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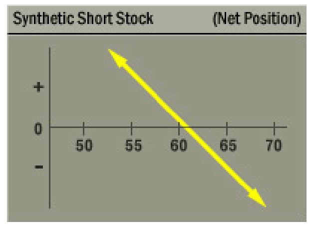
- Long Call Condor
- Long Condor
- Long Iron Butterfly
- Long Put
- Long Put Butterfly
- Long Put Calendar Spread
- Long Put Condor
- Long Ratio Call Spread

Synthetic Short Stock

Description

The strategy combines two option positions: short a call option and long a put option with the same strike and expiration. The net result simulates a comparable **short stock** position's risk and reward. The principal differences are the time limitation imposed by the term of the options, the absence of the large initial cash inflow that a short sale would produce, but also the absence of the practical difficulties and obligations associated with short sales.

If assigned, the investor who doesn't take further steps to cover, ends up with an actual short stock position.



Net Position (at expiration)

EXAMPLE
Short 1 XYZ 60 call
Long 1 XYZ 60 put

MAXIMUM GAIN
Strike paid - net debit paid

MAXIMUM LOSS
Unlimited

Outlook

Looking for a decline in the stock's price during the term of the options.

Since the strategy's term is limited, the longer-term outlook for the stock isn't as critical as for, say, an outright short stock position.

However, the difficulty of pinpointing the exact timing and sequence of a downturn, just before an upturn, suggests it is not an optimal strategy for a long-term bullish investor.

Summary

This strategy is essentially a short futures position on the underlying stock. The **long put** and the **short call** combined simulate a short stock position. The net result entails the same risk/reward profile, though only for the term of the options: limited but large potential for
d the underlying stock rise in

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n is for the stock to rise to infinity. In
and have to sell the stock at the
strike price, resulting in an infinitely large loss. The loss would be higher (lower) by the amount of the debit (credit). In this worst case scenario, the put would of course simultaneously expire worthless.

- Short Strangle
- Short Ratio Call Spread

Max Gain

The maximum gain is substantial but limited. The best that can happen is for the stock to become worthless, in which case the investor could buy stock in the market for zero and sell it at the strike by exercising the put. The gain would be even higher (lower) by the amount of the credit (debit) when the strategy was implemented.

Profit/Loss

As with a short stock position, the potential profit is substantial, and the potential losses are unlimited. An investor can do the research on the underlying and monitor the developments, but there is no guarantee of being able to get out of the short call position before the stock (or the call) becomes unaffordable.

Breakeven

This strategy breaks even if, at expiration, the stock is above (below) the strike price by the amount of the credit (debit) that the investor received (paid) when the strategy was implemented.

Breakeven = strike + net credit

(Breakeven = strike - net debit)

Volatility

Volatility is usually not a major consideration, all other things being equal. Since the strategy involves being both long and short an option with the same strike and expiration, the effects of volatility shifts will roughly offset each other.

Time Decay

Since the strategy involves being both long and short an option with the same strike and term, the effects of time decay will roughly offset each other.

Assignment Risk

Early assignment, while possible at any time, generally occurs only just before the stock goes ex-dividend for calls.

And be aware, a situation where a stock is involved in a restructuring or capitalization event, such as a merger, takeover, spin-off or special dividend, could completely upset typical expectations regarding early exercise of options on the stock.

Expiration Risk

The investor cannot know for sure whether or not assignment in fact occurred until the Monday after expiration.

Comments

This strategy is usually used to provide a nearly perfect hedge against a long position in the underlying stock. See the collar strategy discussion for details.

Related Position

Comparable Position: **Short Stock**

Opposite Position: **Synthetic Long Stock**

Post Rating

6 Ratings

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