



Index Option Strategies for Bullish, Bearish, and Neutral Markets

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CHICAGO BOARD OPTIONS EXCHANGE

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- Bullish Trade
- Bearish Trade
- Neutral Trade
- Q&A / Contact

1. Index Options vs. ETF Options
2. Cash Settlement vs. Delivery
3. \$100 Multiplier vs. 100 Shares
4. Exercise Style: European vs. American
5. Settlement Method (AM vs. PM)

ETF Options are like stock options

- The underlying is 100 shares
- Exercise/Assignment: Buy/Sell Shares

Index Options are different

- The underlying is a cash value
- Exercise/Assignment: Receive/Pay Cash

ETF and Index Options

Many underlying indexes are the same.

<u>Index</u>	<u>ETF</u>	<u>Index Options</u>
DJIA	DIA	DJX
S&P 500	SPY	SPX & SPXpm
S&P 100	OEF	OEX & XEO
NASDAQ 100	QQQ	NDX & MNX
Russell 2000	IWM	RUT

The dollar cost of an index option is:
\$100 *times* the stated option price.

“SPXPM 1200 Call @ 8.00”

Price of Option = $\$100 \times 8 = \800

Cash Settlement –

Example: SPX Index is 1223.53 at expiration

Cash Value of a 1200 Call?

Index Value	1223.53
Less Strike Price	1200.00
Difference	23.53
x Multiplier	<u>x \$100</u>
Cash from Seller to Buyer	\$2,353.00

American-Style Exercise

- Stock and ETF options, OEX Index options
- Can be exercised on any business day.

European-Style Exercise

- SPX, SPXPM, XSP, DJX, NDX, RUT, XEO
- Can be exercised only on the last day.
- Do not confuse buying and selling an option with exercising an option.

PM Settlement – based on closing prices.

- The index is calculated after the market close (typically on Friday) when closing prices are available. Examples: SPXPM, OEX and XEO

AM Settlement – based on opening prices.

- The last trading day is typically a Thursday.
- Settlement is calculated from Friday opening prices.

Examples: SPX, XSP, DJX, NDX, MNX, RUT

ETF's and ETF options are treated like
stock and stock options*

Broad-Based Index Options
receive “60-40” treatment*

* According to Taxes and Investing, published by The Options Industry Council,
available from <http://www.cboe.com/LearnCenter/RCGeneral.asp>

Note: IRS regulations may change. Seek professional tax advice.

