

11.4 BEAR CALL SPREAD STRATEGY



Explainer Video

Bear call spread is exactly opposite to bull call spread. This strategy is used when we are bearish on the underlying asset. Bear Call Spread gives us limited profits and limited loss opportunity. Also, we receive Net Spread here instead of paying.

STEPS TO FORM A BEAR CALL SPREAD STRATEGY

BUY

We buy a call option at a strike price that would be higher than the call option that we would be selling. This is required to convert unlimited loss potential of Selling option to limited loss potential.

SELL

We will sell an option with a strike price that is higher than the current market price. We do not want the market price on expiry to be higher than this strike price as it will lead to losses.

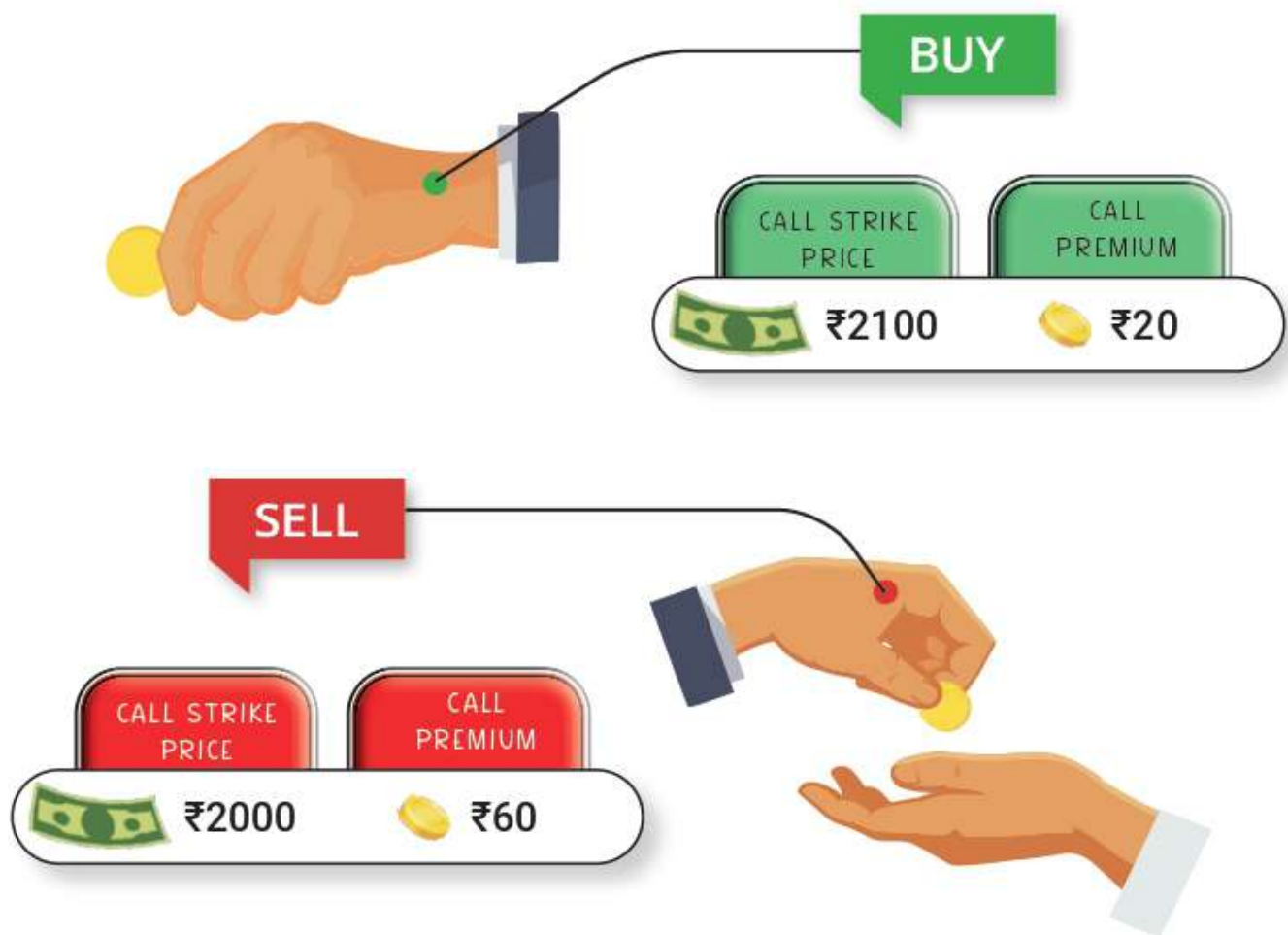


MAXIMUM LOSS = DIFFERENCE IN STRIKE PRICE OF TWO OPTIONS - NET PREMIUM RECEIVED.

