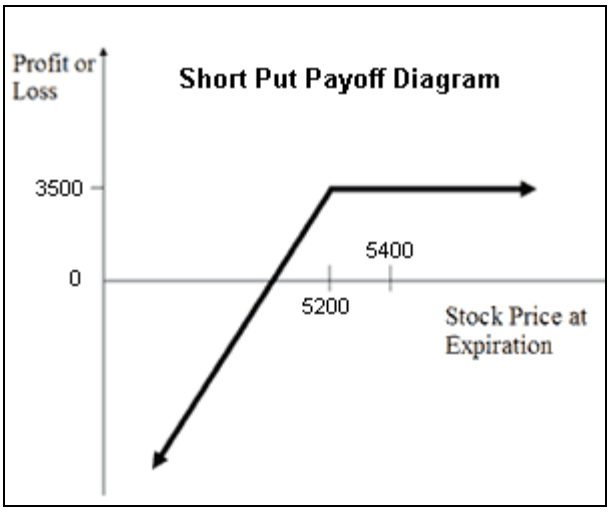
Risk: Losses will be potentially unlimited if the stock skyrockets above the strike price of put.

Reward: His profits will be capped by the premium amount received.

Construction

Sell 1 Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 level and Mr. X is bullish on the market. He expects NIFTY to stay near 5200-5300 levels or even rise further until expiry. He will sell one NIFTY 5200 Put Option for a premium of Rs. 70. The lot size of NIFTY is 50. Mr. X's account will be credited by Rs. 3500 (70*50) which is the premium received on sale of Put option.

Case 1: If the NIFTY closes at 5400, then Mr. X will receive the maximum profit of Rs. 3500.

Case 2: If the NIFTY closes at 5000, then Mr. X will face a loss of Rs. 6500. [(200-70)*50]

Strategy 4: Covered Call

Explanation

Mr. X owns Reliance Shares and expects the price to rise in the near future. Mr. X is entitled to receive dividends for the shares he hold in cash market. Covered Call Strategy involves selling of OTM Call Option of the same underlying asset. The OTM Call Option Strike Price will generally be the price, where Mr. X will look to get out of the stock. He will receive premium amount from writing the Call option.

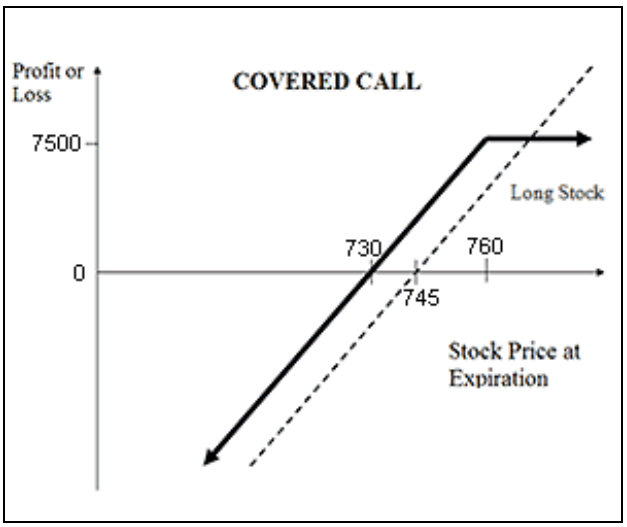
Risk: Mr. X will incur losses on his short position when the stock moves beyond the strike price of the call written. This strategy is generally adopted by the people who are 'Neutral or Moderately Bullish' on the underlying asset.

Reward: Mr. X will make profits when the stock price shoots up and pockets the premium which he received from shorting the Call Option. If it comes down then he is willing to exit at a point, the exit point is where Mr. X has shorted the Call Option.

Construction

Buy 250 RIL Shares
Sell 1 Call Option

Payoff Chart



Example

RIL is trading around Rs 745 levels. Lot size of RIL Option is 250. Mr. X is bullish in nature and buys 250 shares of RIL @ Rs 745 from the market. He also shorts one 760 Call Option for a premium of Rs. 15. His net investment will be Rs. 182500. [{(745)-(15)}*250]

Case 1: If RIL closes at Rs. 755, Mr. X will get a capital appreciation on his investment of Rs. 2500. [(755-745)*250] plus the Call Option premium he received from writing it i.e. Rs.3750 (15*250). His total gain will be Rs 6250.

Case 2: If RIL closes at Rs. 780, Mr. X will make a profit on his long position in spot market but incur loss on his short call. His net payoff will be Rs. 7500. [{(780-745) + (15-20)}*250]

Strategy 5: Long Combo

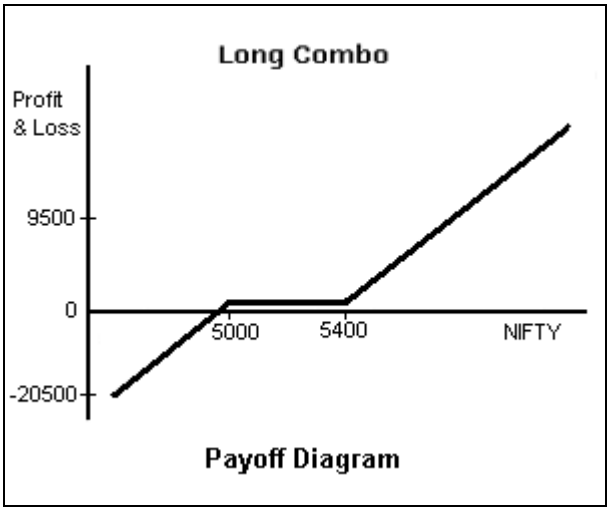
Explanation

Long Combo Option Trading Strategy is implemented when a trader is bullish in nature and expects the stock price to rise in the near future. Here a trader will sell one 'Out of the Money' Put Option and buy one 'Out of the Money' Call Option. This trade will require less capital to implement since the amount required to buy the call will be covered by the amount received from selling the put.

Construction

Sell 1 'Out of the Money' Put Option
Buy 1 'Out of the Money' Call Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 levels, Mr. X wants to enter in a long combo strategy, he will sell one 5000 OTM Put Option for a premium of Rs. 25 & buy one 5400 OTM Call Option for a premium of Rs. 35. The lot size of NIFTY is 50. His net investment will be Rs. 500. [(35-25)*50]

Case 1: At expiry if NIFTY closes at 4800, then Mr. X will incur a loss of Rs. 20500. [{(4800-5200) + (25-35)}*50]

Case 2: At expiry if NIFTY closes at 5100, then Mr. X will make a loss of Rs. 5500. [(5100-5200) + (25-35)*50]

Case 3: At expiry if NIFTY closes at 5600, then Mr. X will make a profit of Rs. 9500. [{(200-35) + (25)}*50]

Strategy 6: The Collar

Explanation

Collar Strategy is an extension to Covered Call Strategy. A trader, who is bullish in nature but has a very low risk appetite and wants to mitigate his risk will implement the Collar Strategy. Collar involves buying of stock in either Cash/Futures Market, buying an ATM Put Option & selling an OTM Call Option. The expiry dates of the options should be same. Here the long position will make profits if things go as per plan i.e. stock gains. The put option will cover the losses if things go in the opposite direction. The profits will be limited on account of the sale of an OTM Call Option.

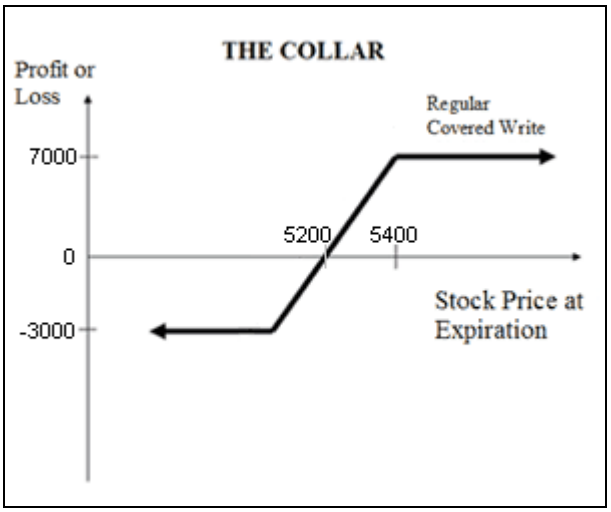
Risk: Limited

Reward: Limited

Construction

Buy shares in Cash/Futures Market
Buy 1 ATM Put Option
Sell 1 OTM Call Option

Payoff Chart



Example

Mr. X is bullish on NIFTY and expects it to rise, but also very conservative in nature. He deploys Collar Strategy where he buys the underlying stock in the futures market, sells an OTM Call Option & buys 1 ATM Put Option. Now his net position is safe from adverse movements in any direction either down or up. Lot size of NIFTY is 50. He buys one NIFTY futures at 5200, sells one 5400 OTM Call Option at a premium of Rs. 25 & buys one 5200 ATM Put Option for a premium of Rs. 85.

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will make a loss of Rs. 3000. [{(25)-(300) + (300-85)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a loss of Rs. 3000. [(25-85)*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a profit of Rs. 7000. [{(25-100) - (85) + (300)}*50]

Strategy 7: Bull Call Spread

Explanation

Bull Call Spread option trading strategy is used by a trader who is bullish in nature and expects the underlying asset to give decent returns in the near future. This strategy includes buying of an 'In The Money' Call Option and selling of 'Deep Out Of the Money' Call Option of the same underlying asset and the same expiration date. When you write a call, you receive premium which results in reducing the cost for buying an ITM Call Option. However, the profits are also minimized in case of a windfall rise in the underlying asset's price. This strategy is also called as 'Bull Call Debit Spread' as your account gets debited while deploying the strategy.

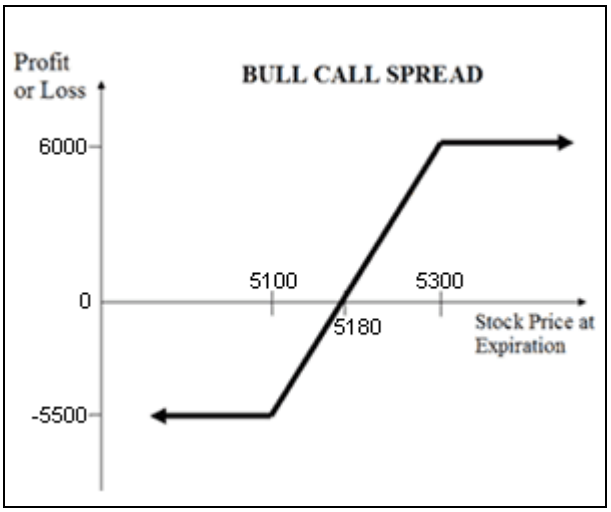
Risk: Limited

Reward: Limited

Construction

Buy 1 'In The Money' Call Option
Sell 1 'Deep Out Of the Money' Call Option

Payoff Chart



Example

Suppose that the NIFTY is trading around 5180 level, and Mr. X enters into Bull-Call-Spread strategy. Lot Size of NIFTY is 50. He buys one 5100 ITM Call Option for a premium of Rs. 165, and sells one 5300 OTM Call Option for Rs. 55. The net investment will be only Rs. 5500 [(165-55)*50], after premium received from writing the 5300 call.

Case 1: At expiry if the NIFTY dips down to 5000 level, the maximum loss will be only Rs. 5500 (Investment Value).

Case 2: At expiry if the NIFTY closes at 5200 level, net profit will be Rs. 6000. [{(55) - (100-165)}*50]

Case 3: At expiry if the spot NIFTY closes at 5400 level, the intrinsic value of the 5100 ITM call will be Rs. 300 and that of 5300 OTM call will be Rs. 100. At expiry, the cash settlement will be done with a credit of Rs. 4500. [{(300-165) - (100-55)}*50]

Strategy 8: Bull Put Spread

Explanation

Bull Put Spread option trading strategy is used by a trader who is bullish in nature and expects the underlying asset to move in an upward trend in the near future. This strategy includes buying of an 'Out of the Money' Put Option and selling of 'In the Money' Put Option of the same underlying asset and the same expiration date. When you write a Put, you will receive premium thereby engulfing the cost for buying of OTM Put Option. This strategy is also called as 'Bull Put Credit Spread' as your account gets credited while deploying the strategy.

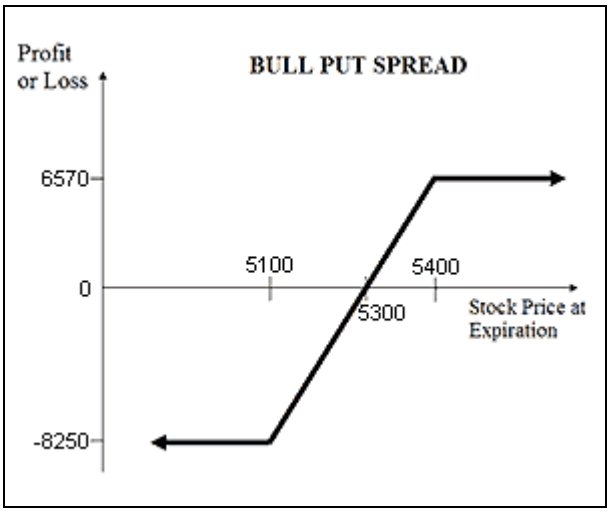
Risk: Limited

Reward: Limited

Construction

Buy 1 'Out of the Money' Put Option
Sell 1 'In the Money' Put Option

Payoff Chart



Example

Suppose that the NIFTY is trading around 5300 level and Mr. X enters into Bull-Put-Spread strategy. Lot Size of NIFTY is 50. He buys one 5100 OTM Put Option for a premium of Rs. 45, and sells one 5400 ITM Put Option for Rs. 180. Hence his account will be credited by Rs. 6750. [(180-45)*50]

Case 1: At expiry if the NIFTY dips down to 5000 level, his net loss will be Rs. 8250. [{(100-45) + (180-400)}*50]

Case 2: At expiry if the NIFTY closes at 5200, then his net loss will be Rs. 3250. [{(180-400)-(45)}*50]

Case 3: At expiry if the spot NIFTY closes at 5500 level, both the Puts expire worthless and Mr. X gets to keep Rs. 6750.

Strategy 9: Call Backspread

Explanation

This strategy is adopted by traders who are bullish in nature. He expects market and volatility to rise in the near future. A trader need not be direction specific here (i.e. an upward or downward trend, but a small bias towards an uptrend should always be present, as the gains will be much higher once the market moves up rather than market moving down and keeping premium as income. This strategy involves buying of 2 OTM Call Options and selling 1 ITM Call Option.