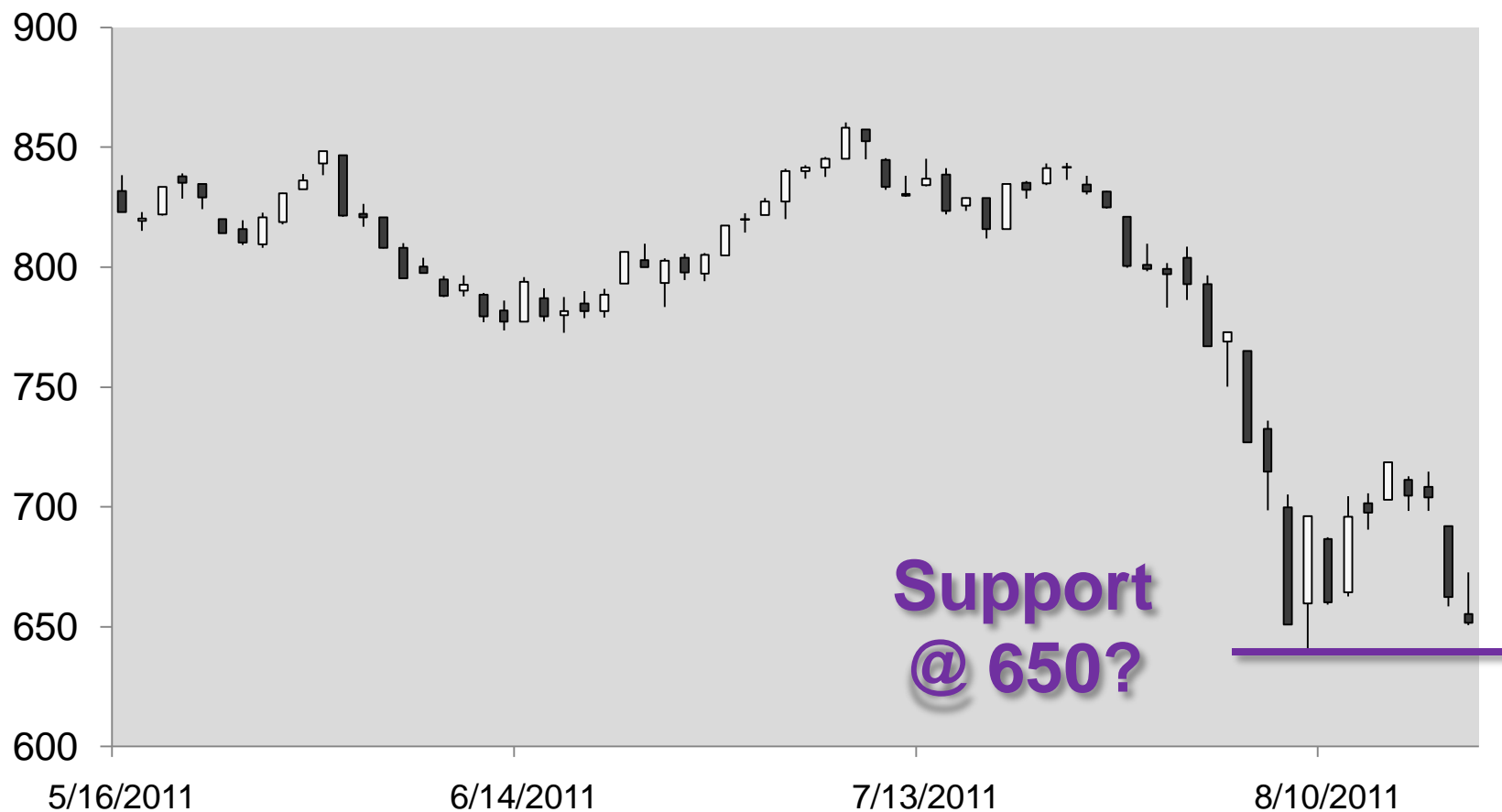
Section 1256 Contracts: regardless of holding period, profits and losses are treated as 60% long-term and 40% short-term.

Reported on Form 6781 and Schedule D

Positions are “marked to market” at year end and taxed as if closed. Year-end prices become basis for next year.

Bullish Strategy

RUT – 8/19/2011 – 651.69



Trade Overview –

- Bullish Outlook for RUT
- Think there is support at 650
- Consider vertical spread
- Weeklys expire in five days (Aug 26)

