



Spreads... What are they?

Spreads are often referred to as verticals. I just like calling them spreads.

Each spread involves buying and writing puts or calls at different strike prices. Each spread has two legs, where one leg is buying an option, and the other leg is selling an option.

This can result in the option position (containing two legs), giving the trader a credit or debit. A debit spread is when putting on the trade costs money. For example, one option costs \$250, but the trader receives \$100 from the other position. The net premium cost is a \$150 debit.

If the situation were reversed, and the trader receives \$250 for putting on an option trade, and the other option costs \$100, the two option contracts combine for a net premium credit of \$150.

Are you bullish or bearish?

If you are very bullish, you might be better off considering stand-alone calls (not a spread). But if you are expecting upside (but not blowing through the roof upside), consider a bull call spread or a bull put spread. They both benefit from a rise (or in the case of a bull put spread it can benefit if the stock stands still!)

Likewise, if you are slightly bearish or just believe a stock isn't likely to rise much more a bear call spread or bear put spread may be the answer. A bear call spread benefits even if a stock stands still. For a bear put spread you do need the stock to fall. This is the exact opposite and should be intuitive to the call side of options trading.

Sometimes I get the question how come the stock went up, but my call did not make money? That's because volatility was initially high and now it is falling. There is no way to predict volatility. Just if it is high or low currently based on module 7.

Rising volatility may favor the option buyer, which favors debit spread strategies! This is important to consider. Declining volatility improves the odds for the option seller, which favors credit spread strategies.

Spreads are great ways to grow small accounts. They require little capital and make huge returns. However, you need to practice them and understand your risk. In the following videos you will learn more about payoffs and risks with real examples I make.