11.6 BULL PUT SPREAD STRATEGY

Explainer Video

The bull put spread strategy is more or less similar to call spread strategy. This strategy is used when we are Bullish on the underlying asset. This strategy would also limit our upside potential profit as well as losses. For this strategy, we receive a net premium instead of paying.

STEPS TO FORM A BULL PUT STRATEGY

BUY

We will buy a put option that has strike price lower than the strike price of the put option that we will be selling.

SELL

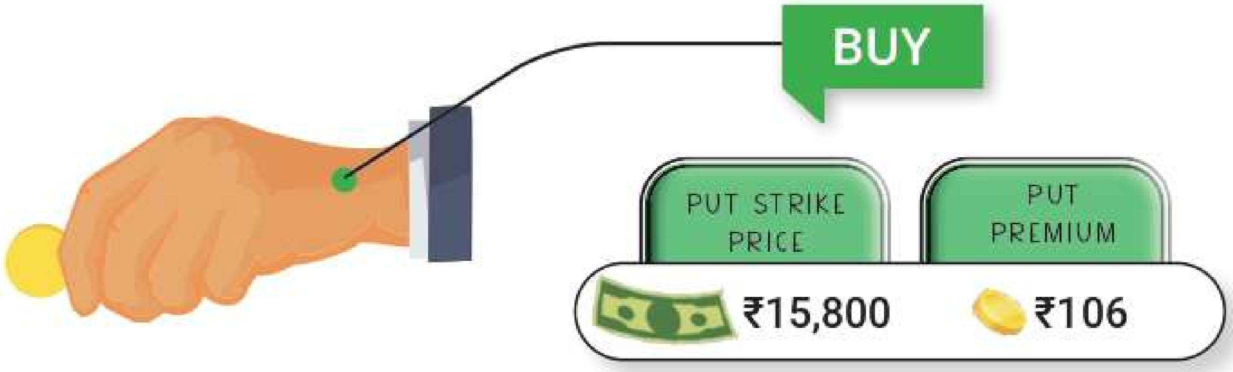
We will sell a Put option with strike price lower than the current market price of the underlying asset. We can even sell At the money or In the money options, but that will increase our risk accordingly as well.

MAXIMUM LOSS = DIFFERENCE IN STRIKE – NET PREMIUM

BREAKEVEN = STRIKE PRICE OF OPTION SOLD – NET PREMIUM

MAXIMUM PROFIT = NET PREMIUM

For instance, we buy a put option at ₹15,800 at a premium of ₹106 and we sell another put option at ₹16,000 at a premium of ₹246.



PREMIUM COLLECTED FROM THIS STRATEGY = ₹246 – ₹106 = ₹140

THIS IS OUR NET PROFIT IN THIS STRATEGY.

MAXIMUM PROFIT = Net premium

= **₹140**

BREAK EVEN POINT = Strike price of short put – Net premium

= **₹16,000 – ₹140 = ₹15,860**

MAXIMUM LOSS = Difference in Strike prices - Net Premium

= **(₹16,000 – ₹15,800) – ₹140 = ₹60**

If the price is above ₹16,000 or at ₹16,000, we will have profits. And if the prices go below ₹15,860, we will start incurring losses. But our losses will also be capped.

Lets take a look at another example to understand this better.