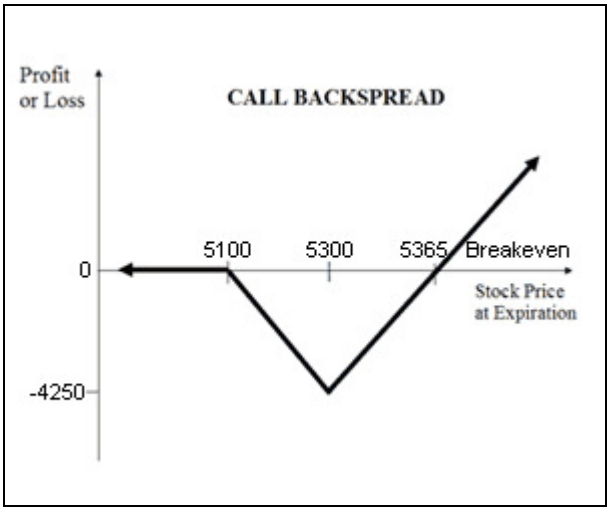
Risk: Limited

Reward: Unlimited

Construction

Sell 1 ITM Call Option
Buy 2 OTM Call Options

Payoff Chart



Example

Suppose NIFTY is trading around 5200 levels, Mr. X is bullish on the market and the volatility. He will apply Call Backspread Strategy. He will sell one 5100 NIFTY ITM Call Option for a premium of Rs. 165 & buys two 5300 NIFTY OTM Call Options at a premium of Rs. 50 each. His net investment will be Rs. 3250. [{165-(50*2)}*50]

Case 1: At expiry if NIFTY closes at 5500, then Mr. X will make a profit of Rs. 3250. [{((200-50)*2) + (400-165)}*50]

Case 2: At expiry if NIFTY closes at 4900, then Mr. X will keep the premium amount received from sale of 5100 NIFTY ITM Call Option. His net gain will be Rs. 3250. [{165-(50*2)}*50]

Case 3: At expiry if NIFTY closes at 5250, then Mr. X will make a loss of Rs. 4250. [{(150-165)-(50*2)}*50]

Strategy 10: Married Put

Explanation

This strategy is applied when trader goes long on the underlying asset i.e. he buys the stock in cash market. He has a bullish view and expects the market to rise in the near future, but simultaneously has the fear of downward movement of the markets. In order to cover his position from vulnerabilities he buys one ATM Put Option of the same underlying asset. Here, a trader will receive all the gains from dividends, bonus issues since he is holding long positions in the cash market.

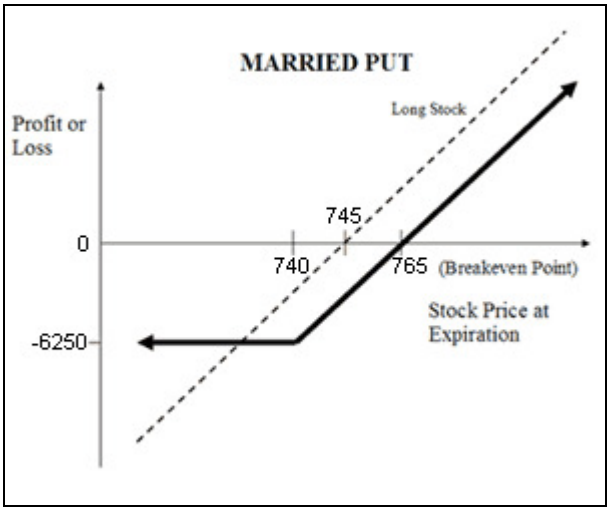
Risk: Limited

Reward: Unlimited

Construction

Buy 250 RIL Shares
Buy 1 ATM Put Option

Payoff Chart



Example

Suppose that RIL is trading at Rs. 745, and Mr. X is bullish on the market. He buys 250 RIL shares in the cash market. Now the risk always persist (downward move) and to cover himself from this adverse move he will buy one 740 RIL ATM Put Option at a premium of Rs. 20. His total investment will be Rs. 191250. [(745+20)*250]

Case 1: At expiry if RIL closes at Rs. 710, then Mr. X will make a loss of Rs. 6250. [{(710-745) + (30-20)}*250]

Case 2: At expiry if RIL closes at Rs. 740, then Mr. X will make a loss of Rs. 6250. [{(740-745) – (20)}*250]

Case 3: At expiry if RIL closes at Rs. 770, then Mr. X will make a profit of Rs. 1250. [{(770-745) – (0-20)}*250]

Strategy 11: Bull Calendar Spread

This strategy is implemented when a trader is bullish on the underlying stock/index in the short term say 2 months or so. A trader will write one Near Month OTM Call Option and buy one next Month OTM Call Option, thereby reducing the cost of purchase, with the same strike price of the same underlying asset. This strategy is used when a trader wants to make profit from a steady increase in the stock price over a short period of time.

Risk: Limited

Reward: Unlimited

Construction

Sell 1 Near-Month OTM Call Option
Buy 1 Mid-Month OTM Call Option

Example

Suppose NIFTY is trading at 5300 levels, Mr. X is bullish on the market and expects it to rise in the near future say 2 months or so. He will sell one 5400 NIFTY April (near-month) OTM Call Option for a premium of Rs. 25 and buy one 5400 NIFTY May (next-month) OTM Call Option at a premium of Rs. 110. The lot size of NIFTY is 50. Hence, his net investment will be Rs. 4250. [(110-25)*50]

Case 1: At Near-Month (April) expiry if NIFTY closes at 5000, then Mr. X will get to keep the premium amount i.e. Rs. 1250. (25*50)
At Mid-Month (May) expiry if NIFTY closes at 4800, then Mr. X will make a loss of premium amount i.e. Rs. 5500. (110*50). His net payoff will result in a loss of Rs. 4250. (5500-1250)

Case 2: At Near-Month (April) expiry if NIFTY closes at 5100, then Mr. X will get to keep the premium amount i.e. Rs. 1250. (25*50)

At Mid-Month (May) expiry if NIFTY closes at 5300, then Mr. X will make a loss on premium amount i.e. Rs. 5500. (110*250). His net payoff will result in a loss of Rs. 4250. (5500-1250)

Case 3: At Near-Month (April) expiry if NIFTY closes at 5500, then Mr. X will incur a loss of Rs. 3750. [(100-25)*50]

At Mid-Month (May) expiry if NIFTY closes at 5700, then Mr. X will make a profit of Rs. 9500. [(300-110)*250]

His net payoff will result in a profit of Rs. 5750. (9500-3750)

Note: Calendar Straddle Option Trading Strategy is similar to this **Bull Calendar Spread**; the only difference is the position acquisition. In Bull Call Calendar Spread we trade in only Call Options, whereas in a Calendar Straddle we will sell one Near-Month Straddle and buy 1 Mid-Month Straddle (Straddle = 1 Call Option + 1 Put Option). The payoffs, ideology and construction of a Calendar Straddle will remain same as of Bull Calendar Spread.

Strategy 12: Covered Combination

Explanation

This strategy involves selling OTM Call & Put Options and buying the underlying asset in either cash or futures market. It is also known as Covered Strangle as the profits are capped and risk is potentially unlimited.

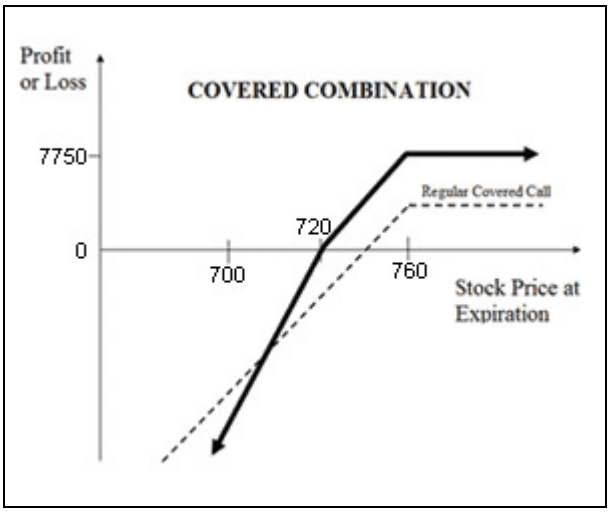
Risk: Unlimited

Reward: Limited

Construction

Buy 250 RIL Shares
Sell 1 OTM Call Option
Sell 1 OTM Put Option

Payoff Chart



Example

Suppose RIL is trading at Rs. 745, and Mr. X has gone long on RIL. Now Mr. X will sell one 760 OTM Call Option for a premium of Rs. 15 and simultaneously sell one 720 OTM Put Option for a premium of Re. 1. His net investment will be Rs. 182250. [(745-15-1)*250]

Case 1: At expiry if RIL closes at Rs. 700, then Mr. X will incur a loss of Rs. 12250. [{(15) – (20-1) + (700-745)}*250]

Case 2: At expiry if RIL closes at Rs. 740, then Mr. X will make a profit of Rs. 2750. [{(15) + (1) + (740-745)}*250]

Case 3: At expiry if RIL closes at Rs. 780, then Mr. X will make a profit of Rs. 7750. [{(1) – (20-15) + (780-745)}*250]

Strategy 13: Diagonal Bull Call Spread

Explanation

This strategy is implemented by a trader when he is neutral – moderately bullish in the near-month contract and bullish in the mid-month contract. It involves sale of 1 Near-Month OTM Call Option and buying of 1 Mid-Month ITM Call Option.

Risk: Limited
Reward: Limited

Construction

Sell 1 Near-Month OTM Call Option
Buy 1 Mid-Month ITM Call Option

Example

Suppose NIFTY is trading at 5300 odd points, Mr. X is neutral for the near-month contract and bullish for the mid-month contract. He applies Diagonal Bull Call Spread Strategy where he will sell 1 5400 Near-Month OTM Call Option for a premium of Rs. 25 and buy 1 5200 Mid-Month ITM Call Option at a premium of Rs. 235. His net investment will be Rs. 10500. [(235-25)*50]

Case 1: At the Near-Month expiry if NIFTY closes at 5000, then Mr. X will get to keep the premium amount of 5400 Near-Month OTM Call Option of Rs. 1250. (25*50)
At the Mid-Month expiry if NIFTY closes at 4900, then Mr. X will make a loss on his premium amount paid for 5200 Mid-Month ITM Call Option i.e. Rs. 11750. (235*50)
His net payoff will result in a loss of his entire investment value i.e. Rs. 10500. [(235-25)*50]

Case 2: At the Near-Month expiry if NIFTY closes at 5200, then Mr. X gets to keep the premium amount of 5400 Near-Month OTM Call Option of Rs. 1250. (25*50)
At the Mid-Month expiry if NIFTY closes at 5300, then Mr. X will make a loss on the 5200 Mid-Month ITM Call Option of Rs. 6750. [(100-235)*50]
His net payoff will result in a loss of Rs. 5500. (6750-1250)

Case 3: At the Near-Month expiry if NIFTY closes at 5400, then Mr. X will get to keep the premium amount of 5400 Near-Month OTM Call Option of Rs. 1250. (25*50)
At the Mid-Month expiry if NIFTY closes at 5500, then Mr. X will make a profit on 5200 Mid-Month ITM Call Option of Rs. 3250. [(300-235)*50]
His net payoff will result in a profit of Rs. 4500. (1250+3250)

Strategy 14: Stock Repair Strategy

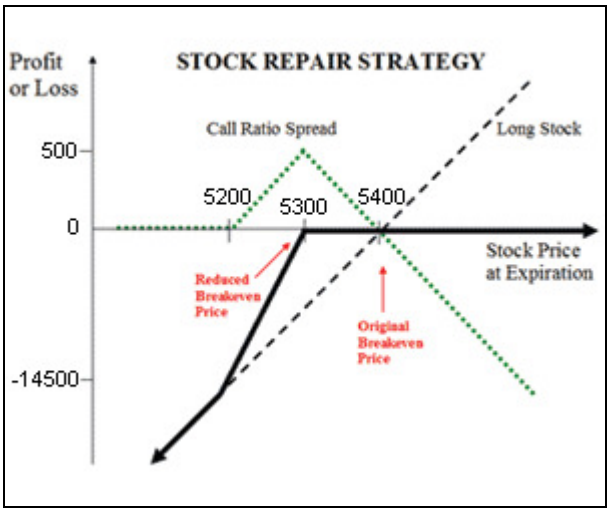
Explanation

This strategy is used to cover up for losses made on long stock position. After the long position suffered losses on stock price fall, a trader will implement this strategy in order to bring down the breakeven price and capping his further losses thereby increasing his probability of loss recovery.

Construction

Buy 1 ATM Call
Sell 2 OTM Call Options

Payoff Chart



Example

Suppose Mr. X has purchased 1 lot of NIFTY Futures at 5400. Lot size of NIFTY is 50. Assume currently NIFTY is trading at 5200 translating it into loss of Rs. 10000 on his long position in future. (200*50)

Now, Mr. X wants to repair his position so he implements Stock Repair Strategy by buying 1 5200 NIFTY ATM Call Option at a premium of Rs. 100 and selling 2 5300 NIFTY OTM Call Options for a premium of Rs. 110 (55*2). By implementing this strategy Mr. X's account will get credited by Rs. 500. [(100-110)*50]

Case 1: At expiry if NIFTY closes at 5100, then Mr. X will make a loss of Rs. 14500. [{(5100-5400) – (100) + (55*2)}*50]

Case 2: At expiry if NIFTY closes at 5300, then Mr. X will make a profit of Rs. 500. [{(5300-5400) – (100-100) + (55*2)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a profit of Rs. 500. [{(5500-5400) + (300-100) – ((200-55)*2)}*50]

Strategy 15: Protective Put

Explanation

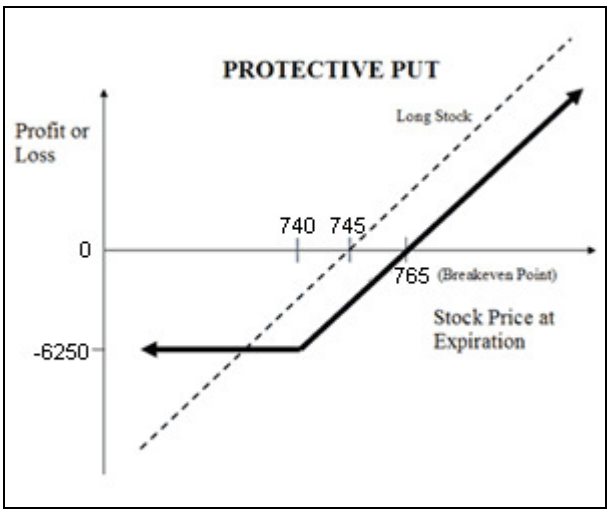
Protective Put Strategy is a hedging strategy where trader guards himself from the downside risk. This strategy is adopted when a trader is long on the underlying asset but skeptical of the downside. He will buy one ATM Put Option to hedge his position. Now, if the underlying asset moves either up or down, the trader is in a safe position.

