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Short Option Strategies
Russell Rhoads, CFA
Instructor – The Options Institute

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- Option Basics Review
- Buying Options versus Selling Option
- Covered Call
- Cash Secured Puts
- Spread Trade
- Time Decay
- Summary / Q&A

An equity call *buyer*:

Has the *right to buy* 100 shares of stock

An equity call *seller*:

Has the *obligation to sell* 100 shares of stock

*Options typically represent 100 shares. Corporate actions such as splits or special dividends may change the deliverable.

An equity put *buyer*:

Has the *right to sell* 100 shares of stock

An equity put *seller*:

Has the *obligation to buy* 100 shares of stock

Buying options –

- Pay a premium
- Receive a right

Should be bullish or bearish

Selling options –

- Receive premium
- Get an obligation

May be bullish, bearish, or neutral

Overview –

- Covered Call is a combination of long stock and short a call option
- Short call option position results in **obligation** to sell shares
- Obligation to sell shares is **covered** by long position in stock
- Motivation may be as an exit strategy and/or to enhance portfolio income

Example –

- Own 100 shares of XYZ at 43.50
- Would be a willing seller of XYZ at 45.00 over the next four to five weeks
- Today is February 15th
- March expiration is March 16th

Sell 1 XYZ Mar 45 Call at 1.15

Covered Call

Payoff Table –

Long 100 XYZ at 43.50

Short 1 XYZ Mar 45 Call at 1.15

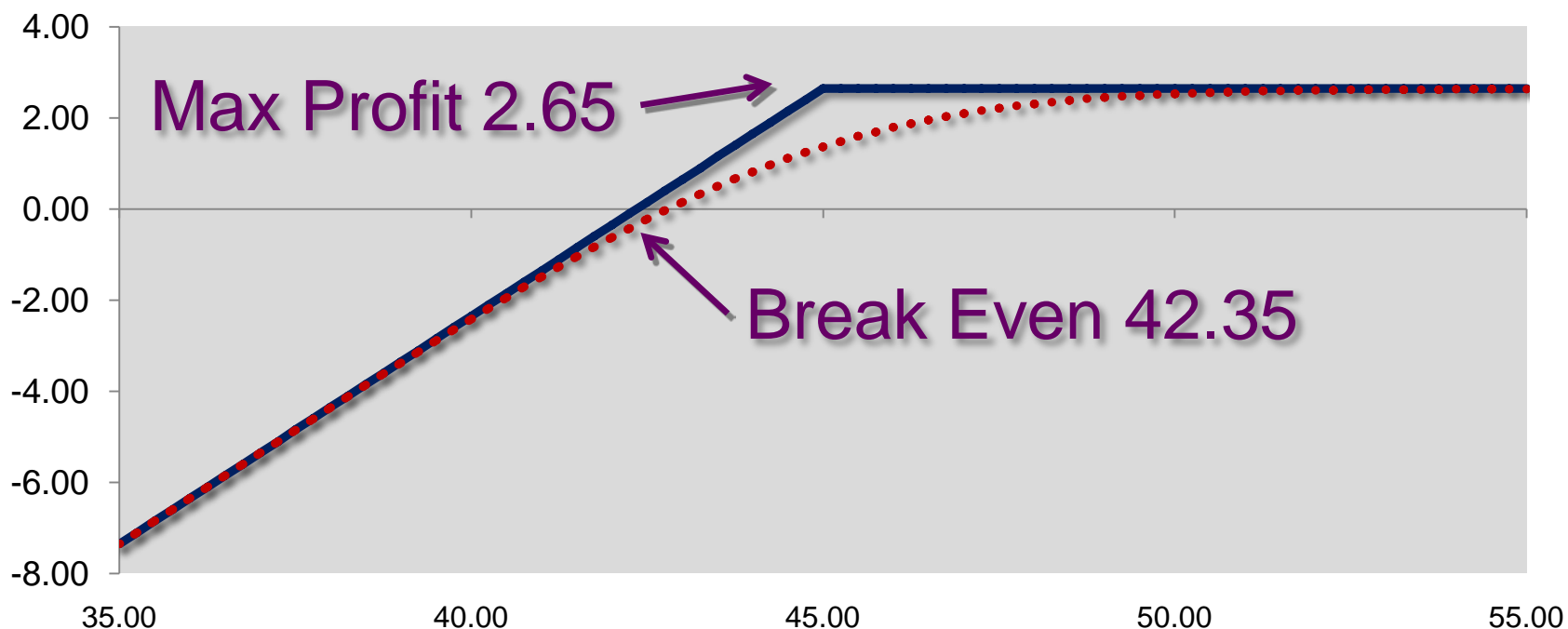
XYZ at Expiration	Long XYZ Stock	Short 1 XYZ Mar 45 Call	Income	Profit / Loss
35.00	(8.50)	0.00	1.15	(7.35)
40.00	(3.50)	0.00	1.15	(2.35)
45.00	1.50	0.00	1.15	2.65
50.00	6.50	(5.00)	1.15	2.65
55.00	11.50	(10.00)	1.15	2.65