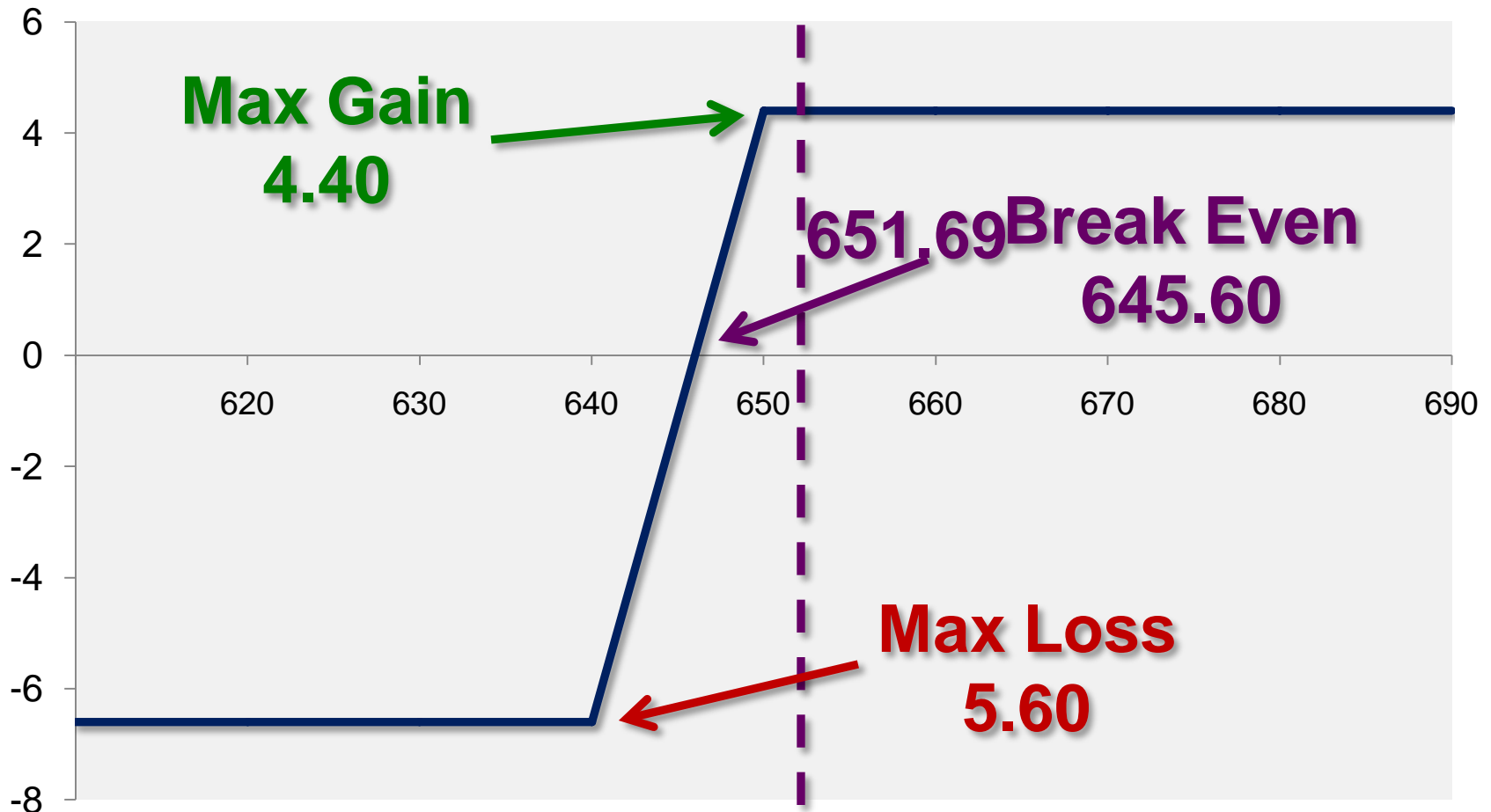
Long 1 RUT Aug 26 640 Put @ 11.10

Short 1 RUT Aug 26 650 Put @ 15.50

Net Credit = 4.40

Bullish Strategy

Profit / Loss on Aug 26 –



8/23/2011 – RUT @ 683.07 +31.73

Long 1 RUT 640 Put @ 0.75 (10.35 loss)

Short 1 RUT 650 Put @ 1.75 (13.75 gain)

Up 3.40 (Potential Profit = 4.40)

