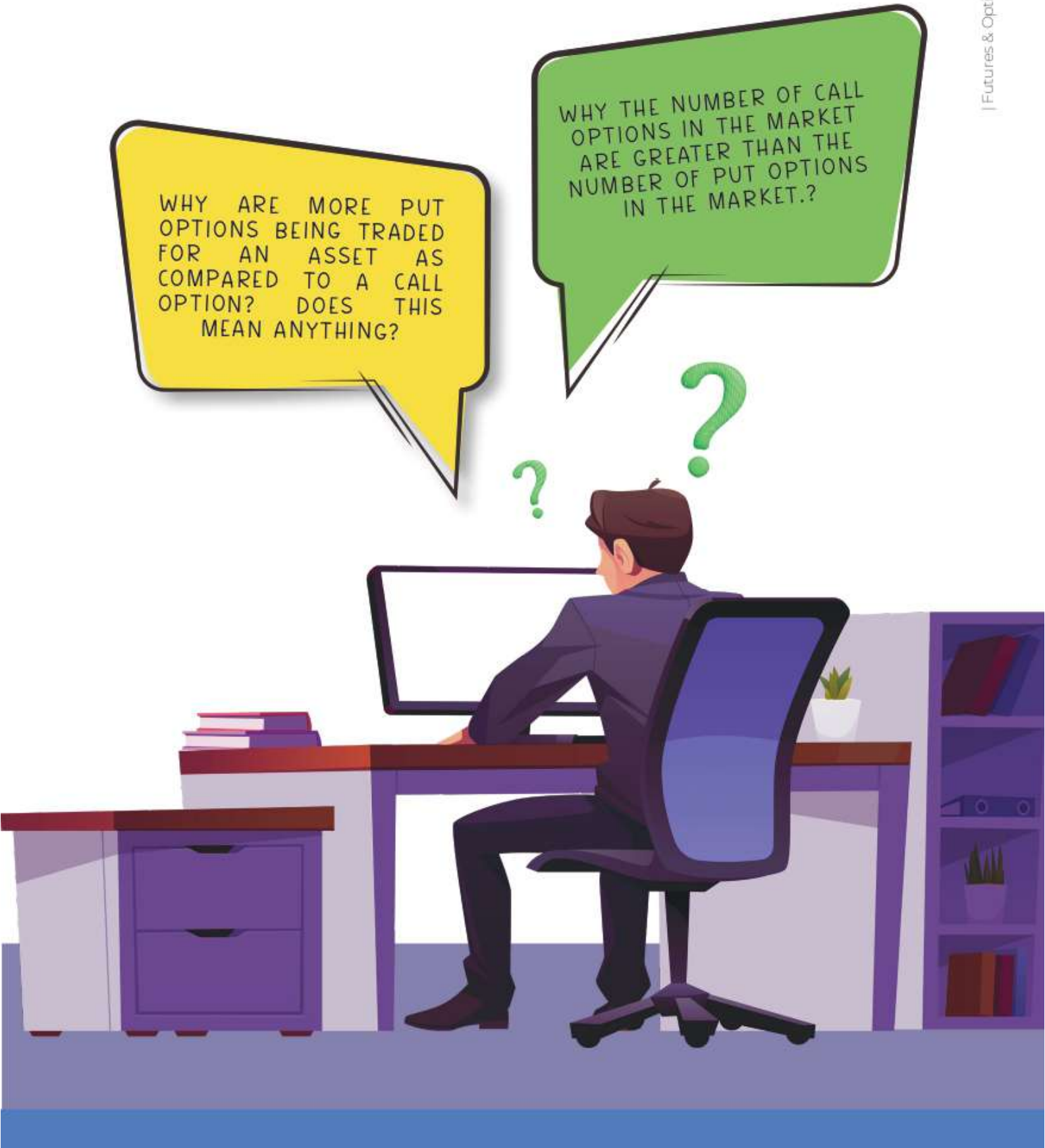
7.4 PUT CALL RATIO (PCR)

Explainer Video



If more put options are being traded, it means that the market opinion is that the underlying asset is going to go down.

While if more call options are being traded, it means that the market opinion is that the underlying asset is going to go up.

"PUT-CALL RATIO IS THE RATIO BETWEEN THE NUMBER OR VOLUME OF PUT OPTIONS AND THE NUMBER OR VOLUME OF CALL OPTIONS THAT ARE CURRENTLY BEING TRADED IN THE MARKET."