Risk: Limited
Reward: Unlimited

Construction

Buy 250 RIL Shares in Cash/Futures Market
Buy 1 ATM Put Option

Payoff Chart



Example

Suppose that RIL is trading at Rs. 745 and Mr. X buys 250 shares in the Cash Market. He will buy One 740 ATM Put Option at a premium of Rs. 20 to hedge his long position. His net investment will be Rs. 191250. [(745+20)*250]

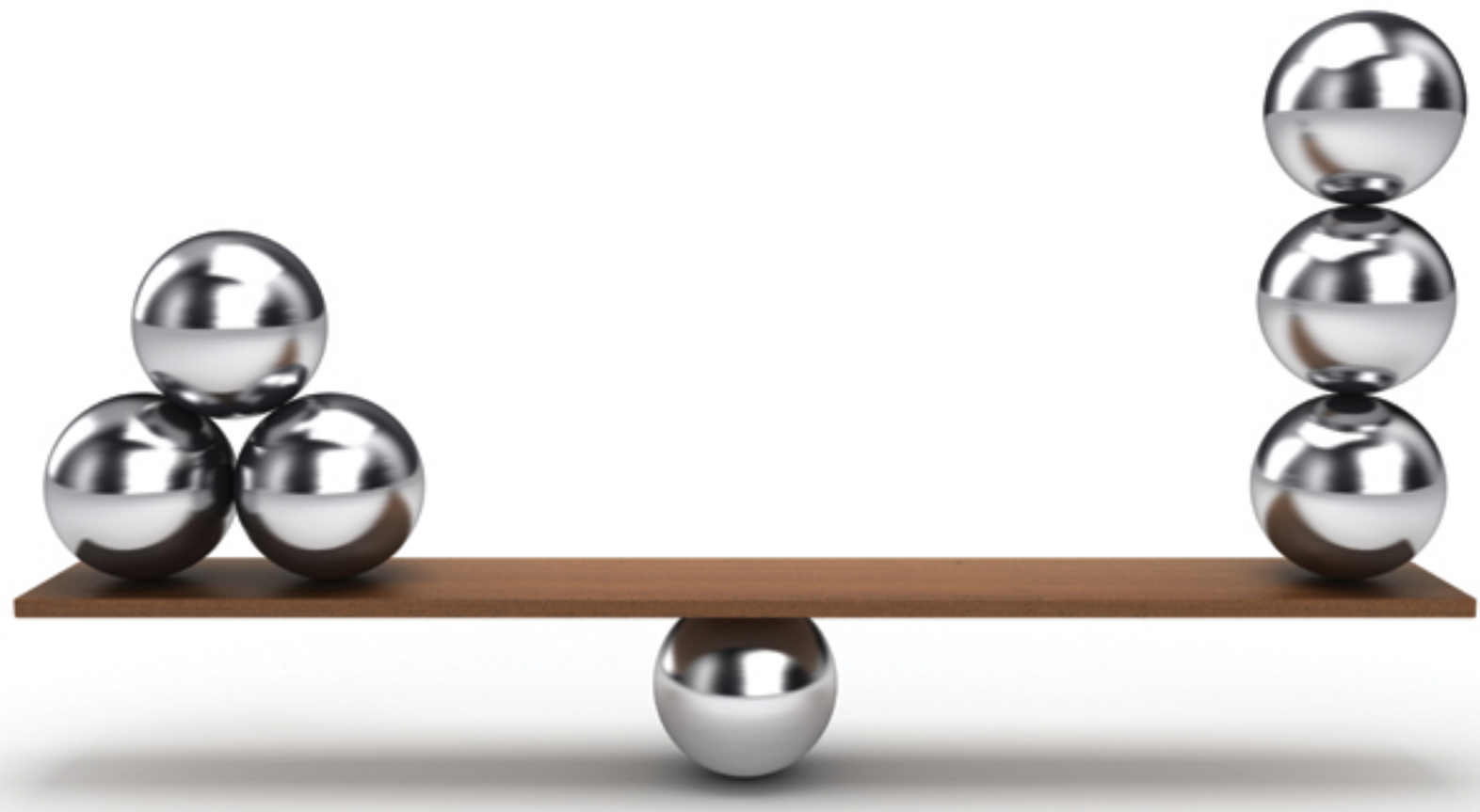
Case 1: At expiry if RIL closes at Rs. 710, then Mr. X will incur a loss of Rs. 6250. [{(710-745) + (30-20)}*250]

Case 2: At expiry if RIL closes at Rs. 740, then Mr. X will incur a loss of Rs. 6250. [{(740-745)-(20)}*250]

Case 3: At expiry if RIL closes at Rs. 770, then Mr. X will make a profit of Rs. 1250. [{(770-745)-(20)}*250]

Note: It is observed that once the stock starts moving up, the time value of Put will shrink half times the cash price. This will also depend on the number of days left in the expiry. A professional trader can also keep a stop loss in ATM Put once stock rallies sharply.

NEUTRAL STRATEGIES



Strategy 1: Long Straddle

Explanation

Straddle is neither bullish nor bearish strategy; it is a market neutral strategy. Here a trader wishes to take advantage of the volatility in the market. This strategy involves buying of one Call option and one Put option of the same strike price, same expiry date and of the same underlying asset. Now a trader is bound to make profits once stock moves in either direction. If the prices rise significantly, the call generates income and put expires worthless. If the prices decrease significantly, the put generates income and call expires worthless. Here a trader is looking for high volatility and expects the market to move with high magnitude.

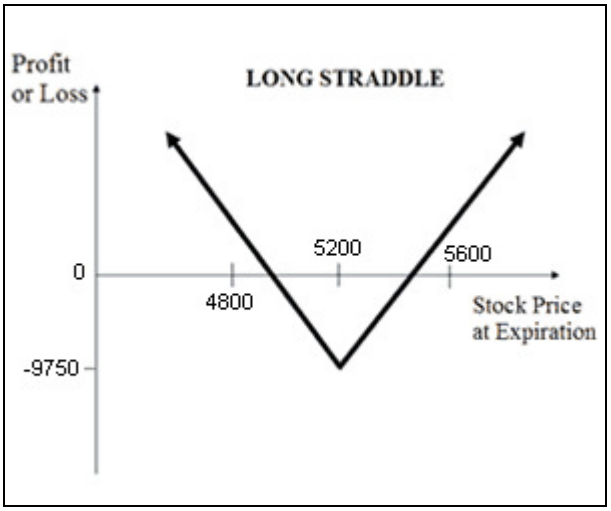
Risk: Limited

Reward: Unlimited

Construction

Buy 1 Call Option
Buy 1 Put Option

Payoff Chart



Example

Nifty is trading at 5250 level; Mr. X expects the market to move with high magnitude in either of the directions, he will implement Long Straddle Strategy. He will buy one 5200 Call Option for a premium of Rs. 130 & buy one 5200 Put Option for a premium of Rs. 65. Lot size of NIFTY is 50. His net investments will be Rs. 9750. [(130+65)*50]

Case 1: At expiry if NIFTY closes at 4600 level, then Mr. X will make a profit of Rs. 20250. [{(600-65)-(130)}*50]

Case 2: At expiry if NIFTY closes at 5100, then Mr. X will make a loss of Rs. 4750. [{(100-65)-(130)}*50]

Case 3: At expiry if NIFTY closes at 5600, then Mr. X will make a profit of Rs. 10250. [{(400-130)-(65)}*50]

Strategy 2: Short Straddle

Explanation

This strategy is just the opposite of Long Straddle. A trader should adopt this strategy when he expects less volatility in the near future. Here, a trader will sell one Call Option & one Put Option of the same strike price, same expiry date and of the same underlying asset. If the stock/index hovers around the same levels then both the options will expire worthless and the option writer (i.e. trader) will get the premium. However this is a very risky strategy. If the price moves up or down sharply then the losses will be significant for the option writer (trader). So this strategy should be implemented only if you are ready to take calculated risk i.e. it should be precisely quantified.

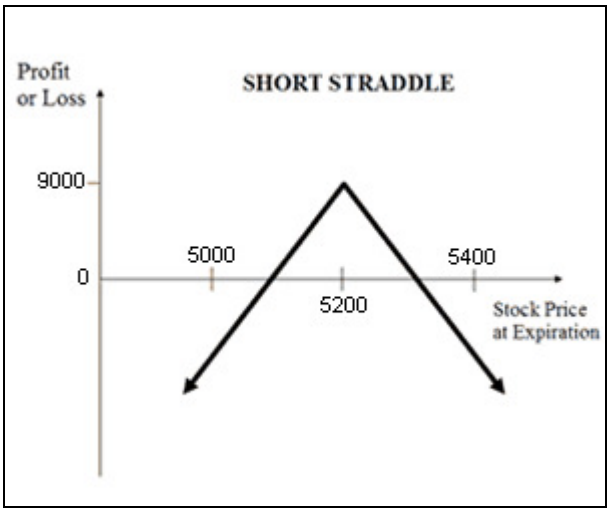
Risk: Unlimited

Reward: Limited

Construction

Sell 1 Call Option
Sell 1 Put Option

Payoff Chart



Example

Suppose NIFTY is trading around 5200 levels, Mr. X does not expect the market to move sharply in the near future and implements a Short Straddle Strategy. He will sell one 5200 Call Option for a premium of Rs. 100 & sell one 5200 Put Option for a premium of Rs. 80. Lot size of NIFTY is 50. His account will get credited by Rs. 9000. [(100+80)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a loss of Rs. 1000. [{(100) + (80 - 200)}*50]

Case 2: At expiry if NIFTY closes at 5250, then Mr. X will make a profit of Rs. 6500. [{(100-50) + (80)}*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a loss of Rs. 1000. [{(80) – (200-100)}*50]

Strategy 3: Long Strangle

Explanation

A Strangle is similar to Straddle. In Strangle, a trader will purchase one OTM Call Option and one OTM Put Option, of the same expiry date and the same underlying asset. This strategy will reduce the entry cost for trader and it is also cheaper than straddle. A trader will make profits, if the market moves sharply in either direction and gives extra-ordinary returns in the near future so that either of the options will make money.

In case of low volatility a trader will lose his entire investment i.e. the premium paid for buying the options. The volatility should be on higher side. Also, the volatility required for strangle to make profits should be more than the volatility required for straddle to make profits.

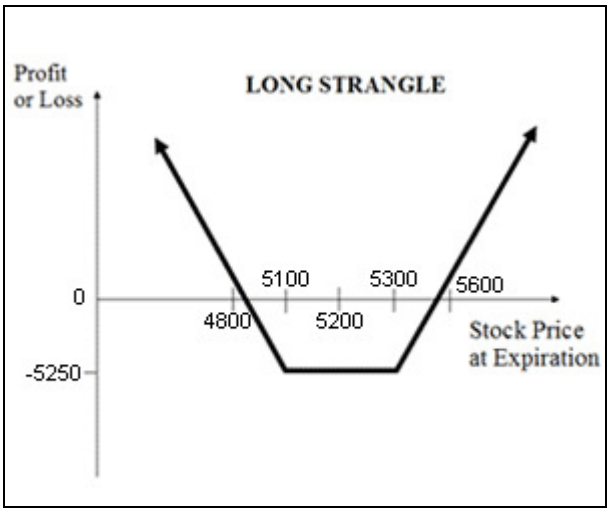
Risk: Limited

Reward: Unlimited

Construction

Buy 1 OTM Call Option
Buy 1 OTM Put Option

Payoff Chart



Example

If NIFTY is trading around 5200 levels and Mr. X expects the market to rally significantly on either side, he applies a Strangle Strategy. He buys one 5300 OTM Call Option for a premium of Rs. 55 & buys one 5100 OTM Put Option for a premium of Rs. 50. His net investment will be Rs. 5250. [(55+50)*50]

Case 1: If NIFTY expires at 4800, then Mr. X will make a profit of Rs. 9750. [{(300-50)-(55)}*50]

Case 2: If NIFTY expires at 5100, then Mr. X will make a loss of Rs. 5250. [(55+50)*50]

Case 3: If NIFTY expires at 5600, then Mr. X will make a profit of Rs. 9750. [{(300-55)-(50)}*50]

Strategy 4: Short Strangle

Explanation

This strategy is similar to Short Straddle; the only difference is of the strike prices at which the positions are built. Short Strangle involves selling of one OTM Call Option and selling of one OTM Put Option, of the same expiry date and same underlying asset. Here the probability of making profits is more as there is a spread between the two strike prices, and if the markets do remain less volatile, then this strategy will start making profits for traders. The ideology behind this strategy is that the market will not be much volatile in the near future and the expected volatility will lie between the 2 strike prices. This strategy is used by expert traders who quantify the implied volatility accurately.

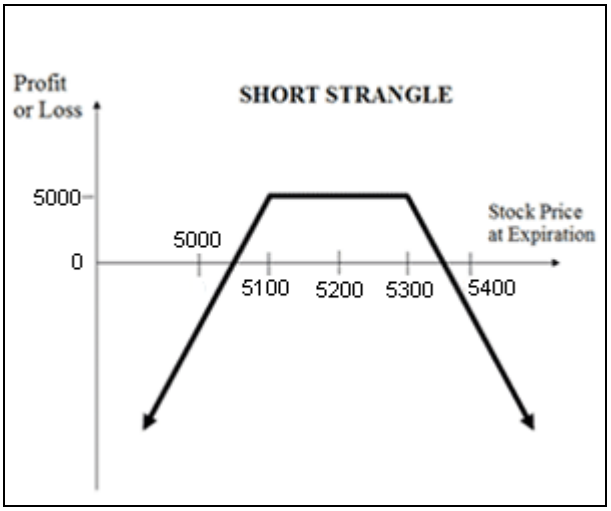
Risk: Unlimited

Reward: Limited

Construction

Sell 1 OTM Call Option
Sell 1 OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading around 5200 odd points, Mr. X does not expect the market to move much in the near future. As he is neutral about the volatility of NIFTY he will enter in a Short Strangle Strategy. He will sell 1 5300 OTM Call Option for a premium of Rs. 55 & sell 1 5100 OTM Put Option for a premium of Rs. 50. The lot size of NIFTY is 50. Hence, his account will get credited by Rs. 5000. [(50+50)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will neither make profit nor loss. His net cash flow will be 0. [{(50)-(100-50)}*50]

Case 2: At expiry if NIFTY closes at 5250, then Mr. X will make a profit of Rs. 5000. [(50+50)*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will neither make profits nor losses. His net cash flow will be 0. [{(100-50)-(50)}*50]

Strategy 5: Long Call Butterfly

Explanation

A trader, who is neutral in nature and believes that there will be very low volatility i.e. expects the market to remain range bound, will implement this strategy. This strategy involves selling of 2 ATM Call Options, buying 1 ITM Call Option & buying 1 OTM Call Option of the same expiry date & same underlying asset. The difference between the strikes should be equal.

