12. Bull Call Spread.

Bull call spread option trading strategy is employed when the options trader thinks that the price of the underlying asset will go up moderately in the near term. It can be implemented by buying an at-the-money call option while simultaneously writing a higher striking out-of-the-money call option of the same underlying security and the same expiration month.

Bull Call Spread Construction

Buy 1 ITM; Sell 1 OTM

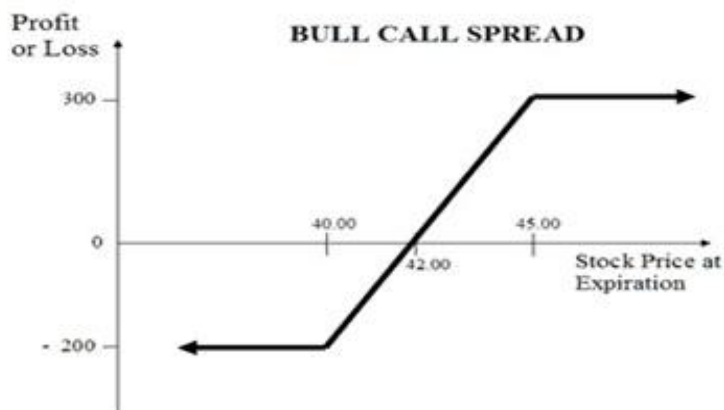
By shorting the out-of-the-money call, the trader reduces the cost of establishing the bullish position but forgoes the chance of making a large profit in the event that the underlying asset price skyrockets. This strategy also known as the bull call debit spread as a debit is taken upon entering the trade.

Example

An options trader believes that XYZ stock trading at Rs.42 is going to rally soon and enters a bull call spread by buying a JUL 40 call for Rs.300 and writing a JUL 45 call for Rs.100. The net investment required to put on the spread is a debit of Rs.200.

The stock price of XYZ begins to rise and closes at Rs.46 on expiration date. Both options expire in-the-money with the JUL 40 call having an intrinsic value of Rs.600 and the JUL 45 call having an intrinsic value of Rs.100. This means that the spread is now worth Rs.500 at expiration. Since the trader had a debit of Rs.200 when he bought the spread, his net profit is Rs.300.

If the price of XYZ had declined to Rs.38 instead, both options expire worthless. The trader will lose his entire investment of Rs.200, which is also his maximum possible loss.



Limited Upside profits

Maximum gain is reached for the bull call spread options strategy when the stock price move above the higher strike price of the two calls and it is equal to the difference between the strike prices of the two call options minus the initial debit taken to enter the position.

The formula for calculating maximum profit is given below:

Max Profit = Strike Price of Short Call - Strike Price of Long Call - Net Premium Paid - Commissions Paid

Max Profit Achieved When Price of Underlying >= Strike Price of Short Call

Limited Downside risk

The bull call spread strategy will result in a loss if the stock price declines at expiration. Maximum loss cannot be more than the initial debit taken to enter the spread position.

The formula for calculating maximum loss is given below:

Max Loss = Net Premium Paid + Commissions Paid

Max Loss Occurs When Price of Underlying <= Strike Price of Long Call

Breakeven Point

The underlier price at which break-even is achieved for the bull call spread position can be calculated using the following formula.

Breakeven Point = Strike Price of Long Call + Net Premium Paid

For any queries related to above topic, kindly contact us on knowledge@grovalue.in