BREAKEVEN POINT = LOWER STRIKE + NET PREMIUM

MAXIMUM PROFIT = NET PREMIUM

For instance, we buy a call option at ₹2100 at a premium of ₹20 and we sell another call option at ₹2000 for a premium of ₹60.



Netting the two positions,

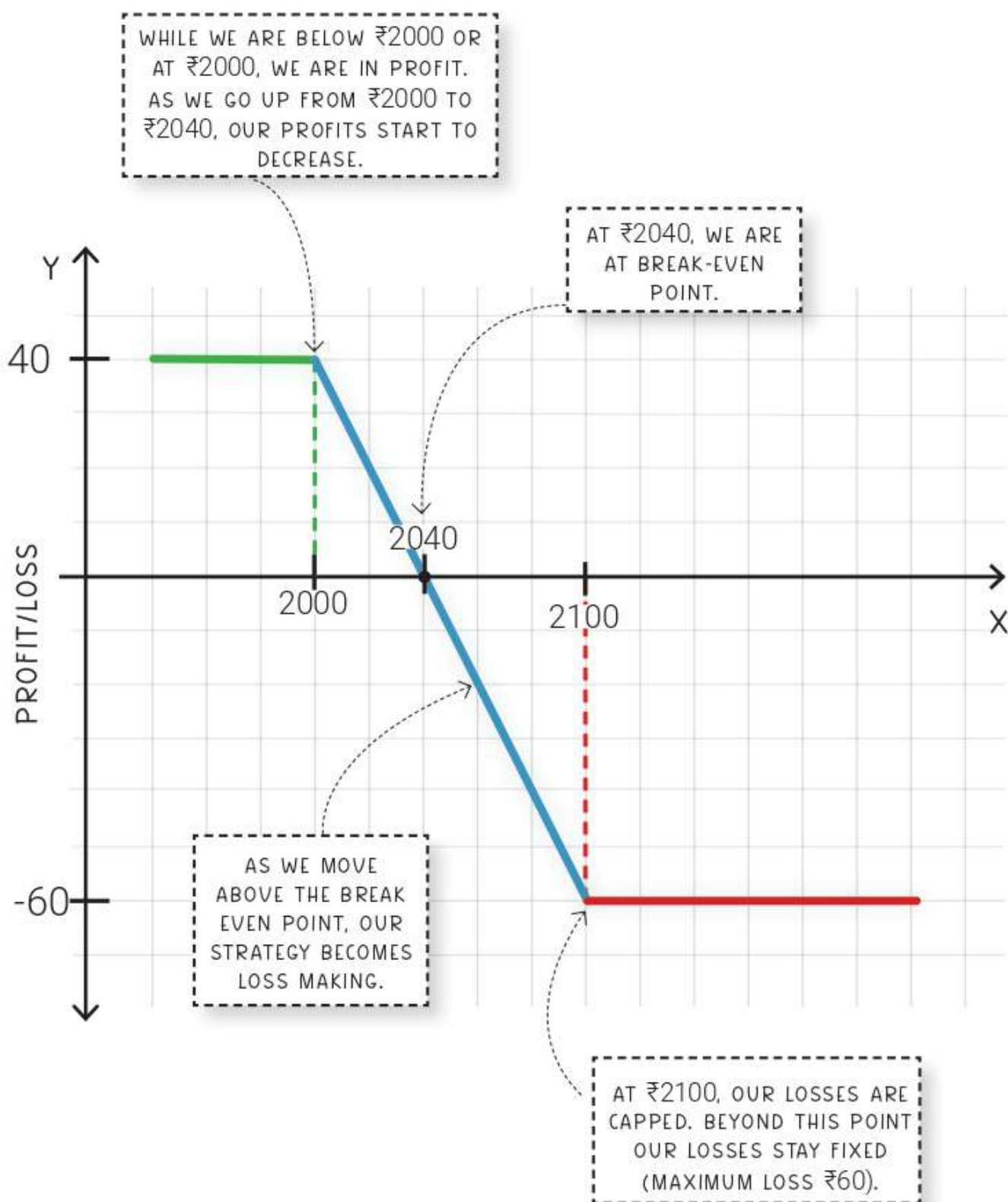
PROFIT FROM CREATING THE STRATEGY = ₹60 – ₹20 = ₹40

THIS IS OUR NET PREMIUM RECEIVED IN THIS STRATEGY.

MAXIMUM PROFIT = Net Premium
= ₹40

BREAK EVEN POINT = Lower strike price + Net premium cost
= ₹2000 + ₹40 = ₹2040

MAXIMUM LOSS = Difference in Strike prices – Net premium
= (₹2100 – ₹2000) – ₹40 = ₹60



Beyond ₹2100, the profits we make from the call option bought are exactly same as the losses we make on call option sold. This is why the maximum losses are fixed at ₹60 in this case.