If the market remains range bound then this strategy will start making profits. If the market moves out of strike range in either way, then it will start making loss. The loss generated will also be capped.

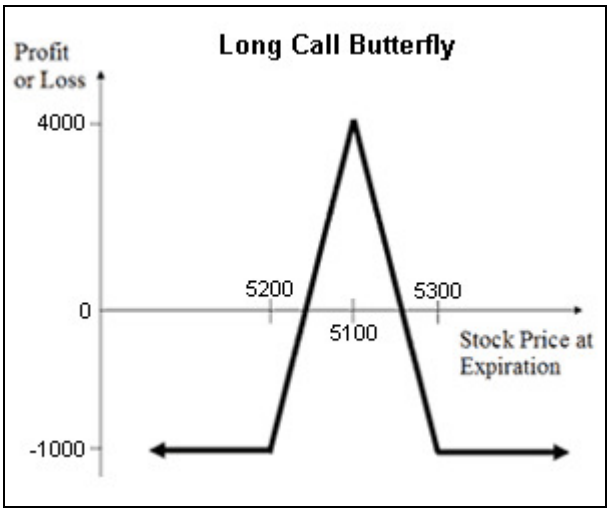
Risk: Limited

Reward: Limited

Construction

Sell 2 ATM Call Options
Buy 1 ITM Call Option
But 1 OTM Call Option

Payoff Chart



Example

Suppose that NIFTY is trading at 5200 levels, Mr. X thinks that there is low volatility in the market and expects it to stay between a certain range, then he will implement the Long Call Butterfly Strategy. He will sell 2 NIFTY 5200 ATM Call Options for a premium of Rs. 200 (100*2), buy 1 NIFTY 5100 ITM Call Option at a premium of Rs. 165 & buy 1 NIFTY 5300 OTM Call Option at a premium of Rs. 55. The net investment will only be Rs. 1000. [{(100*2)-(165)-(55)}*50]

Case 1: At expiry if NIFTY closes at 4900, Mr. X will make a loss of Rs. 1000. [{(100*2)-(165)-(55)}*50]

Case 2: At expiry if NIFTY closes at 5200, Mr. X will make a profit of Rs. 4000. [{(100-165) + (100*2)-(55)}*50]

Case 3: At expiry if NIFTY closes at 5400, Mr. X will make a loss of Rs. 1000. [{(300-165) - ((200-100)*2) + (100-55)}*50]

Strategy 6: Short Call Butterfly

Explanation

This strategy is opposite of the Long Call Butterfly Strategy, a trader expects the market to remain range bound in Long Call Butterfly, but here he expects the market to move beyond strike boundaries in Short Call Butterfly. If the trader is bullish on the market's volatility, he will implement this strategy. Here also there should be equal distance between the strikes. Profits from this strategy are capped.

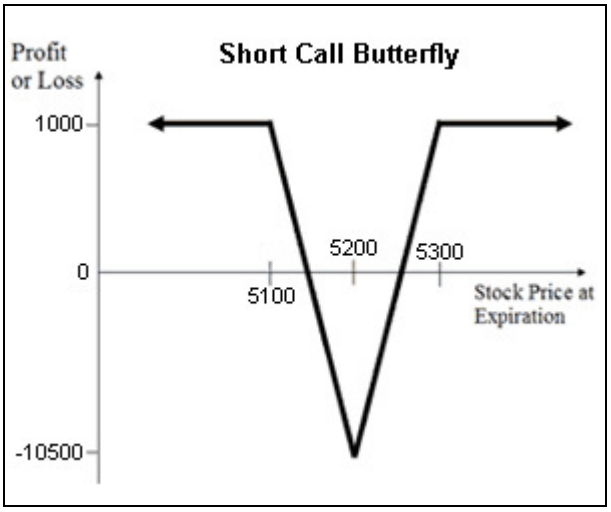
Risk: Limited

Reward: Limited

Construction

Buy 2 ATM Call Options
Sell 1 ITM Call Option
Sell 1 OTM Call Option

Payoff Chart



Example

Suppose that NIFTY is trading at 5200, Mr. X implements the Short Call Butterfly Strategy. He buys 2 NIFTY 5200 ATM Call Options for a premium of Rs. 200 (100*2), sells 1 NIFTY 5100 ITM Call Option for a premium of Rs. 165 & sells 1 NIFTY 5300 OTM Call Option for a premium of Rs. 55. He will get a credit of Rs. 1000 [{(165) + (55) – (100*2)}*50] since he sold 2 Call Options.

Case 1: At expiry if the NIFTY closes at 4900, then Mr. X will make a profit of Rs. 1000. [{165+55 – (100*2)}*50]

Case 2: At expiry if the NIFTY closes at 5200, then Mr. X will make a loss of Rs. 10500. [{(100-165) + 55 - (100*2)}*50]

Case 3: At expiry if the NIFTY closes at 5500, then Mr. X will make a profit of Rs. 1000. [{(400-165) + ((300-100)*2) – (200-55)}*50]

Strategy 7: Long Put Butterfly

Explanation

The Long Put Butterfly is a neutral strategy where a trader will be bearish on the volatility i.e. he thinks the market will have sideways kind of movement and will not rally sharply in either direction in the near future. This strategy involves sale of 2 ATM Put Options, buy 1 ITM and 1 OTM Put Option. The risk and reward are limited.

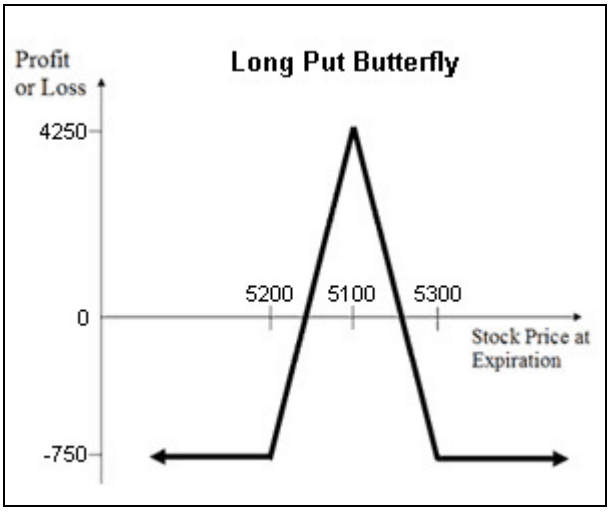
Risk: Limited

Reward: Limited

Construction

Sell 2 ATM Put Options
Buy 1 ITM Put Option
Buy 1 OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 levels. Mr. X is bearish on volatility and expects the market to move sideways. He will implement Long Put Butterfly Strategy. He will sell two 5200 ATM Put Options for a premium of Rs. 85, buys one 5100 NIFTY OTM Put Option at a premium of Rs. 50 & goes long on one 5300 NIFTY ITM Put Option at a premium of Rs. 135. His net investment will be Rs. 750. [(85*2)-50-135)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a loss of Rs. 750. [{(100-50) – ((200-85)*2) + (300-135)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a profit of Rs. 4250. [{(85*2) - (50) + (100-135)}*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a loss of Rs. 750 (Investment value). [{(85*2)-(50)-(135)}*50]

Strategy 8: Short Put Butterfly

Explanation

In Short Put Butterfly strategy, a trader is neutral in nature and expects the market to remain range bound in the near future. A trader will buy 2 ATM Put Options; sell 1 ITM & 1 OTM Put Options. Here risk and returns both are limited.

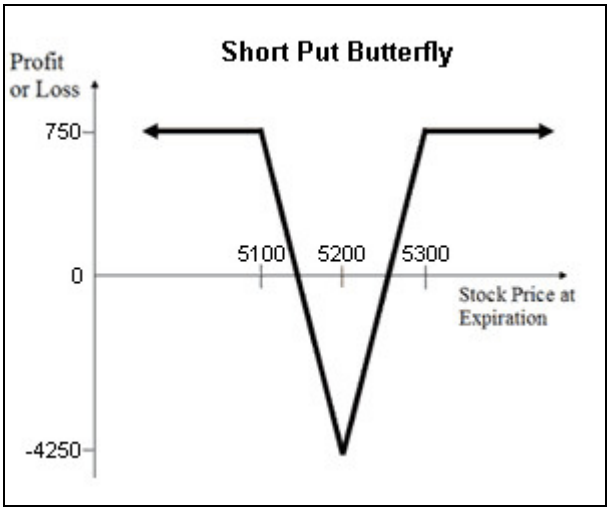
Risk: Limited

Reward: Limited

Construction

Buy 2 ATM Put Options
Sell 1 ITM Put Option
Sell 1 OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 odd points. Mr. X is bearish on volatility and expects the market to move upwards gradually at a very slow pace. He will implement Short Put Butterfly Strategy. He will buy two 5200 ATM Put Options at a premium of Rs. 85, sell one 5100 NIFTY OTM Put Option for a premium of Rs. 50 & shorts one 5300 NIFTY ITM Put Option for a premium of Rs. 135.

Case 1: At expiry if NIFTY closes at 5000 level, then Mr. X will make a profit of Rs. 750. [{((200-85)*2) - (100-50) - (300-135)}*50]

Case 2: At expiry if NIFTY closes at 5200 level, then Mr. X will make a loss of Rs. 4250. [{(50)-(85*2)-(100-135)}*50]

Case 3: At expiry if NIFTY closes at 5400 level, then Mr. X will make a profit of Rs. 750. [(50) - (85*2) + (135)*50]

Strategy 9: Strap

Explanation

Strap Strategy is similar to Long Straddle, the only difference is the quantity traded. A trader will buy two Call Options and one Put Options. In this strategy, a trader is very bullish on the market and volatility on upside but wants to hedge himself in case the stock doesn't perform as per his expectations. This strategy will make more profits compared to long straddle since he has bought 2 calls.

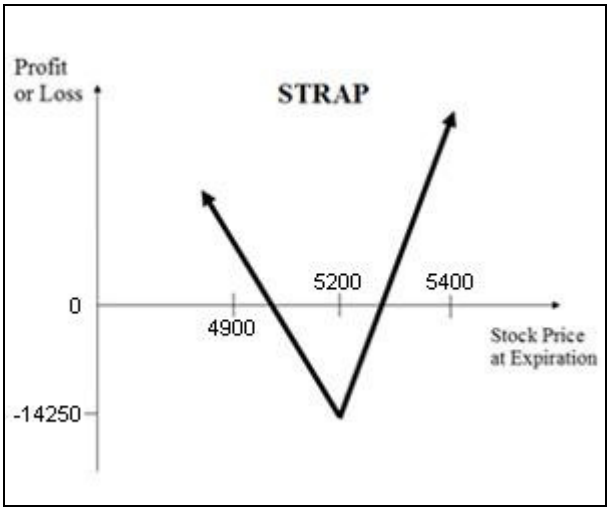
Risk: Limited

Reward: Unlimited

Construction

Buy 2 ATM Call Options
Buy 1 ATM Put Option

Payoff Chart



Example

Mr. X is bullish on NIFTY and enters in a Strap Strategy. He buys two 5200 NIFTY ATM Call Options at a premium of Rs. 100 and simultaneously buys one 5200 ATM Put Option at a premium of Rs. 85. His net investment will be Rs. 14250 [{(100*2) + (85)}*50]

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will make a profit of Rs. 750. [{(300-85) + (0-200)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a loss of Rs. 14250 (Entire investment amount). [{(0-200) + (0-85)}*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a profit of Rs. 5750. [{((200-100)*2)-(85)}*50]

Strategy 10: Strip

Explanation

Strip Strategy is the opposite of Strap Strategy. When a trader is bearish on the market and bullish on volatility then he will implement this strategy by buying two ATM Put Options & one ATM Call Option, of the same strike price, expiry date & underlying asset. If the prices move downwards then this strategy will make more profits compared to short straddle because of the (double) quantity involved.

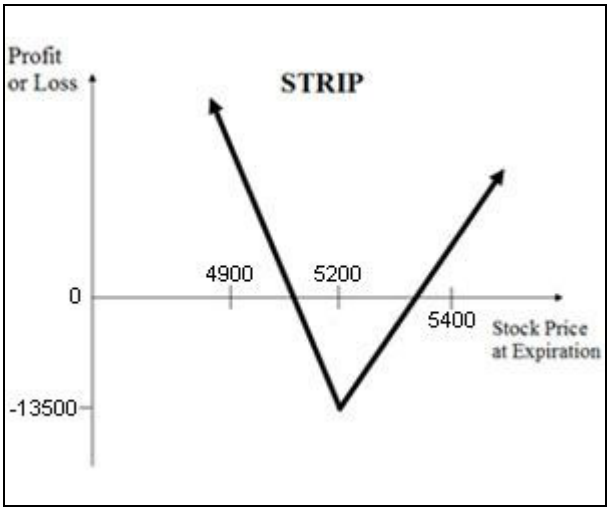
Risk: Limited

Reward: Unlimited

Construction

Buy 2 ATM Put Options
Buy 1 ATM Call Option

Payoff Chart



Example

Mr. X is bearish on NIFTY and enters in a Strip Strategy, buys 2 5200 NIFTY ATM Put Options at a premium of Rs. 85, buys 1 5200 ATM Call Option at a premium of Rs. 100. His net investment will be Rs. 13500 [{(85*2) + (100)}*50]

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will make a profit of Rs. 16500. [{((300-85)*2) - (100)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a loss of Rs. 13500 (entire investment value). [{((0-85)*2) + (0-100)}*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a loss of Rs. 3500. [{(200-100)-(85*2)}*50]

Strategy 11: Long Call Ladder

Explanation

Long Call Ladder Strategy is an extension to Bull Call Spread Strategy. A trader will be slightly bullish about the market, in this strategy but bearish over volatility. It involves buying of an ITM Call Option and sale of 1 ATM & 1 OTM Call Options. However, the risk associated with this strategy is unlimited and reward is limited.

