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ABOUT OIC

The Options Industry Council (OIC) was formed in 1992 as a unified industry effort to educate individual investors about the benefits and risks of exchange-traded options. OIC conducts hundreds of seminars, distributes educational brochures, maintains a website and offers live help from options professionals. The goal of OIC, comprised of the U.S. options exchanges and OCC, is to increase the awareness, knowledge and responsible use of exchange-listed equity options among a global audience of investors—including individuals, financial advisors and institutional managers—by providing independent, unbiased education and practical knowledge.
HOW TO USE THIS BOOK

Each strategy has an accompanying graph showing profit and loss at expiration.

- The vertical axis shows the profit/loss scale.
- When the strategy line is below the horizontal axis, it assumes you paid for the position or had a loss. When it is above the horizontal axis, it assumes you received a credit for the position or had a profit.
- The dotted line indicates the strike price.
- The intersection of the strategy line and the horizontal axis is the break-even point (BEP) not including transaction costs, commissions, or margin (borrowing) costs.
- These graphs are not drawn to any specific scale and are meant only for illustrative and educational purposes.
- The risks/rewards described are generalizations and may be lesser or greater than indicated.
 TERMS AND DEFINITIONS

**Break-Even Point (BEP):** The stock price(s) at which an option strategy results in neither a profit nor loss.

**Call:** An option contract that gives the holder the right to buy the underlying security at a specified price for a certain, fixed period of time.

**In-the-money:** A call option is in-the-money if the strike price is less than the market price of the underlying security. A put option is in-the-money if the strike price is greater than the market price of the underlying security.

**Long position:** A position wherein an investor is a net holder in a particular options series.

**Out-of-the-money:** A call option is out-of-the-money if the strike price is greater than the market price of the underlying security. A put option is out-of-the-money if the strike price is less than the market price of the underlying security.

**Premium:** The price a put or call buyer must pay to a put or call seller (writer) for an option contract. Market supply and demand forces determine the premium.
**Put:** An option contract that gives the holder the right to sell the underlying security at a specified price for a certain, fixed period of time.

**Ratio Spread:** A multi-leg option trade of either all calls or all puts whereby the number of long options to short options is something other than 1:1. Typically, to manage risk, the number of short options is lower than the number of long options (i.e. 1 short call: 2 long calls).

**Short position:** A position wherein the investor is a net writer (seller) of a particular options series.

**Strike price or exercise price:** The stated price per share for which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

**Synthetic position:** A strategy involving two or more instruments that has the same risk/reward profile as a strategy involving only one instrument.

**Time decay or erosion:** A term used to describe how the time value of an option can “decay” or reduce with the passage of time.

**Volatility:** A measure of the fluctuation in the market price of the underlying security. Mathematically, volatility is the annualized standard deviation of returns.
**Example:** Buy call

**Market Outlook:** Bullish

**Risk:** Limited

**Reward:** Unlimited

**Increase in Volatility:** Helps position

**Time Erosion:** Hurts position

**BEP:** Strike price plus premium paid
**Example:** Buy 1 call; sell 1 call at higher strike

**Market Outlook:** Bullish

**Risk:** Limited

**Reward:** Limited

**Increase in Volatility:** Helps or hurts depending on strikes chosen

**Time Erosion:** Helps or hurts depending on strikes chosen

**BEP:** Long call strike plus net premium paid
**Example:** Sell 1 put; buy 1 put at lower strike with same expiry

**Market Outlook:** Neutral to bullish

**Risk:** Limited

**Reward:** Limited

**Increase in Volatility:** Typically hurts position slightly

**Time Erosion:** Helps position

**BEP:** Short put strike minus credit received
**Example:** Buy stock; sell calls on a share-for-share basis

**Market Outlook:** Neutral to slightly bullish

**Risk:** Limited, but substantial (risk is from a fall in stock price)

**Reward:** Limited

**Increase in Volatility:** Hurts position

**Time Erosion:** Helps position

**BEP:** Starting stock price minus premium received
**Example:** Own 100 shares of stock; buy 1 put

**Market Outlook:** Cautiously bullish

**Risk:** Limited

**Reward:** Unlimited

**Increase in Volatility:** Helps position

**Time Erosion:** Hurts position

**BEP:** Starting stock price plus premium paid
bull strategy  CASH-SECURED SHORT PUT

Example: Sell 1 put; hold cash equal to strike price x 100

Market Outlook: Neutral to slightly bullish

Risk: Limited, but substantial

Reward: Limited

Increase in Volatility: Hurts position

Time Erosion: Helps position

BEP: Strike price minus premium received
**bear strategy | LONG PUT**

**Example:** Buy put  
**Market Outlook:** Bearish  
**Risk:** Limited  
**Reward:** Limited, but substantial  
**Increase in Volatility:** Helps position  
**Time Erosion:** Hurts position  
**BEP:** Strike price minus premium paid
**Example**: Sell 1 put; buy 1 put at higher strike