LOT SIZE
100 shares

CURRENT MARKET PRICE
₹550

BUY
OTM Put Option

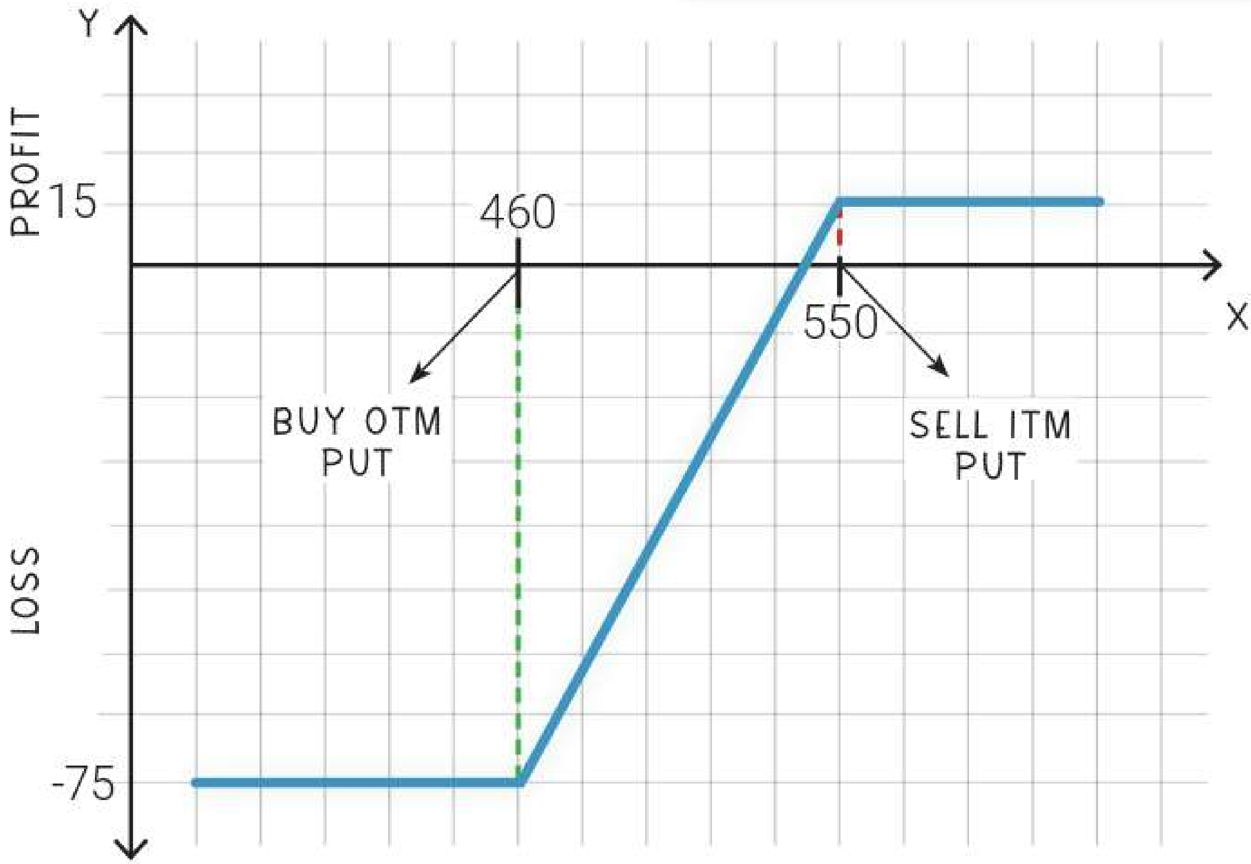
PUT STRIKE PRICE
₹460

PUT PREMIUM
₹5

SELL
ATM Put Option

PUT STRIKE PRICE
₹550

PUT PREMIUM
₹20



Price	Buy Option 460PE	Sell Option 550PE
Price > ₹600	✗ Exercised	✗ Exercised
Price = ₹500	✗ Exercised	✓ Exercised
Price < ₹460	✓ Exercised	✓ Exercised

MAXIMUM LOSS = Difference in Strike prices - Net Premium

= (₹550 – ₹460) – ₹15

= **₹75**

BREAK EVEN POINT = Strike price of short put – Net premium

= ₹550 – ₹15

= **₹535**

If the price is above ₹550, we will be making profits. As we reach ₹535, we hit the break-even point.
At prices below ₹535, we will start incurring losses. But our losses will also be limited to ₹75.

NET INFLOW/MAXIMUM PROFIT = Net premium

= ₹30 – ₹15

= **₹15** per share

With this we have understood all kinds of Spread strategies. We can make it even more complicated by increasing number of option contracts involved. You can experiment with different strike prices and difference in the strike prices and work on creating trading strategies on your own. Next, we will move on to understand Strangle.