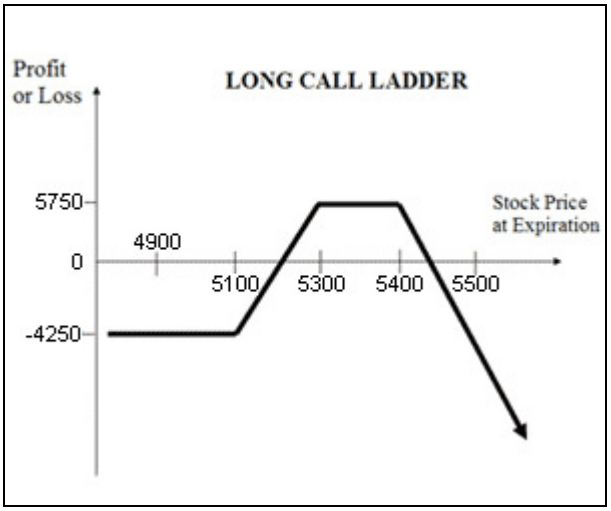
Risk: Limited Downside Risk, Unlimited Risk to the Upside

Reward: Limited

Construction

Buy 1 ITM Call Option
Sell 1 ATM Call Option
Sell 1 OTM Call Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 odd levels. Mr. X feels that the market will slightly rise with less volatility. He buys 1 5100 ITM Call Option at a premium of Rs. 165, sells 1 5300 ATM Call Option for a premium of Rs. 55 & sells 1 5400 OTM Call Option for a premium of Rs. 25. Mr. X's net investment will be Rs. 4250. [{165-55-25*50]

Case 1: At expiry if Nifty closes at 5100, then Mr. X will make a loss of Rs. 4250. [{(55+25)-(165)}*50]

Case 2: At expiry if Nifty closes at 5300, then Mr. X will make a profit of Rs. 5750. [{(200-165) + (55) + (25)}*50]

Case 3: At expiry if Nifty closes at 5500, then Mr. X will make a profit of Rs. 750. [{(400-165)-(200-55)-(100-25)}*50]

Strategy 12: Long Put Ladder

Explanation

Long Put Ladder can be implemented when a trader is slightly bearish on the market and volatility. It involves buying of an ITM Put Option and sale of 1 ATM & 1 OTM Put Options. However, the risk associated with this strategy is unlimited and reward is limited.

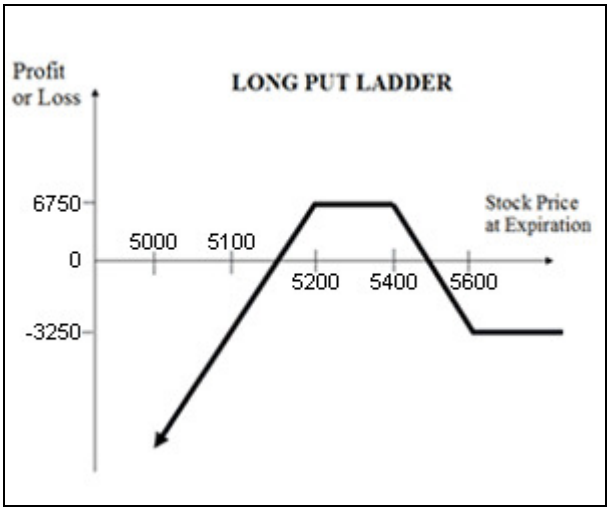
Risk: Unlimited

Reward: Limited

Construction

Buy 1 ITM Put Option
Sell 1 ATM Put Option
Sell 1 OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 levels. Mr. X feels that the market will slightly dip and will be less volatile. He buys one 5400 ITM Put Option at a premium of Rs. 200, sells 1 5200 ATM Put Option for a premium of Rs. 85 & sells 1 5100 OTM Put Option for a premium of Rs. 50. Mr. X's net investment will be Rs. 3250. [{200-85-50*50]

Case 1: At expiry if Nifty closes at 5100, then Mr. X will make a profit of Rs. 6750. [{(300-200) - (100-85) + (50)}*50]

Case 2: At expiry if Nifty closes at 5300, then Mr. X will make a profit of Rs. 1750. [{(100-200) + (85) + (50)}*50]

Case 3: At expiry if Nifty closes at 5500, then Mr. X will make a loss of Rs. 3250. [{(55) + (25) - (200)}*50]

Strategy 13: Short Call Ladder

Explanation

This strategy is implemented when a trader is moderately bullish on the market, and volatility. It involves sale of an ITM Call Option, buying of an ATM Call Option & OTM Call Option. The risk associated with the strategy is limited.

Risk: Limited

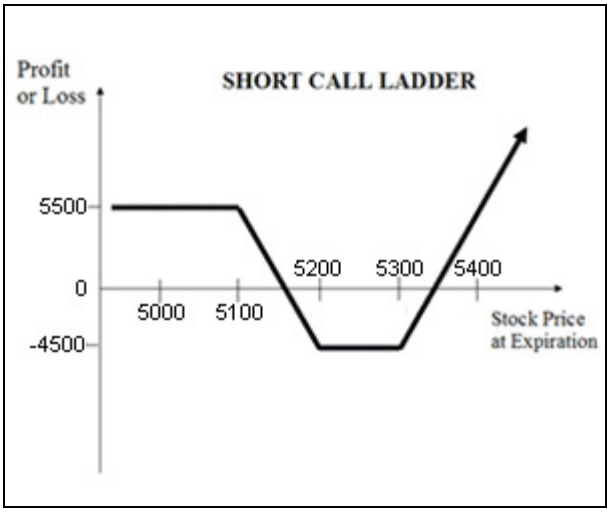
Reward: Unlimited

Break-Even Point: Long Call Strikes (Sum) – Short Call Strike +/- Premium Paid/Received

Construction

Sell 1 ITM Call Option
Buy 1 ATM Call Option
Buy 1 OTM Call Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 levels, Mr. X is bullish on the market and expects it to rise in the near future. He also expects the volatility to shoot up with rise in prices. Lot size of NIFTY is 50. He will sell one 5100 NIFTY ITM Call Option for a premium of Rs. 8250 (165*50), buy one 5200 NIFTY ATM Call Option at a premium of Rs. 5000 (100*50) & buy 5300 NIFTY OTM Call Option at a premium of Rs. 2750 (55*50). His net investment will be Rs. 500. [(165-100-55)*50]

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will make a profit of Rs. 500. [(165-100-55)*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a loss of Rs. 4500. [{(100)-(55)-(100-165)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a profit of Rs. 5500. [{(300-100) + (200-55) -(400-165)}*50]

Strategy 14: Short Put Ladder

Explanation

This strategy is implemented when a trader is slightly bearish on the market. A trader is required to be bullish over the volatility in the market. It involves sale of an ITM Put Option and buying of 1 ATM & 1 OTM Put Options. However, the risk associated with this strategy is limited.

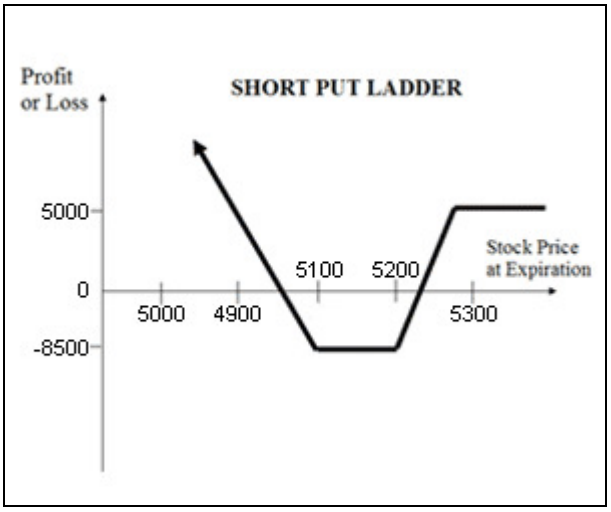
Risk: Limited

Reward: Unlimited

Construction

Sell 1 ITM Put Option
Buy 1 ATM Put Option
Buy 1 OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 levels, Mr. X is bearish on the market and expects it to fall in the near future along with the rise in volatility. Lot size of NIFTY is 50. He will sell one 5300 NIFTY ITM Put Option for a premium of Rs. 6700 (135*50), buy one 5200 NIFTY ATM Put Option at a premium of Rs. 4250 (85*50) & buy one 5100 NIFTY OTM Put Option at a premium of Rs. 2500 (50*50). Mr. X net investment will be zero as the sale of ITM Put Option will totally engulf the cost of buying ATM & OTM Put Options.

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will make a profit of Rs. 5000. [{(300-85) + (200-50) – (400-135)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a loss of Rs. 8500. [{(100-135) - (85) - (50)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will neither make profit nor loss. His net payoff will be zero. [(135-85-50)*50]

Strategy 15: Long Call Condor Spread

Explanation

This strategy is implemented when a trader is bearish on the volatility and expects the market to move sideways. Using Call Options of the same expiry date, he will buy one Deep ITM Call Option, sell 1 ITM Call Option, sell 1 OTM Call Option, buy 1 Deep OTM Call Option. The risk and reward both are limited due to offsetting of long and short positions. For this strategy to make profits the underlying asset should remain range bound i.e. between the 4 strikes.

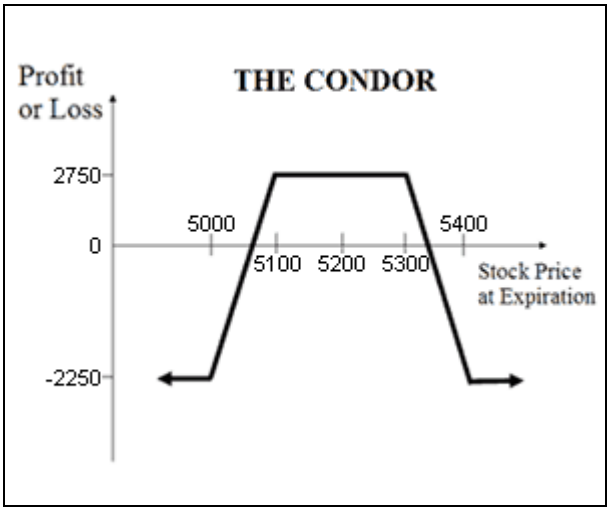
Risk: Limited

Reward: Limited

Construction

Buy 1 Deep ITM Call Option
Sell 1 ITM Call Option
Sell 1 OTM Call Option
Buy 1 Deep OTM Call Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 levels, Mr. X is bearish on volatility and expects the market to move sideways. He will buy one 5000 Deep ITM Call Option for a premium of Rs. 240, sell one 5100 ITM Call Option at a premium of Rs. 165, sell one 5300 OTM Call Option for a premium of Rs. 55, buy one 5400 Deep OTM Call Option at a premium of Rs. 25. His net investment will be Rs. 2250. [{(165+55)-(240+25)}*50]

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will make a loss of Rs. 2250. (His investment value)

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a profit of Rs. 2750. [{(55) + (200-240) + (165-100) – (25)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a loss of Rs. 2250. [{(500-240) – (400-165) – (200-55) + (100-25)}*50]

Strategy 16: Short Call Condor Spread

Explanation

Short Call Condor Spread is the opposite of Long Call Condor Spread i.e. sell 1 Deep ITM Call Option, buy 1 ITM Call Option, buy 1 OTM Call Option, sell 1 Deep OTM Call Option. Similar to Long Call Condor, the risk and rewards associated with this strategy are limited. Credit is received at the time of entering into this strategy.

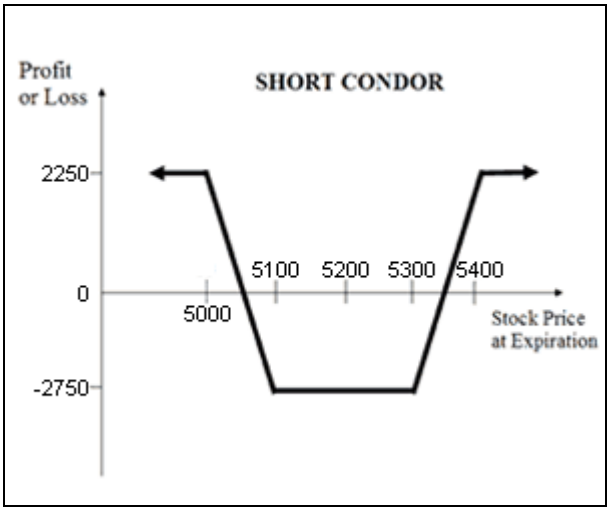
Risk: Limited

Reward: Limited

Construction

Sell 1 Deep ITM Call Option
Buy 1 ITM Call Option
Buy 1 OTM Call Option
Sell 1 Deep OTM Call Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 odd points, Mr. X implements the Short Call Condor Spread. He will sell 1 5000 Deep ITM Call Option for a premium of Rs. 240, buy 1 5100 ITM Call Option at a premium of Rs. 165, buy 1 5300 OTM Call Option for a premium of Rs. 55, sell 1 5400 Deep OTM Call Option at a premium of Rs. 25. His account will be credited by Rs. 2250. [{(240+25)-(165+55)}*50]

Case 1: At expiry if NIFTY closes at 4900, then Mr. X will get to keep his premium Rs. 2250.

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a loss of Rs. 2750. [{(55) - (200-240) + (100-165) + (25)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a profit of Rs. 2250. [{(400-165) + (200-55) – (500-240) – (100-25)}*50]

Strategy 17: Neutral Calendar Spread

Explanation

This strategy is implemented if the trader is neutral in the near future for say 2 months or so. This strategy involves writing of Near Month 1 ATM Call Option and buying 1 Mid Month ATM Call Option, hence reducing the cost of purchase, with the same strike price of the same underlying asset. This strategy is used when the trader wants to make money from the rapid time decay of the option.

