9. Bullish strategies.

In last chapter we discussed about different strategies such Bullish strategies, Bearish strategies and Neutral strategies. In Today's session we will start with the Bullish strategies. There are many Bullish strategies available in option trading. Some of them are listed below and we are going to discuss them in upcoming chapters.

1. Call Buying.
2. Bull call spread.
3. The Collar.
4. Bull calendar spread.
5. Covered calls.
6. Naked Puts.
7. Covered straddle.

From above list we have already discussed call buying in previous chapters. Therefore today we will begin with Bull call spread.

Bull Call Spread:

The 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. Bull call spreads 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 ATM Call; Sell 1 OTM Call

By shorting the out-of-the-money call, the options 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.

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 XYZ 40 call for Rs.300 and writing a XYZ 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 XYZ 40 call having an intrinsic value of Rs.600 and the XYZ 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.380 instead, both options expire worthless. The trader will lose his entire investment of Rs.200, which is also his maximum possible loss.

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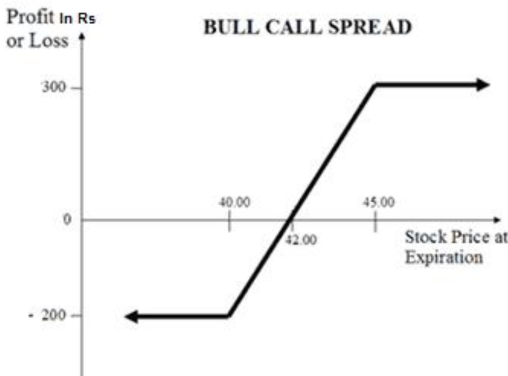
Bull Call Spread Payoff Diagram



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 underlying 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

In next session we will discuss further strategies which we have listed at start of the topic. For more details kindly contact us on knowledge@grovalue.in