Let's take another example on this.

LOT SIZE
100 shares

CURRENT MARKET PRICE
 **₹470**

BUY

Call Option

CALL STRIKE
PRICE



₹550

CALL
PREMIUM



₹15

SELL

Call Option

CALL STRIKE
PRICE

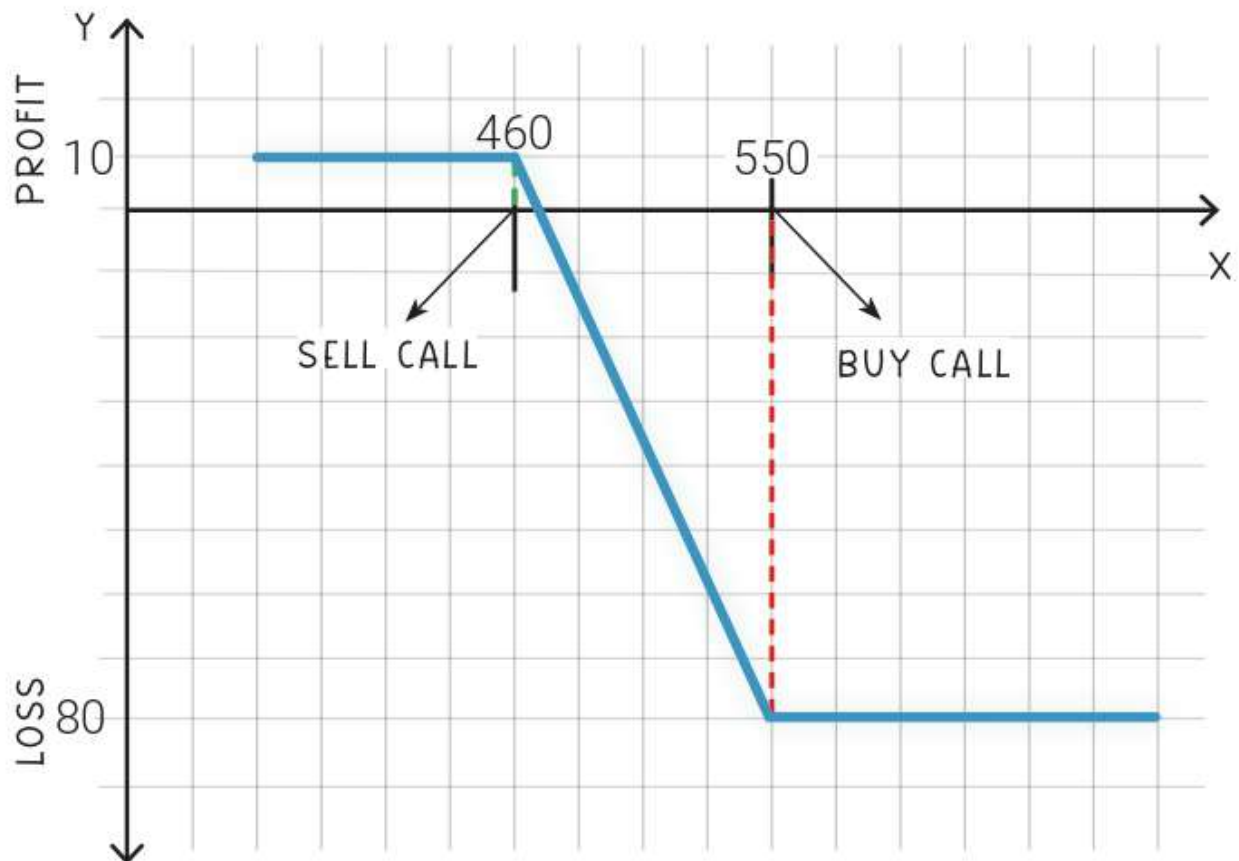


₹460

CALL
PREMIUM



₹25



Price	Buy Option CE550	Sell Option CE460
Price < ₹460	✗ Exercised	✗ Exercised
Price = ₹500	✗ Exercised	✓ Exercised
Price > ₹600	✓ Exercised	✓ Exercised



NET INFLOW/MAXIMUM PROFIT = Net premium
 $= ₹25 - ₹15$
 $= ₹10$ per share

So, while we are below ₹460 or at ₹460, we are in profits. As we go up from ₹460 to ₹470, our profits start to reduce.



BREAK EVEN POINT = Lower strike price + Net premium
 $= ₹460 + ₹10$
 $= ₹470$

As we move beyond break-even point to ₹550, we make losses. At ₹550, again, our losses are capped.



MAXIMUM LOSS = Difference in Strike prices - Net Premium
 $= (₹550 - ₹460) - ₹10$
 $= ₹80$

Beyond ₹550, we have reached maximum losses any increase in price will not increase our loss.