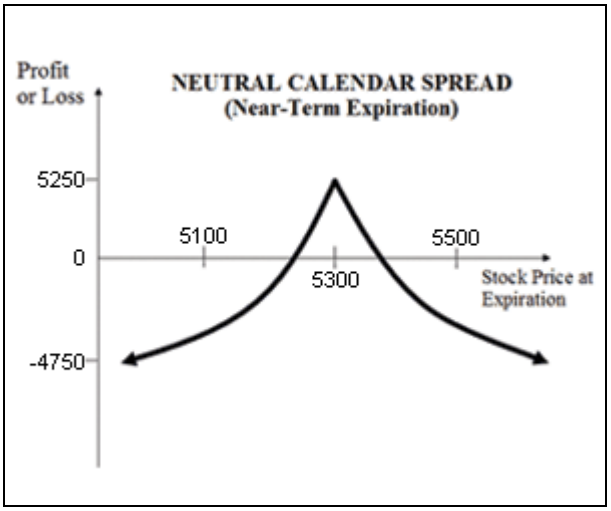
Risk: Limited

Reward: Limited

Construction

Sell 1 Near-Month ATM Call Option
Buy 1 Mid-Month ATM Call Option

Payoff Chart



Example

Suppose that NIFTY is trading at 5300 levels, Mr. X is neutral about the market and expects it to remain sideways in the near future say 2 months or so. Hence, he will implement this Neutral Calendar Spread Strategy, he will sell 1 5300 NIFTY April (near-month) ATM Call Option for a premium of Rs. 65 and buy 1 5300 NIFTY May (mid-month) ATM Call Option at a premium of Rs. 160. The lot size of NIFTY is 50. Hence, his net investment will be Rs. 4750. [(160-65)*50]

Case 1: At Near-Month (April) expiry if NIFTY closes at 5000, then Mr. X will get to keep the premium amount i.e. Rs. 3250. (65*50). At Mid-Month (May) expiry if NIFTY closes at 4800, then Mr. X will make a loss of premium amount i.e. Rs. 8000 (160*250). His net payoff will result in a loss of Rs. 4750 (3250-8000)

Case 2: At Near-Month (April) expiry if NIFTY closes at 5100, then Mr. X will get to keep the premium amount i.e. Rs. 3250. (65*50). At Mid-Month (May) expiry if NIFTY closes at 5300, then Mr. X will make a loss of premium amount i.e. Rs. 8000 (160*250). His net payoff will result in a loss of Rs. 4750 (3250-8000)

Case 3: At Near-Month (April) expiry if NIFTY closes at 5500, then Mr. X will incur a loss of Rs. 6750 [(200-65)*50]. At Mid-Month (May) expiry if NIFTY closes at 5700, then Mr. X will make a profit of Rs. 12000 [(400-160)*250]. His net payoff will result in a profit of Rs. 5250 (12000-6750)

Strategy 18: Long Guts

Explanation

This strategy is implemented by a trader when he is neutral on the movements and bullish on volatility i.e. he expects the stock to move in either direction with high magnitude. This strategy involves buying 1 ITM Call Option and 1 ITM Put Option. This strategy can be called as Debit Spread because trader's account is debited at the time of entering the positions.

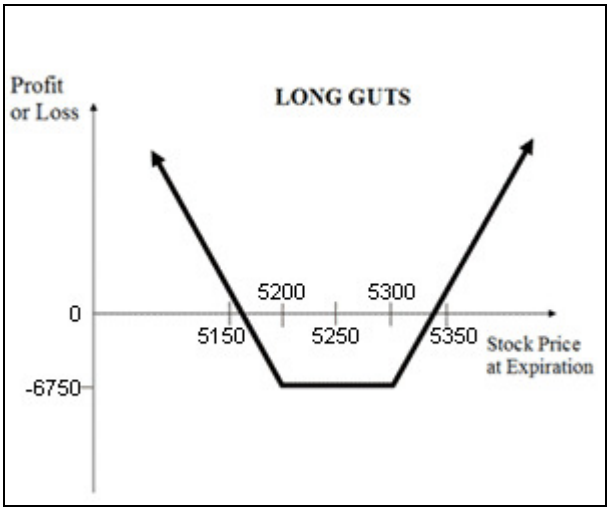
Risk: Limited

Reward: Unlimited

Construction

Buy 1 ITM Call Option
Buy 1 ITM Put Option

Payoff Chart



Example

Suppose NIFTY is trading around 5250 odd points. Mr. X is bullish on the volatility and expects the market to move significantly in either direction in the near future. Long Guts Strategy involves buying 1 5200 NIFTY ITM Call Option at a premium of Rs. 100 and buying 1 5300 NIFTY ITM Put Option at a premium of Rs. 135. His net investment will be Rs. 11750. [(100+135)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a profit of Rs. 3250. [{(300-135)-(100)}*50]

Case 2: At expiry if NIFTY closes at 5250, then Mr. X will incur a loss of Rs. 6750. [{(50-100) + (50-135)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a profit of Rs. 6750. [{(300-100)-(135)}*50]

Strategy 19: Short Guts

Explanation

This strategy is implemented by a trader when he is neutral on the movements and bearish on volatility i.e. he expects the stock to be range bound in the near future. This strategy involves sale of 1 ITM Call Option and 1 ITM Put Option. This strategy can be called as Credit Spread since his account is credited at the time of entering in the positions.

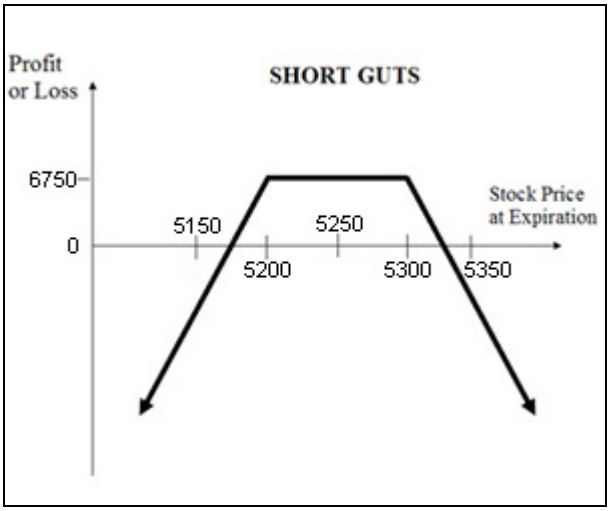
Risk: Unlimited

Reward: Limited

Construction

Sell 1 ITM Call Option
Sell 1 ITM Put Option

Payoff Chart



Example

Suppose NIFTY is trading around 5250 odd points. Mr. X is bearish on volatility and expects the market to be range bound in the near future. Short Guts Strategy involves selling of 1 5200 NIFTY ITM Call Option at a premium of Rs. 100 and selling 1 5300 NIFTY ITM Put Option at a premium of Rs. 135. His net credit amount will be Rs. 11750. [(100+135)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a loss of Rs. 3250. [{(100)-(300-135)}*50]

Case 2: At expiry if NIFTY closes at 5250, then Mr. X will make a profit of Rs. 6750. [{(100-50) + (135-50)}*50]

Case 3: At expiry if NIFTY closes at 5500, then Mr. X will make a loss of Rs. 3250. [{(135)-(300-100)}*50]

Strategy 20: Ratio Call Spread

Explanation

As the name suggests, a ratio of 2:1 is followed i.e. buy 1 ITM Call and simultaneously sell OTM Calls double the number of ITM Calls (In this case 2). This strategy is used by trader who is neutral on the market and bearish on the volatility in the near future. Here profits will be capped up to the premium amount and risk will be potentially unlimited since he is selling two calls.

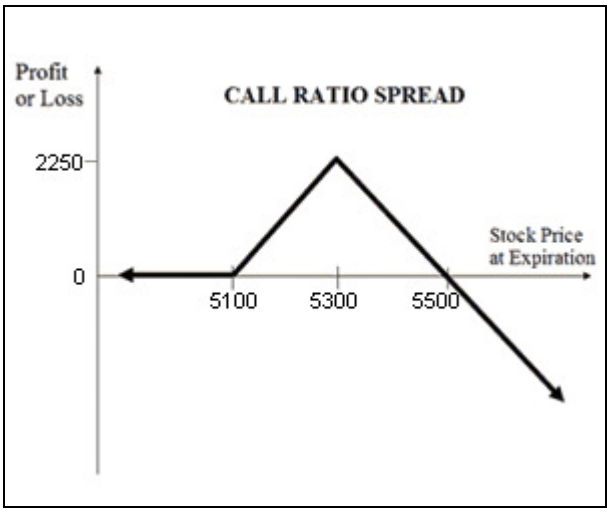
Risk: Unlimited

Reward: Limited

Construction

Buy 1 ITM Call Option
Sell 2 OTM Call Options

Payoff Chart



Example

Suppose NIFTY is trading around 5200 odd points, Mr. X is bearish on volatility and neutral on the market. He will buy 1 NIFTY 5100 ITM Call Option at a premium of Rs. 165 and sell 2 5300 NIFTY OTM Call Options for a premium of Rs. 110 (55*2). His net investment will be Rs. 2750. [(110-165)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will lose his entire investment value i.e. Rs. 2750.

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a profit of Rs. 2250. [{(55*2) + (100-165)}*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a profit of Rs. 2250. [{(300-165) – ((100-55)*2)}*50]

Strategy 21: Ratio Call Write

Explanation

This strategy involves buying of an underlying asset in the cash/futures market and simultaneously selling ATM Calls double the number of long quantity. This strategy is used by a trader who is neutral on the market and bearish on the volatility in the near future. Here profits will be capped up to the premium amount and risk will be potentially unlimited.

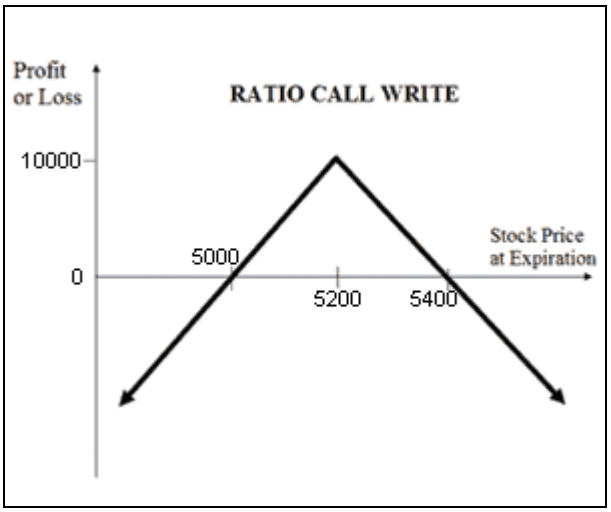
Risk: Unlimited

Reward: Limited

Construction

Buy 1 NIFTY in Futures Market
Sell 2 NIFTY ATM Call Options

Payoff Chart



Example

Suppose NIFTY is trading around 5200, Mr. X is bearish on volatility and neutral on market. He will buy 1 NIFTY Future @ 5200 and sell 2 5200 ATM Call Options for a premium of Rs. 10000 (100*2). Lot size of NIFTY is 50. His net investment will be Rs. 250000. [(5200-200)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will neither make profit nor loss. [{(100*2) + (5000-5200)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will get to keep the premium amount by sale of two 5200 NIFTY ATM Call Options, Rs. 10000. [(100*2)*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will neither make profit nor loss, his payoff will be zero. [{(5400-5200) – ((200-100)*2)}*50]

Strategy 22: Ratio Put Spread

Explanation

This strategy involves buying ITM Puts and simultaneously selling OTM Puts, double the number of ITM Puts. This strategy is used by a trader who is neutral on the market and bearish on the volatility in the near future. Here profits will be capped up to the premium amount and risk will be potentially unlimited.

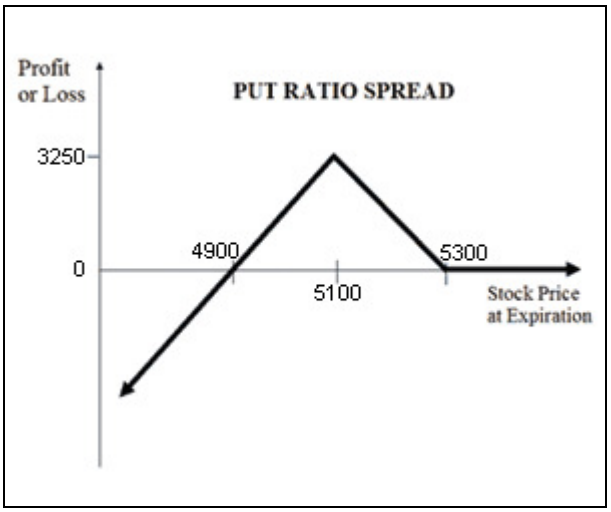
Risk: Unlimited

Reward: Limited

Construction

Buy 1 ITM Put Option
Sell 2 OTM Put Options

Payoff Chart



Example

Suppose that NIFTY is trading around 5200 odd points, Mr. X is bearish on volatility and neutral on market. He will buy 1 NIFTY 5300 ITM Put Option at a premium of Rs. 135 and sell 2 5100 NIFTY OTM Put Options for a premium of Rs. 100 (50*2). His net investment will be Rs. 1750. [(100-135)*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a profit of Rs. 3250. [{(300-135) – ((100-50)*2)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will make a profit of Rs. 3250. [{(50*2) + (100-135)}*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a loss of Rs. 1750. [{(135) – (50*2)}*50]

Strategy 23: Ratio Put Write

Explanation
This strategy is implemented by selling (short) the underlying asset in the cash/futures market. Simultaneously, sell ATM Puts double the number of long quantity. This strategy is used by a trader who in neutral on the market and bearish on the volatility in the near future. Here profits will be capped up to the premium amount and risk will be potentially unlimited.

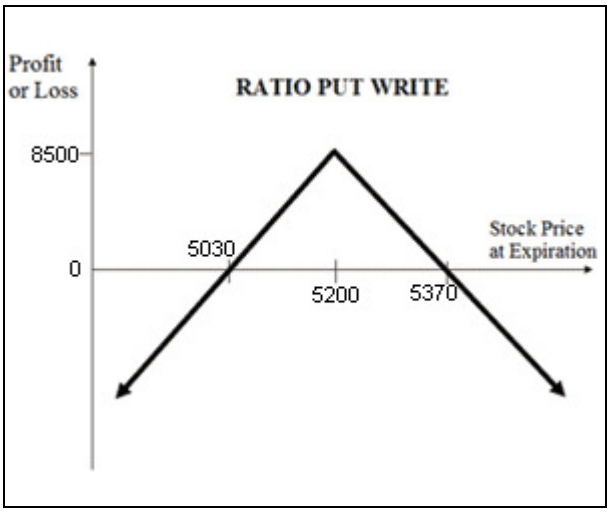
Risk: Unlimited

Reward: Limited

Construction

Sell 1 NIFTY Future
Sell 2 NIFTY ATM Call Options

Payoff Chart



Example

Suppose NIFTY is trading around 5200 odd points, Mr. X is bearish on volatility and neutral on market. He will sell (short) 1 NIFTY Future @ 5200 and sell 2 5200 ATM Put Options (CMP Rs 85) for a premium of Rs. 8500 (85*2). Lot size of NIFTY is 50.

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a loss of Rs. 1500. [{(85-200)*2 + (5200-5000)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will get to keep the premium amount by sale of 5200 NIFTY OTM Put Options of Rs. 8500. [(85*2)*50]

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a loss of Rs. 1500. [{(5200-5400) + (85*2)}*50]

Strategy 24: Iron Condors

Explanation

Iron Condor is a neutral trading strategy. A trader tries to make profit from low volatility in the price of the underlying asset. This strategy will be better understood if you recall 'Bull Put Spread' & 'Bear Call Spread'. A trader will buy one Deep OTM Put Option and sell one OTM Put Option,. He will also sell one OTM Call Option and buy one Deep OTM Call Option.