**Market Outlook**: Bearish

**Risk**: Limited

**Reward**: Limited

**Increase in Volatility**: Helps or hurts depending on strikes chosen

**Time Erosion**: Helps or hurts depending on strikes chosen

**BEP**: Long put strike minus net premium paid
**Example:** Sell 1 call; buy 1 call at higher strike

**Market Outlook:** Neutral to bearish

**Risk:** Limited

**Reward:** Limited

**Increase in Volatility:** Typically hurts position slightly

**Time Erosion:** Helps position

**BEP:** Short call strike plus credit received
neutral strategy | COLLAR

**Example:** Own stock, protect by purchasing 1 put and selling 1 call with a higher strike

**Market Outlook:** Neutral

**Risk:** Limited

**Reward:** Limited

**Increase in Volatility:** Effect varies, none in most cases

**Time Erosion:** Effect varies

**BEP:** In principle, breaks even if, at expiration, the stock is above/(below) its initial level by the amount of the debit/(credit)
**Example:** Sell 1 call; sell 1 put at same strike

**Market Outlook:** Neutral

**Risk:** Unlimited

**Reward:** Limited

**Increase in Volatility:** Hurts position

**Time Erosion:** Helps position

**BEP:** Two BEPs
1. Call strike plus premium received
2. Put strike minus premium received
**neutral strategy**  SHORT STRANGLE

**Example:** Sell 1 call with higher strike; sell 1 put with lower strike

**Market Outlook:** Neutral

**Risk:** Unlimited

**Reward:** Limited

**Increase in Volatility:** Hurts position

**Time Erosion:** Helps position

**BEP:** Two BEPs
1. Call strike plus premium received
2. Put strike minus premium received

[Graph showing profit and loss for a short strangle strategy]
**Example:** Sell 1 call; buy 1 call at higher strike; sell 1 put; buy 1 put at lower strike; all options have the same expiry. Underlying price typically between short call and short put strikes.

**Market Outlook:** Range bound or neutral

**Risk:** Limited

**Reward:** Limited

**Increase in Volatility:** Typically hurts position

**Time Erosion:** Helps position

**BEP:** Two BEPs
1. Short call strike plus credit received
2. Short put strike minus credit received
**Example:** Sell 1 call; buy 1 call at same strike but longer expiration; also can be done with puts

**Market Outlook:** Near term neutral (if strikes = stock price); can be slanted bullish (with OTM call options) or bearish (with OTM put options)

**Risk:** Limited

**Reward:** Limited; substantial after near term expiry

**Increase in Volatility:** Helps position

**Time Erosion:** Helps until near term option expiry

**BEP:** Varies; after near term expiry long call strike plus debit paid or (if done with puts) short put strike minus debit paid
**Example:** Own stock; sell one call; sell one put; underlying price typically between short call and short put strikes

**Market Outlook:** Range bound or neutral, moderately bullish; willing to buy more shares and sell existing shares

**Risk:** Limited, but substantial

**Reward:** Limited

**Increase in Volatility:** Typically hurts position

**Time Erosion:** Typically hurts position

**BEP:** Two BEPs
   1. Short call strike plus total credit
   2. Short put strike minus total credit
**Example:** Sell 2 calls; 
buy 1 call at next lower strike; 
buy 1 call at next higher strike 
(the strikes are equidistant)

**Market Outlook:** Neutral around strike

**Risk:** Limited

**Reward:** Limited

**Increase in Volatility:** Typically hurts position

**Time Erosion:** Typically helps position

**BEP:** Two BEPs
1. Lower long call strike plus 
   net premium paid
2. Higher long call strike minus 
   net premium paid
**Example:** Buy 1 call; buy 1 put at same strike

**Market Outlook:** Large move in either direction

**Risk:** Limited

**Reward:** Unlimited

**Increase in Volatility:** Helps position

**Time Erosion:** Hurts position

**BEP:** Two BEPs
1. Call strike plus premium paid
2. Put strike minus premium paid
**Example:** Buy 1 call with higher strike; buy 1 put with lower strike

**Market Outlook:** Large move in either direction

**Risk:** Limited

**Reward:** Unlimited

**Increase in Volatility:** Helps position

**Time Erosion:** Hurts position

**BEP:** Two BEPs
1. Call strike plus premium paid
2. Put strike minus premium paid
**Example:** Sell 1 call; buy 2 calls at higher strike

**Market Outlook:** Bullish

**Risk:** Limited

**Reward:** Unlimited

**Increase in Volatility:** Typically helps position

**Time Erosion:** Typically hurts position

**BEP:** Varies, depends if established for a credit or debit. If done for a credit, two BEP’s with the lower BEP being the short strike plus the credit
volatility strategy PUT BACKSPREAD

**Example:** Sell 1 put; buy 2 puts at lower strike

**Market Outlook:** Bearish

**Risk:** Limited

**Reward:** Limited, but substantial

**Increase in Volatility:** Typically helps position

**Time Erosion:** Typically hurts position

**BEP:** Varies, depends if established for a credit or debit. If done for a credit, two BEP’s and the lower BEP is the short strike minus the credit