Believe RUT will continue higher

Managing Trade 8/23/2011 – RUT 683.07

Cover 1 RUT 650 Put @ 1.75

Sell 1 RUT 670 Put @ 6.05

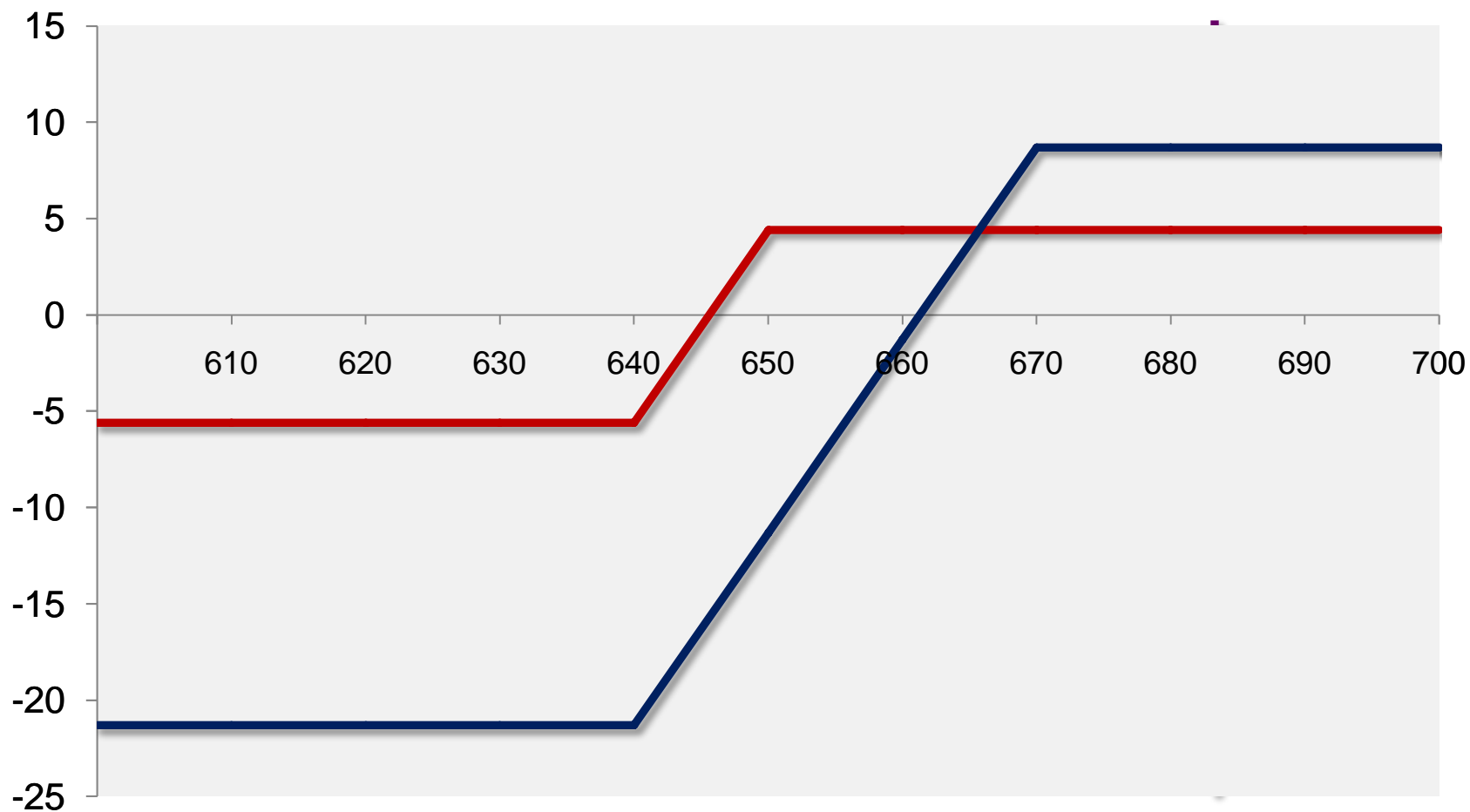
Credit = 4.30

Long 1 RUT 640 Put

Short 1 RUT 670 Put

Net Credit = 8.70

New Profit / Loss on Aug 26 –



Bearish Strategy

DJIA at 12605.32 on 5/19/2011



Trade Overview –

- Bearing Outlook for DJIA (DJX)
- Seeing beginning of downtrend
- Consider vertical spread
- Weeklys expire in six days (May 27)

Short 1 DJX May 27 126 Call @ 1.20

Long 1 DJX May 27 128 Call @ 0.40

Net Credit = 0.80

Bearish Strategy

Profit / Loss on May 27 –



5/23/2011 – DJX @ 123.81 -1.31

Short 1 DJX 126 Call @ 0.40 (0.80 gain)

Long 1 DJX 128 Call @ 0.10 (0.30 loss)

Up 0.50 (Potential Profit = 0.80)

Believe DJX will continue lower

Managing Trade 5/23/2011 – DJX 123.81

Cover 1 DJX 126 Call @ 0.40

Sell 1 DJX 124 Call @ 1.10

Credit = 0.70

Short 1 DJX 124 Call

Long 1 DJX 128 Call

Net Credit = 1.50

Bearish Strategy

New Profit / Loss on May 27 –



OEX – 10/29/2010 – 533.08



Trade Overview –

- Think OEX is stuck in a range
- Range between 530 and 535
- Would consider managing trade if there is a break out or break down
- Weeklys expire on November 5th (6 days)