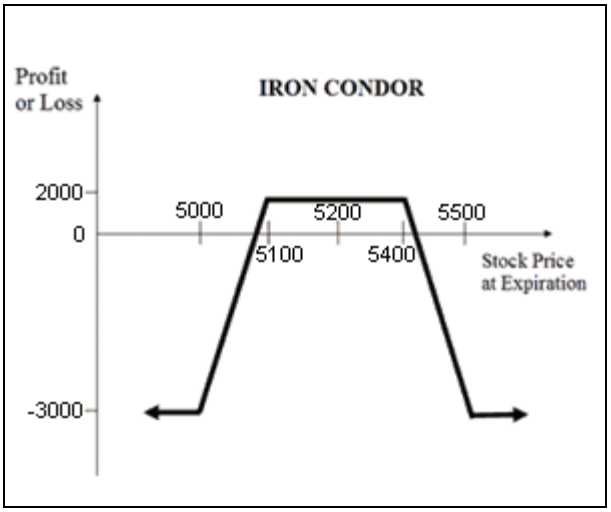
Risk: Limited

Reward: Limited

Construction

Buy 1 Deep OTM Call Option
Sell 1 OTM Call Option
Sell 1 OTM Put Option
Buy 1 Deep OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 odd points, Mr. X is bearish on volatility and neutral on market. He will sell one 5400 NIFTY OTM Call Option for a premium of Rs. 25, buy one 5500 NIFTY Deep OTM Call Option at a premium of Rs. 10, sell one 5100 NIFTY OTM Put Option for a premium of Rs. 50, buy one 5000 Deep OTM Put Option at a premium of Rs. 25. Lot size of NIFTY is 50. His account will get credited by Rs. 2000. [{(25+50)-(10+25)}*50]

Case 1: At expiry if NIFTY closes at 4800, then Mr. X will incur a loss of Rs. 3000. [{(25) – (10) – (300-50) + (200-25)}*50]

Case 2: At expiry if NIFTY closes at 5300, then Mr. X gets to keep the premium amount that was credited at the time of entering the positions i.e. Rs. 2000.

Case 3: At expiry if NIFTY closes at 5700, then Mr. X will incur a loss of Rs. 3000. [{(200-10) – (300-25) + (50) – (25)}*50]

Strategy 25: Iron Butterfly

Explanation

This strategy is implemented when a trader is bearish on the volatility of market and neutral on the market movements. A trader will buy 1 OTM Put Option, sell 1 ATM Put Option, sell 1 ATM Call Option, buy 1 OTM Call Option. Due to offsetting of long and short positions, this strategy bags limited profit with limited risk.

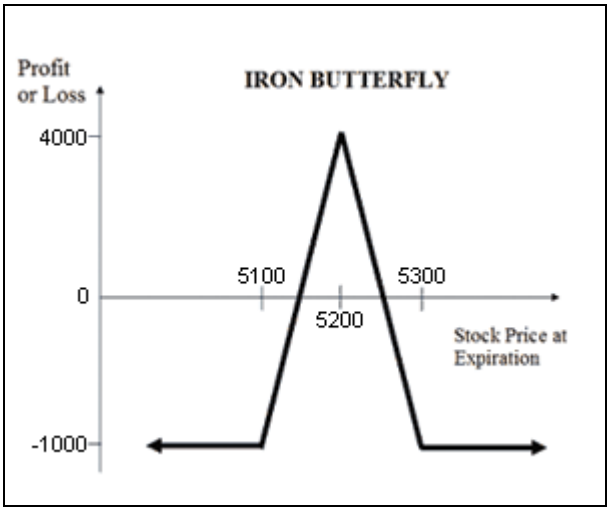
Risk: Limited

Reward: Limited

Construction

Buy 1 OTM Call Option
Sell 1 ATM Call Option
Sell 1 ATM Put Option
Buy 1 OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 odd points, Mr. X is bearish on volatility and neutral on market movements. He will sell 1 5200 NIFTY ATM Call Option for a premium of Rs. 100, buy 1 5300 NIFTY OTM Call Option at a premium of Rs. 55, sell 1 5200 NIFTY ATM Put Option for a premium of Rs. 85, buy 1 5100 OTM Put Option at a premium of Rs. 50. Lot size of NIFTY is 50. Mr. X's account will get credited by Rs. 4000. [{(100+85)-(50+55)}*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will incur a loss of Rs. 1000. [{(100) – (55) – (200-85) + (100-50)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X gets to keep the premium amount that was credited at the time of entering the positions i.e. Rs. 4000.

Case 3: At expiry of NIFTY closes at 5400, then Mr. X will incur a loss of Rs. 1000. [{(200-100) – (100-55) + (85) – (50)}*50]

Strategy 26: Reverse Iron Condor

Explanation

Reverse Iron Condor as the name suggests is the opposite of Iron Condors. In Reverse Iron Condor, a trader is bullish about volatility and expects the market to make a significant move in the near future in either direction. Here a trader will buy 1 OTM Call Option, sell 1 Deep OTM Call Option, buy 1 OTM Put Option, sell 1 Deep OTM Put Option. This strategy also bags limited profits with limited risk.

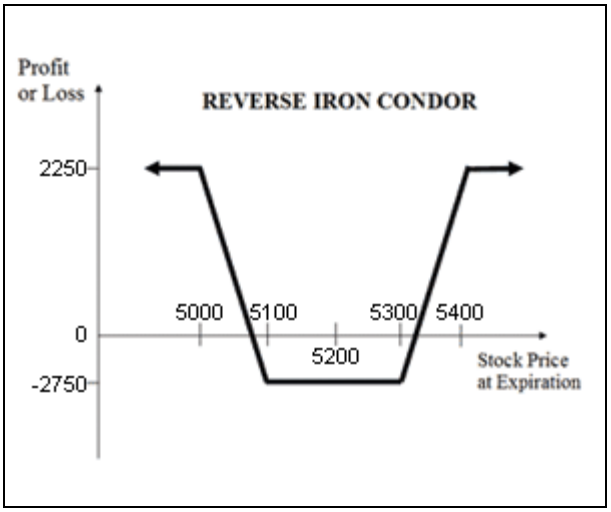
Risk: Limited

Reward: Limited

Construction

Sell 1 Deep OTM Call Option
Buy 1 OTM Call Option
Buy 1 OTM Put Option
Sell 1 Deep OTM Put Option

Payoff Chart



Example

Suppose NIFTY is trading at 5200 odd points, Mr. X is bullish on volatility and indecisive on market movements. He will sell 1 5400 NIFTY Deep OTM Call Option for a premium of Rs. 25, buy 1 5300 NIFTY OTM Call Option at a premium of Rs. 55, buy 1 5100 NIFTY OTM Put Option for a premium of Rs. 50, sell 1 5000 Deep OTM Put Option at a premium of Rs. 25. Lot size of NIFTY is 50. Mr. X's account will be debited by Rs. 2750. [{(25+25)-(55+50)}*50]

Case 1: At expiry if NIFTY closes at 4800, then Mr. X will make a profit of Rs. 2250. [{(25) – (55) + (300-50) – (200-25)}*50]

Case 2: At expiry if NIFTY closes at 5200, then Mr. X will lose the premium amount that was paid at the time of entering the positions i.e. Rs. 2750.

Case 3: At expiry if NIFTY closes at 5600, then Mr. X will make a profit of Rs. 2250. [{(300-55) – (200-25) – (50) + (25)}*50]

Strategy 27: Reverse Iron Butterfly

Explanation

Reverse Iron Butterfly as the name suggests is the opposite of Iron Butterfly. In Reverse Iron Butterfly, a trader is bullish on volatility and expects the market to make significant move in the near future in either directions. Here a trader will buy 1 ATM Call Option, sell 1 OTM Call Option, buy 1 ATM Put Option, sell 1 OTM Put Option. This strategy also bags limited profit with limited risk.

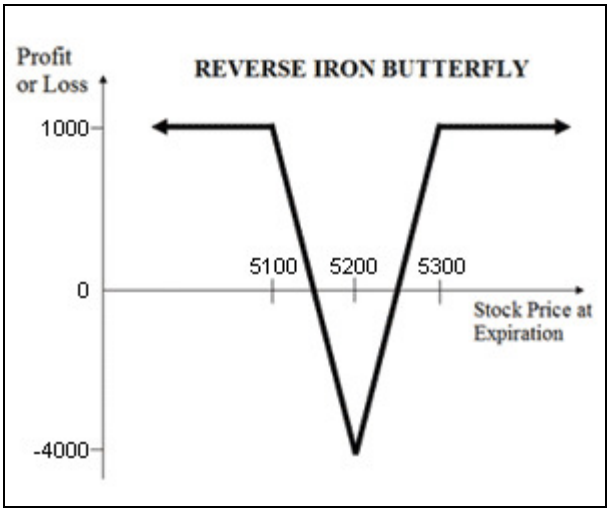
Risk: Limited

Reward: Limited

Construction

Sell 1 OTM Call Option
Buy 1 ATM Call Option
Buy 1 ATM Put Option
Sell 1 OTM Put Option

Payoff Chart



Explanation

Suppose NIFTY is trading around 5200 odd points and Mr. X is bullish on the market volatility. He will sell 1 5300 OTM Call Option for a premium of Rs. 55, buy 1 5200 ATM Call Option at a premium of Rs. 100, buy 1 5200 ATM Put Option at a premium of Rs. 85, sell 1 5100 OTM Put Option for a premium of Rs. 50. Lot size of NIFTY is 50. His net investment will be Rs. 4000. [{(50+55)-(100+85)}*50]

Case 1: At expiry if NIFTY closes at 5000, then Mr. X will make a profit of Rs. 1000. [{(55) – (100) + (200-85) – (100-50)}*50]

Case 2: At expiry if NIFTY closes at 5200 levels, then Mr. X lose the premium amount that was paid at the time of entering the positions i.e. Rs. 4000.

Case 3: At expiry if NIFTY closes at 5400, then Mr. X will make a profit of Rs. 1000. [{(200-100) – (100-55) – (85) + (50)}*50]

BEARISH STRATEGIES

Strategy 1: Short Call

Explanation

A trader shorts or writes a Call Option when he feels that underlying stock price is likely to go down. Selling Call Option is a strategy preferred for experienced traders.

However this strategy is very risky in nature. If the stock rallies on the upside, your risk becomes potentially unquantifiable and unlimited. If the strategy works out in your favor then you will pocket the premium amount as your reward.

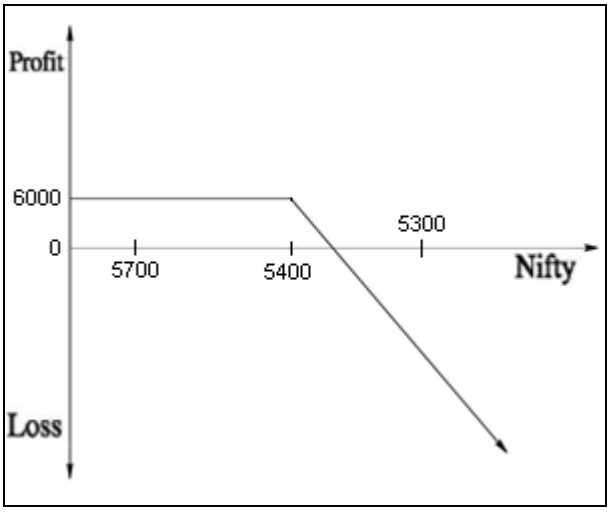
Risk: Unlimited

Reward: Limited

Construction

Sell 1 Call Option

Payoff Chart



Example

If the NIFTY is trading around 5300 levels, Mr. X feels that Nifty is likely to fall in the near future then he will sell one 5400 Call Option for a premium of Rs. 120. Mr. X will get a credit of Rs 6000 (120*50) in his account for selling or writing the call option.

Case 1: NIFTY closes at 5200 levels, Mr. X will bag the premium amount i.e. Rs. 6000. (120*50)

Case 2: NIFTY closes at 5600 levels; Mr. X will incur a loss of Rs. 4000. [(Strike Price - Expiry Price) + Premium Price * 50] [(5400-5600) + 120)*50]

Strategy 2: Long Put

Explanation

This strategy is implemented by buying 1 Put Option i.e. a single position, when the person is bearish on the market and expects the market to move downwards in the near future.

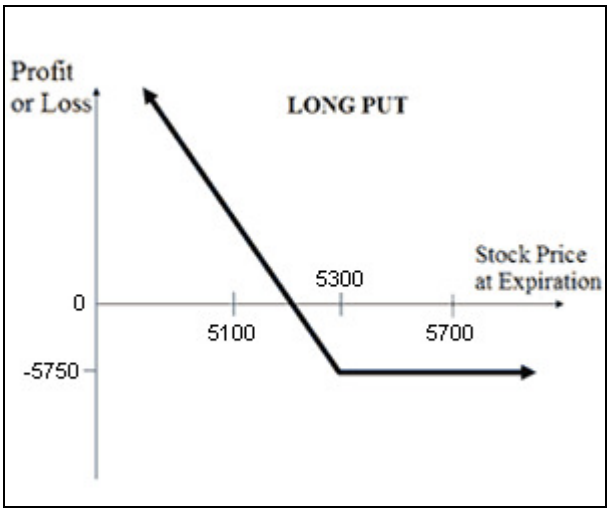
Risk: The maximum loss will be the premium amount paid.

Reward: The profits will be limited by the maximum fall in the underlying asset price i.e. potentially null value (i.e. zero '0').

Construction

Buy 1 Put Option

Payoff Chart



Example

Mr. X is bearish on NIFTY and expects the market to move downwards in the near future. NIFTY is currently trading around Rs. 5200 level. Lot size of NIFTY is 50. Mr. X buys 1 5300 Put Option of NIFTY for a premium of Rs. 115. His initial investment will be Rs. 5750. (115*50)

Case 1: If the market moves as per Mr. X's expectations and dips down to Rs. 5100 level, then the net profit will be Rs. 4250. [(200-115)*50]

Case 2: If the market moves upwards against his expectations then the maximum loss/risk will be the premium amount paid i.e. Rs. 5750. (115*50)

Strategy 3: Protective Call

Explanation

This strategy is simply the reversal of the Synthetic Call Strategy. This strategy is implemented when a trader is bearish on the market and expects to go down. Trader will short underlying stock in the cash market and buy either an ATM Call Option or OTM Call Option. The Call Option is bought to protect / hedge the upside risk on the short position. The net payoff will be similar to that of Long Put.