Covered Call

Payoff Table –

Long 100 XYZ at 43.50

Short 1 XYZ Mar 45 Call at 1.15



At Expiration –

XYZ over 45.00

Option Assigned
Sell 100 XYZ
Effective Price = 46.15

XYZ below 45.00

Option Expires

Overview –

- Combination of Short Put and Cash
- Short Put results in obligation to purchase shares
- Cash on hand to fulfill obligation to purchase shares
- Short Put is 'covered' by Cash

Example –

- XYZ Trading at 51.50
- Would be like to be long 100 shares of XYZ below 50.00 in 30 days
- Today is February 15th
- March expiration is March 16th

Sell 1 XYZ Mar 50 Put at 1.35

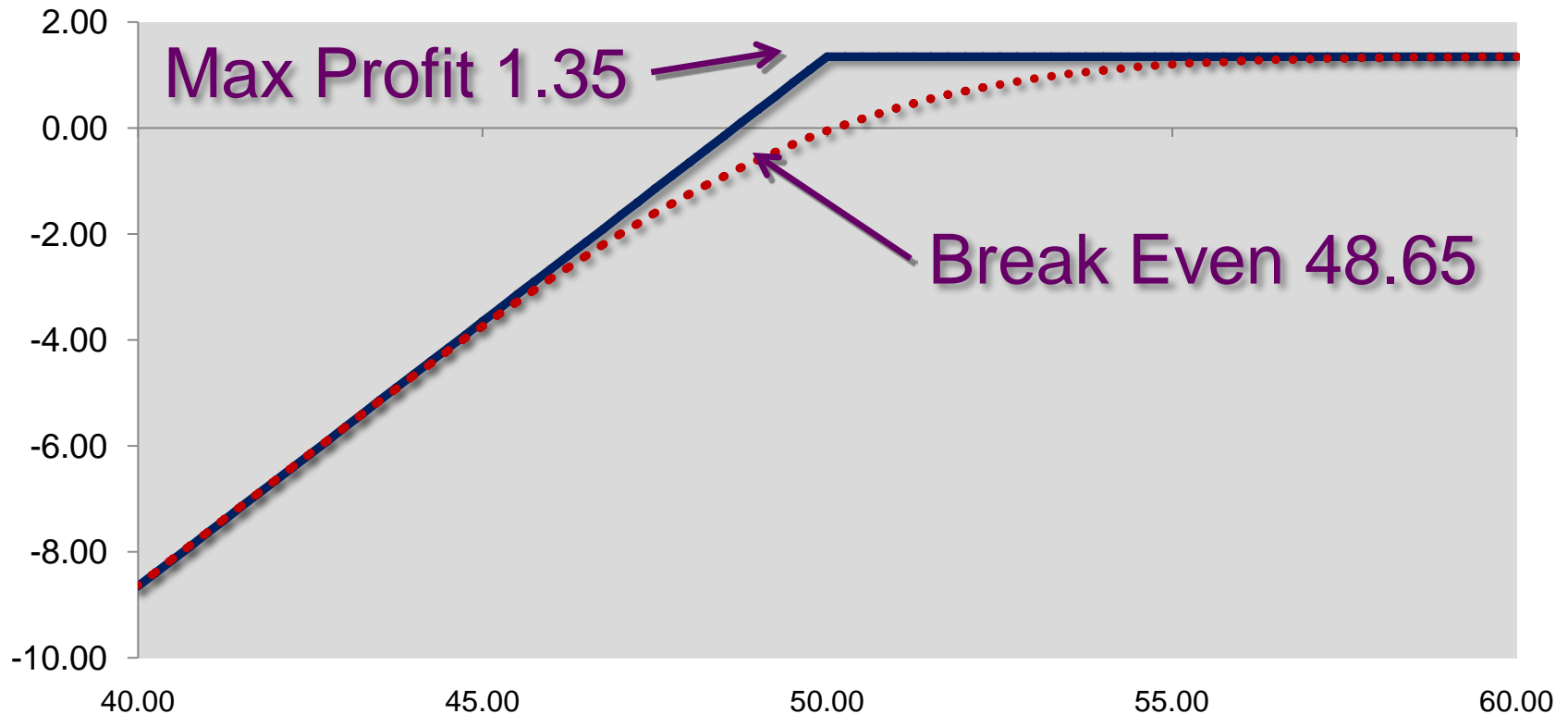
Payoff Table –

Short 1 XYZ Mar 50 Put at 1.35

XYZ at Expiration	Short 1 XYZ Mar 50 Put	Income	Profit / Loss
40.00	(10.00)	1.35	(8.65)
45.00	(5.00)	1.35	(3.65)
50.00	0.00	1.35	1.35
55.00	0.00	1.35	1.35
60.00	0.00	1.35	1.35

Payoff Diagram –

Short 1 XYZ Mar 50 Put at 1.35



At Expiration –

XYZ over 50.00

Option Expires

XYZ below 50.00

Option Assigned
Buy 100 XYZ
Effective Price = 48.65

Overview –

- Option spread trade can be a wide variety of strategies
- Many involve a short option position
- A spread may be superior to a pure long option trade

Example –

- XYZ is trading at 37.50
- Believe XYZ should trade to 40.00
- Move should occur over the next two months
- Today is February 15
- April expiration in two months