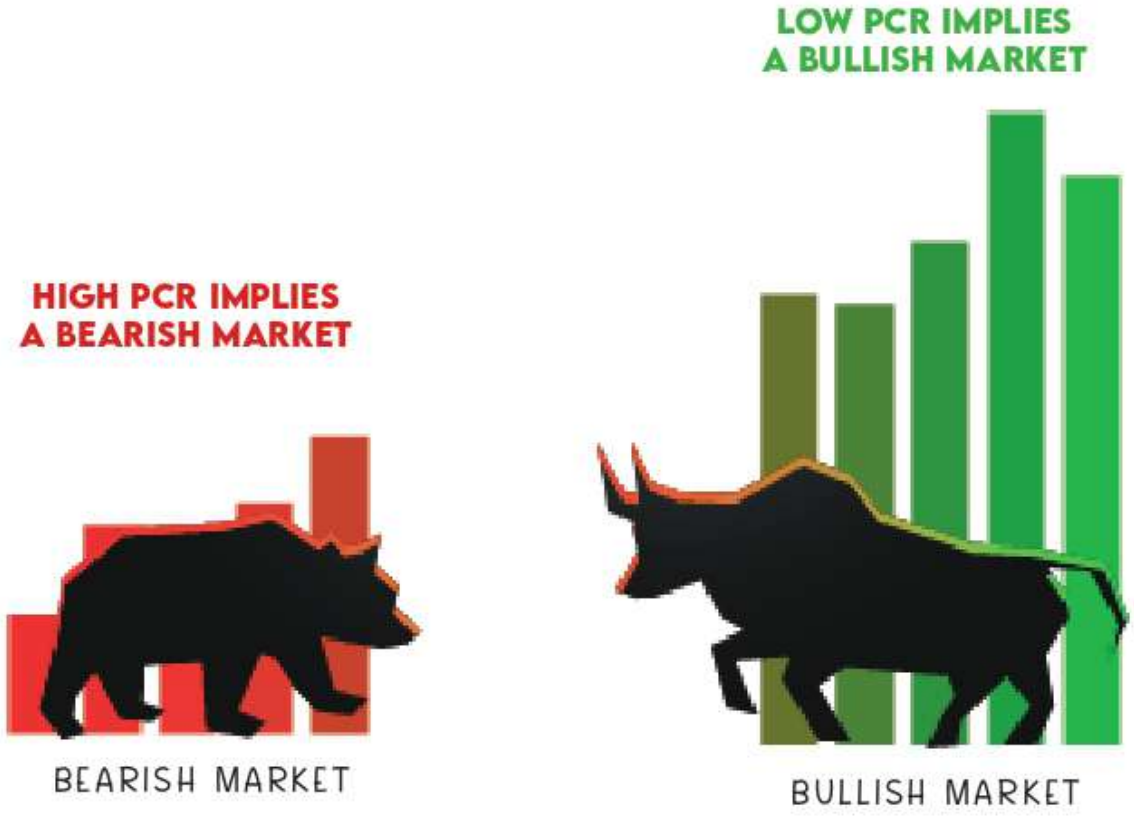
Alternatively, it can be calculated as open interest of all put options combined divided by open interest of all call options combined.

$$\text{Put-Call Ratio} = \frac{\text{Number/Volume of Put Options}}{\text{Number/Volume of Call Options}} = \frac{V_{PE}}{V_{CE}}$$

OR

$$= \frac{\text{Open Interest Put Options}}{\text{Open Interest Call Options}} = \frac{OI_{PE}}{OI_{CE}}$$

The put-call ratio is, therefore, calculated as the proportion of total put options and call options trading on a particular day. It tells us if the market sentiment around that particular asset is bullish or bearish.

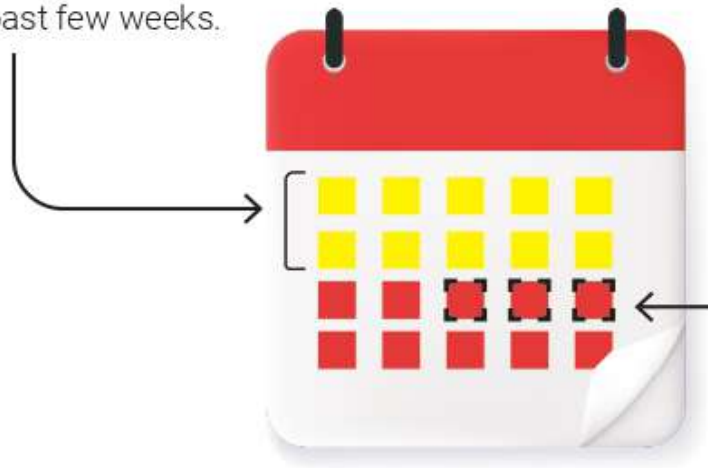


PCR OPEN INTEREST

Put Call Ratio based on Open Interest shows the market sentiment for the past few weeks.

PCR VOLUME

Put Call Ratio based on Volume of Options traded, shows the market sentiment on a particular day.



The PCR helps traders understand the overall sentiment of the market. It is an important indicator used to get a fair understanding of the markets

We can further use PCRs (Put Call Ratio) to plot points in a graphical representation to understand the trend of the put-call ratio in the market. We can use this graph to visually understand the sentiment in the market in the recent past. We can even understand the current sentiments in the market.

We can use the Put-call ratio for individual stocks and sectors as well. Put Call ratios are not a good indicator where overall trading volumes are low for the asset. This is because few trades can change the PCR but not really impact the market sentiment. As a result, this should only be used on Indices and large cap stocks.