Going to put on an Iron Condor

Iron Condor –

Long 1 OEX Nov 5 525 Put @ 3.50

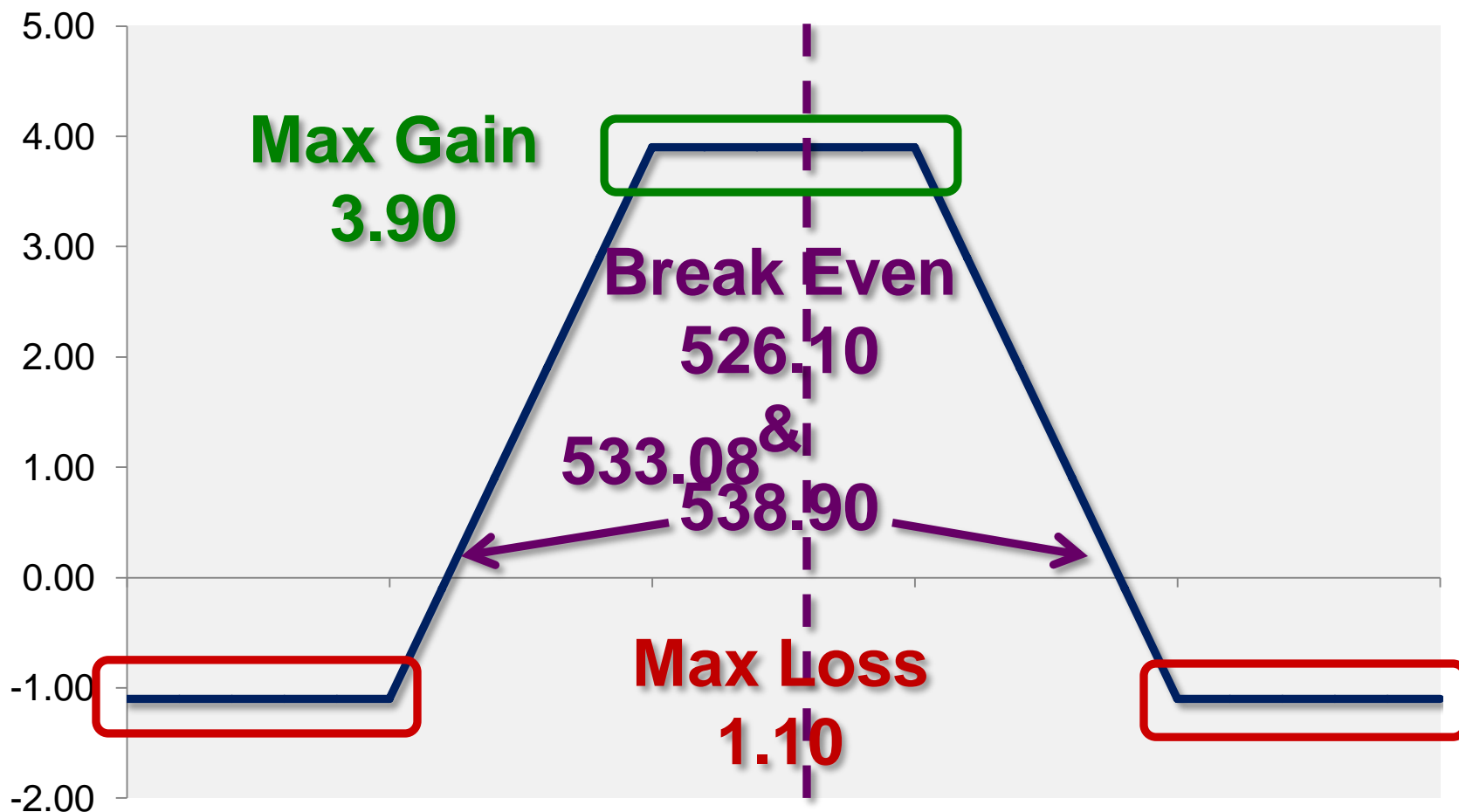
Short 1 OEX Nov 5 530 Put @ 5.40

Short 1 OEX Nov 5 535 Call @ 6.00

Long 1 OEX Nov 5 540 Call @ 4.00

Net Credit = 3.90

Profit / Loss on November 5 –



11/3/2010 – OEX @ 540.21

Long OEX 525 Put @ 0.25 -3.25

Short OEX 530 Put @ 0.80 +4.60

Short OEX 535 Call @ 7.15 -1.15

Long OEX 540 Call @ 4.15 +0.15

Spread up 0.35

Believe OEX will continue higher

Managing Trade 11/3/2010 - OEX @ 540.21

Cover 1 OEX 530 Put @ 0.80

Short 1 OEX 540 Put @ 3.90

Net Credit = 3.10

Total Net Credit = 7.00

Managing Trade – New Positions

Long 1 OEX 525 Put

Short 1 OEX 540 Put

Short 1 OEX 535 Call

Long 1 OEX 540 Put

Net Credit = 7.00

New Profit / Loss on November 5 –



- Index options give traders a wide variety of alternatives for trading a market outlook
- In all environments there should be several different methods for trading
- Although based on the same equity market, indexes have different components and behave differently
- A large number of strikes allows for managing to react to market changes

Questions / Comments?

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