Buy 1 XYZ Apr 35 Call @ 4.15

Sell 1 XYZ Apr 40 Call @ 1.75

Net Debit = 2.40

Spread Trade

Long 1 XYZ Apr 35 Call @ 4.15

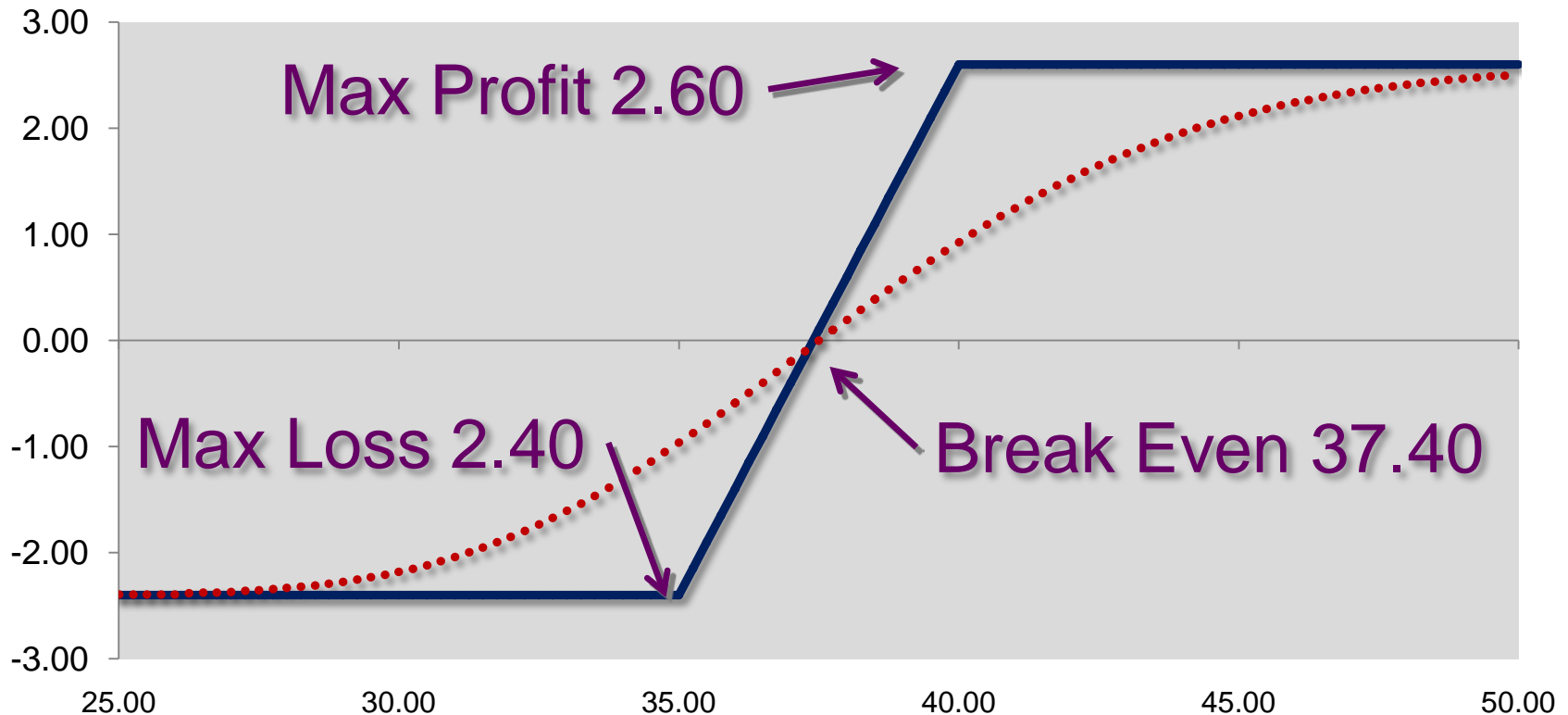
Short 1 XYZ Apr 40 Call @ 1.75

XYZ at Expiration	Long 1 XYZ 35 Call	Short 1 XYZ 40 Call	Cost	Profit / Loss
25.00	0.00	0.00	(2.40)	(2.40)
30.00	0.00	0.00	(2.40)	(2.40)
35.00	0.00	0.00	(2.40)	(2.40)
40.00	5.00	0.00	(2.40)	2.60
45.00	10.00	(5.00)	(2.40)	2.60
50.00	15.00	(10.00)	(2.40)	2.60

Spread Trade

Long 1 XYZ Apr 35 Call @ 4.15

Short 1 XYZ Apr 40 Call @ 1.75



At Expiration –

XYZ below 35.00

Both Options Expires

XYZ between 35.00 and 40.00

Long 35 Call In The Money

XYZ above 40.00

Long 35 Call In The Money
Short 40 Call In The Money

Why use the spread trade?

Buy 1 XYZ Apr 35 Call @ 4.15

XYZ at 40.00 – 0.85 Profit

XYZ Apr 35 – 40 Spread @ 2.40

XYZ at 40.00 – 2.60 Profit

Why use the spread trade (part 2)?

Buy 1 XYZ Apr 35 Call @ 4.15

Break Even = 39.15

XYZ Apr 35 – 40 Spread @ 2.40

Break Even = 37.40

Why use the spread trade (part 3)?