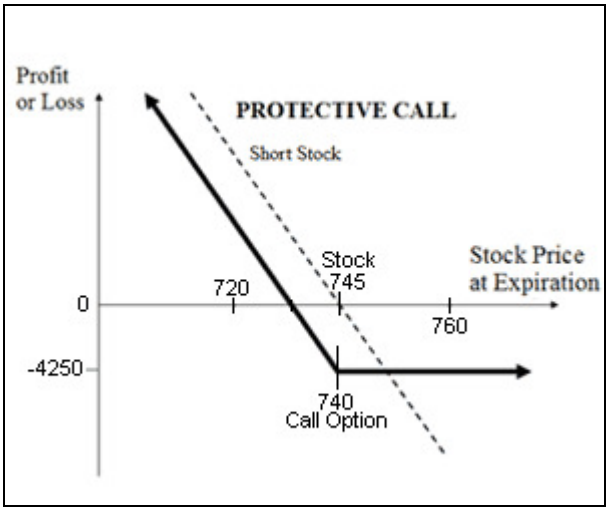
Risk: Limited

Reward: Unlimited

Construction

Sell 250 RIL Shares
Buy 1 ATM Call Option

Payoff Chart



Example

RIL is trading at Rs. 745 levels; Mr. X is bearish and expects the stock to fall in the near future. He shorts 250 shares of RIL @ Rs. 745 in the futures market. Remember when you short in cash market you have to cover it by end of the day, so here you will short in the futures market so that you can hold your short positions till expiry. In order to hedge himself in short positions, he will buy one 740 ATM Call Option at a premium of Rs. 22. The lot size of RIL Option is 250.

Case 1: At expiry if RIL falls up to Rs. 720, then Mr. X will make a profit of Rs. 750. [(745-720)-22)*250]

Case 2: At expiry if RIL stays at Rs. 742, then Mr. X will make a loss of Rs. 4250. [(745-742) + (2-22)*250]

Case 3: At expiry if RIL goes up to Rs. 760, then Mr. X will make a loss of Rs. 4250 [{(745-760) + (20-22)}*250]. Here Mr. X will make loss both on his short position and long call position

Strategy 4: Covered Put

Explanation

This strategy is exactly opposite to Covered Call Strategy. Here the investor is neutral or moderately bearish in nature and wants to take advantage of the price fall in the near future. The trader will short one lot of stock future. Now the trader will short ATM Put Option, the option strike price will be his exit price.

If the prices rally above the strike price, the Put Option will become ITM and will be squared off. If the prices stay below the strike price, then the trader will square off his Futures position and make money and also pocket the Put Option premium.

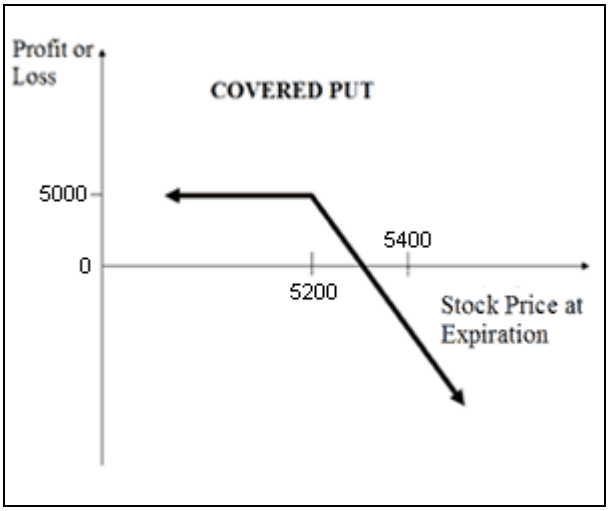
Risk: Unlimited

Reward: Limited

Construction

Sell (Short) 1 lot of NIFTY
Sell (Short) 1 NIFTY OTM Put Option

Payoff Chart



Example

NIFTY is trading at 5200 levels; Mr. X is neutral or moderately bearish and expects the NIFTY to fall. NIFTY lot size is 50. He shorts 1 NIFTY Futures, and simultaneously writes one 5200 ATM Put Option for a premium of Rs 100.

Case 1: On expiry, if NIFTY closes at 5000 level, then Mr. X will make a profit of Rs. 5000. [(5200-5000) + (100-200)*50]

Case 2: On expiry, if NIFTY closes at 5200, then Mr. X will make a profit of Rs 5000. [(5200-5200) + 100*50]

Case 3: On expiry, if NIFTY closes at 5400 level, then Mr. X will make a loss of Rs 5000. [(5200-5400) + 100*50]

Strategy 5: Bear Call Spread

Explanation

Bear Call Spread option trading strategy is used by a trader who is bearish in nature and expects the underlying asset to dip in the near future. This strategy includes buying of an 'Out of the Money' Call Option and selling one 'In the Money' Call Option of the same underlying asset and the same expiration date. When you write a call, you receive premium thereby reducing the cost for buying of OTM Call Option. This strategy is also called as 'Bear Call Credit Spread' as your account gets credited at the time of entering the positions.

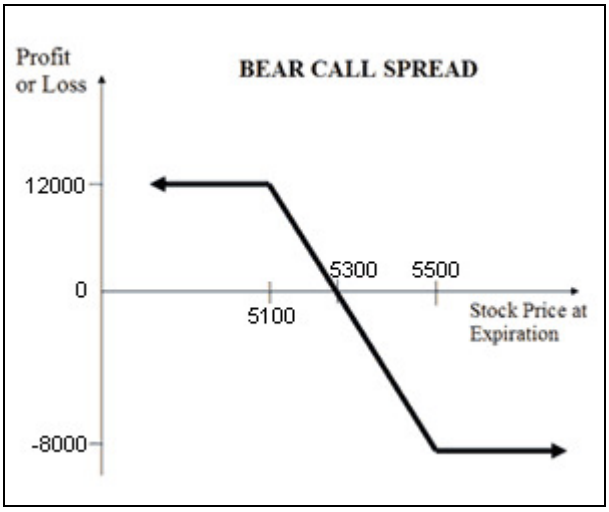
Risk: Limited

Reward: Limited

Construction

Buy 1 'Out of the Money' Call Option
Sell 1 'In the Money' Call Option

Payoff Chart



Example

Suppose that the NIFTY is trading around 5300 level, and Mr. X enters into Bear-Call-Spread strategy. The Lot Size of NIFTY is 50. He buys one 5500 OTM Call Option for a premium of Rs. 35, and sells one 5100 ITM Call Option for Rs. 275. His account will be credited by Rs 12000. [(275-35)*50]

Case 1: At expiry, if the NIFTY closes at 5000 level, then Mr. X is allowed to keep the credit amount i.e. Rs. 12000.

Case 2: At expiry, if the NIFTY closes at 5200 level, then the trader will make a profit of Rs. 7000. [{(275-100) - (35)}*50]

Case 3: At expiry, if the NIFTY closes at 5600 level, then Mr. X would have made loss on the short position of 5100 which will be mitigated by profits made in the long position of 5500. The loss amount would be Rs. 8000. [{(100-35) – (500-275)}*50]

Strategy 6: Bear Put Spread

Explanation

When a trader is moderately bearish on the market he can implement this strategy. Bear-Put-Spread involves buying of ITM Put Option and selling of an OTM Put Option. If prices fall, the ITM Put option starts making profits and the OTM Put option also adds to profit at a certain extent if the expiry price stays above the OTM strike. However, if it falls below the OTM strike, then it starts making losses which will be mitigated by ITM Put which generates profit.

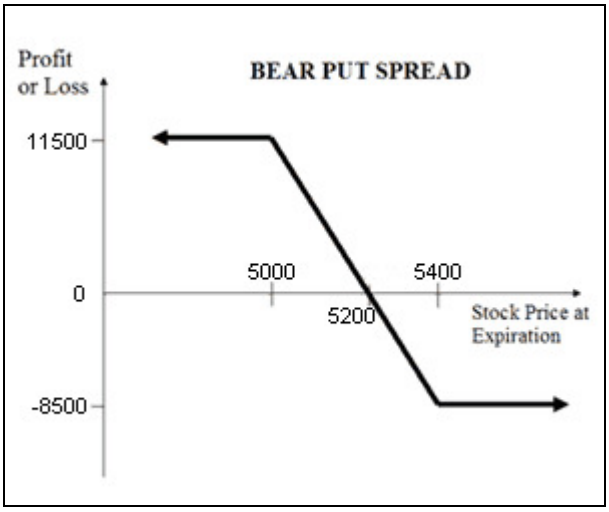
Risk: Limited

Reward: Limited

Construction

Buy ITM Put Option
Sell OTM Put Option

Payoff Chart



Example

Suppose that NIFTY is trading at 5200 levels and Mr. X is bearish on the market and expects it to fall in the near future. He implements the Bear-Put-Strategy, he buys one NIFTY 5400 ITM Put Option for a premium of Rs. 200 & sells one NIFTY 5000 OTM Put Option for a premium of Rs. 30. His net investment will be Rs. 13500. [(200-30)*50]

Case 1: If the NIFTY closes at 4900, then Mr. X will make a profit of Rs. 11500. [{(500-200)-(100-30)}*50]

Case 2: If the NIFTY closes at 5300, then Mr. X will make a loss of Rs. 3500. [{(100-200) + (30)}*50]

Case 3: If the NIFTY closes at 5500, then Mr. X will make a loss of Rs. 8500. [(30-200)*50]

Strategy 7: Put Backspread

Explanation

If the trader is bearish on market and bullish in volatility, he will implement this strategy. However the trader can be neutral in nature i.e. indifferent if the market moves in either of the direction, this strategy will make profits, but uptrend will give a capped income than downtrend which will give unlimited returns.

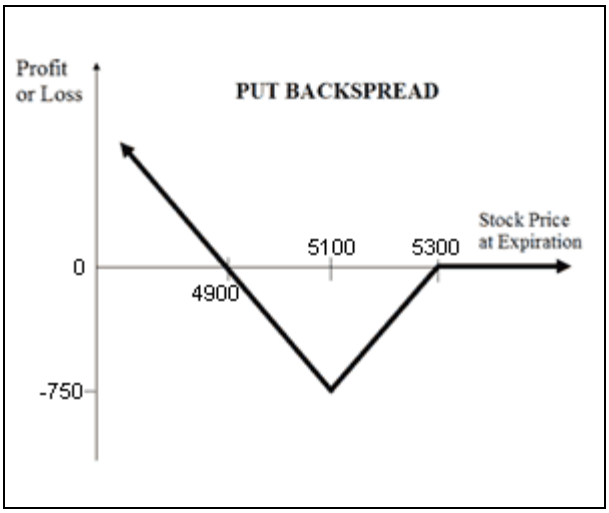
Risk: Limited

Reward: Unlimited

Construction

Sell 1 ITM Put Option
Buy 2 OTM Put Options

Payoff Chart



Example

Suppose NIFTY is trading at Rs. 5200 levels, Mr. X feels bearish on the market and bullish on volatility; he will apply Put Backspread Strategy. He will sell 1 5300 NIFTY ITM Put Option for a premium of Rs. 135 & buy 2 5100 NIFTY OTM Put Options at a premium of Rs. 50 each. His account will be credited by Rs. 1750. [{135-(50*2)}*50]

Case 1: At expiry if NIFTY closes at Rs. 4900, then Mr. X will make a profit of Rs. 1750. [{((200-50)*2) – (400-135)}*50]

Case 2: At expiry if NIFTY closes at Rs. 5250, then Mr. X will make a loss of Rs. 750. [{(50*2)-(50-135)}*50]

Case 3: At expiry if NIFTY closes at Rs. 5500, then Mr. X will get to keep his premium i.e. Rs. 1750. [{(135)-(50*2)}*50]

Strategy 8: Diagonal Bear Put Spread

Explanation

When the trader is neutral – bearish in the near-month and bearish in the mid-month, he will apply Diagonal Bear Put Spread. This strategy involves buying Mid-Month ITM Put Options and selling (short/write) equal number of Near-Month OTM Put Options, of the same underlying asset. This strategy bags limited rewards with limited risk.

Risk: Limited

Reward: Limited

Construction

Sell 1 Near-Month OTM Put Option
Buy 1 Mid-Month ITM Put Option

Example

Suppose NIFTY is trading at 5300 levels, Mr. X is neutral to bearish in the near-month and is bearish in the mid-month; hence he will apply Diagonal Bear Put Spread. He will sell 1 5200 NIFTY Near-Month OTM Put Option for a premium of Rs. 10 and buy 1 5400 NIFTY Mid-Month ITM Put Option at a premium of Rs. 145. His net investment will be Rs. 6750. [(10-145)*50]

Case 1: If at the near-month expiry, NIFTY closes at 5100 levels, then Mr. X will incur a loss on the 5200 NIFTY Near-Month OTM Put Option of Rs. 4500. [(100-10)*50]
If at the mid-month expiry, NIFTY closes at 5000 levels, then Mr. X will make a profit on the 5400 NIFTY Mid-Month ITM Put Option of Rs. 12750. [(400-145)*50]
His net payoff will result in a profit of Rs. 8250. (12750-4500)

Case 2: If at the near-month expiry, NIFTY closes at 5300 levels, then Mr. X will get to keep the premium of 5200 NIFTY Near-Month OTM Put Option of Rs. 500. (10*50)
If at the mid-month expiry, NIFTY closes at 5200 levels, then Mr. X will make a profit on the 5400 NIFTY Mid-Month ITM Put Option of Rs. 2750. [(200-145)*50]
His net payoff will result in a profit of Rs. 3250. (2750+500)

Case 3: If at the near-month expiry, NIFTY closes at 5500 levels, then Mr. X will get to keep the premium of 5200 NIFTY Near-Month OTM Put Option of Rs. 500. (10*50)
If at the mid-month expiry, NIFTY closes at 5000 levels, then Mr. X will lose the premium paid for the 5400 NIFTY Mid-Month ITM Put Option of Rs. 7250. (145*50)
His net payoff will result in a loss of Rs. 6250. (500-7250)

Disclaimers

1. We have not taken in to consideration the exercising part of the option; because in India we do not have physical delivery based settlements. Our positions if not manually squared up before expiry, they are automatically squared off by the system itself and the position is cash settled.

2. For simple understanding, we have not taken in to consideration the margin system. These options are financially leveraged instruments wherein you have to pay only 20% (estimate) of the total amount as an upfront margin for entering the trade. Later on as the position takes turn your account is settled by mark to market margin system.

3. In Calendar Spread Strategies, we do not take the Mid-Month Option payoff thereof at the time of Near-Month Option expiry date. But we have to calculate our net payoff at that point of time because of the mark to market margin system.

4. The strategies mentioned in this e-book are only for learning purpose and cannot be construed as recommendations. Please consult your broker/financial adviser before executing a trade.

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