Buy 1 XYZ Apr 35 Call @ 4.15

Potential profit = unlimited

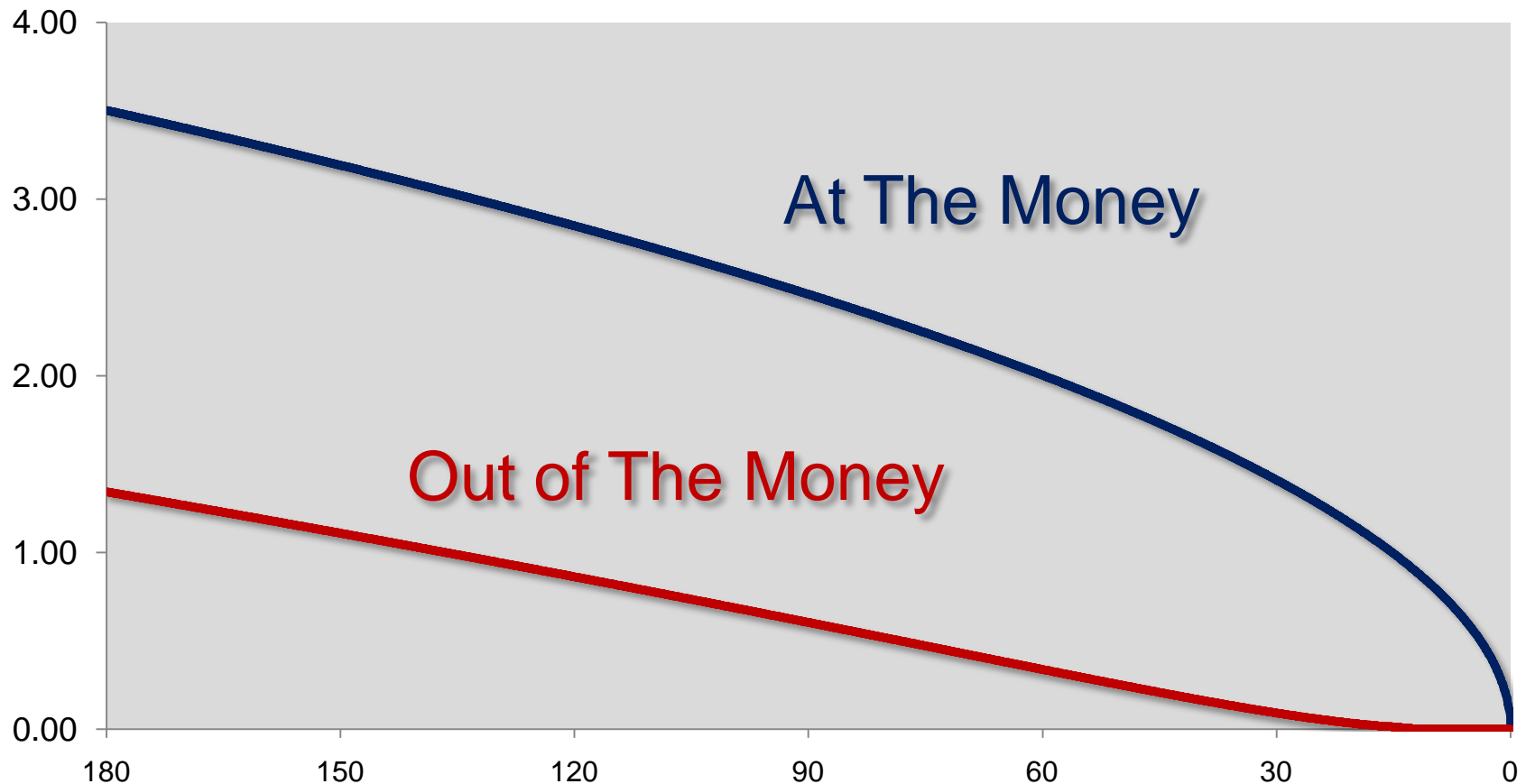
XYZ Apr 35 – 40 Spread @ 2.40

Potential profit = 2.60

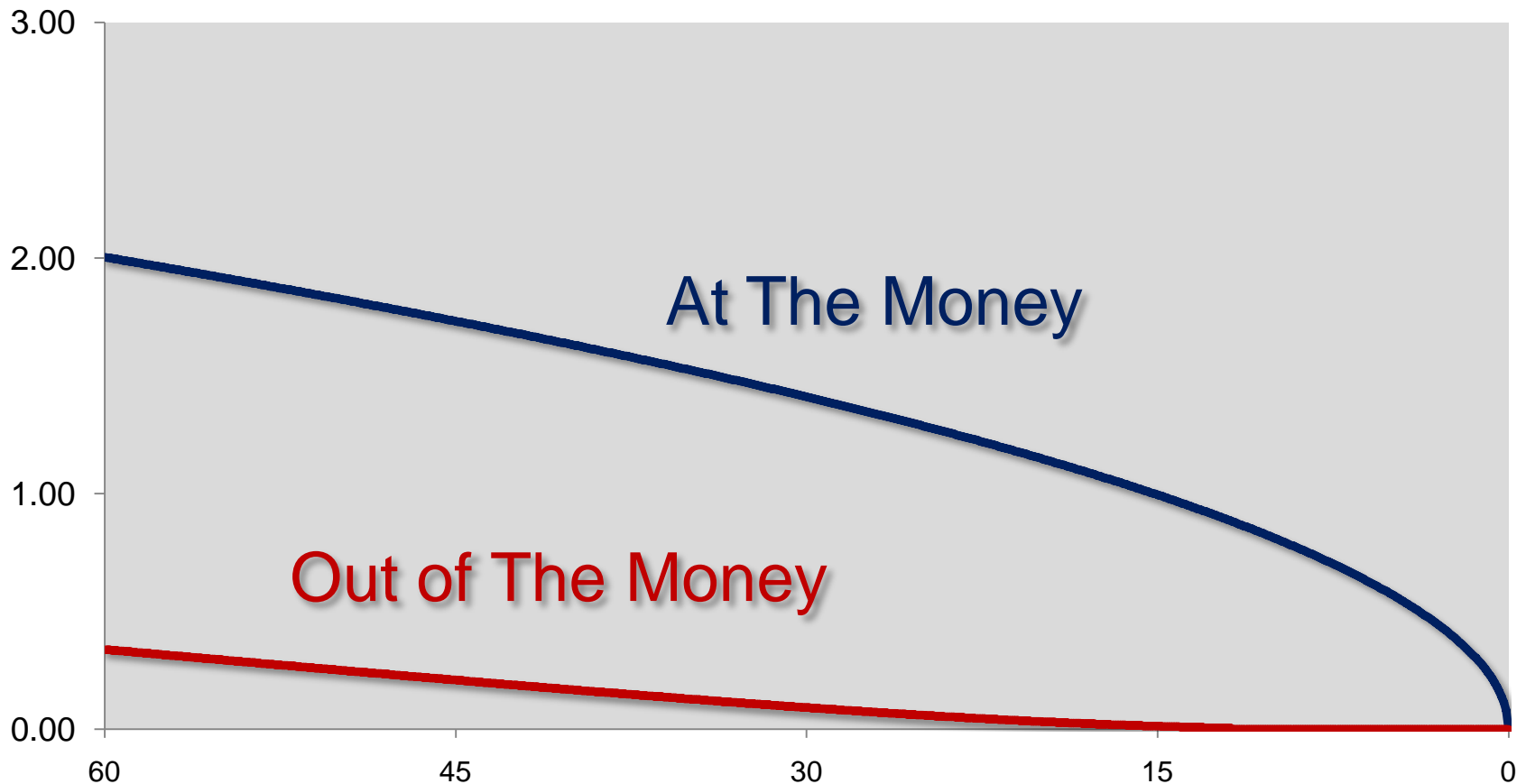
- When we sell options we can benefit from the time value of an option decaying
- This contributes to selling options possibly being a neutral strategy
- The nature of time decay varies based on a variety of factors

At the Money Options
experience non-linear time decay

At the Money vs. Out of the Money (180 days) –



At the Money vs. Out of the Money (60 days) –



Things to know about time decay –

- Short option positions can benefit from the passage of time
- The benefit received from a short position can vary based on the selected option contract
- Strike price relative to stock price and time to expiration both influence the potential time decay benefit

- A short option trade results in receiving a premium but also taking on an obligation
- Selling a call option results in the obligation to sell a stock
- A short put option position results in the obligation to purchase shares
- When short an option position often the benefit is the passage of time.
- Time decay should be taken into account when considering a short option position

rhoads@cboe.com

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