BEAR BULL TRADERS

Risk Profiles of Options

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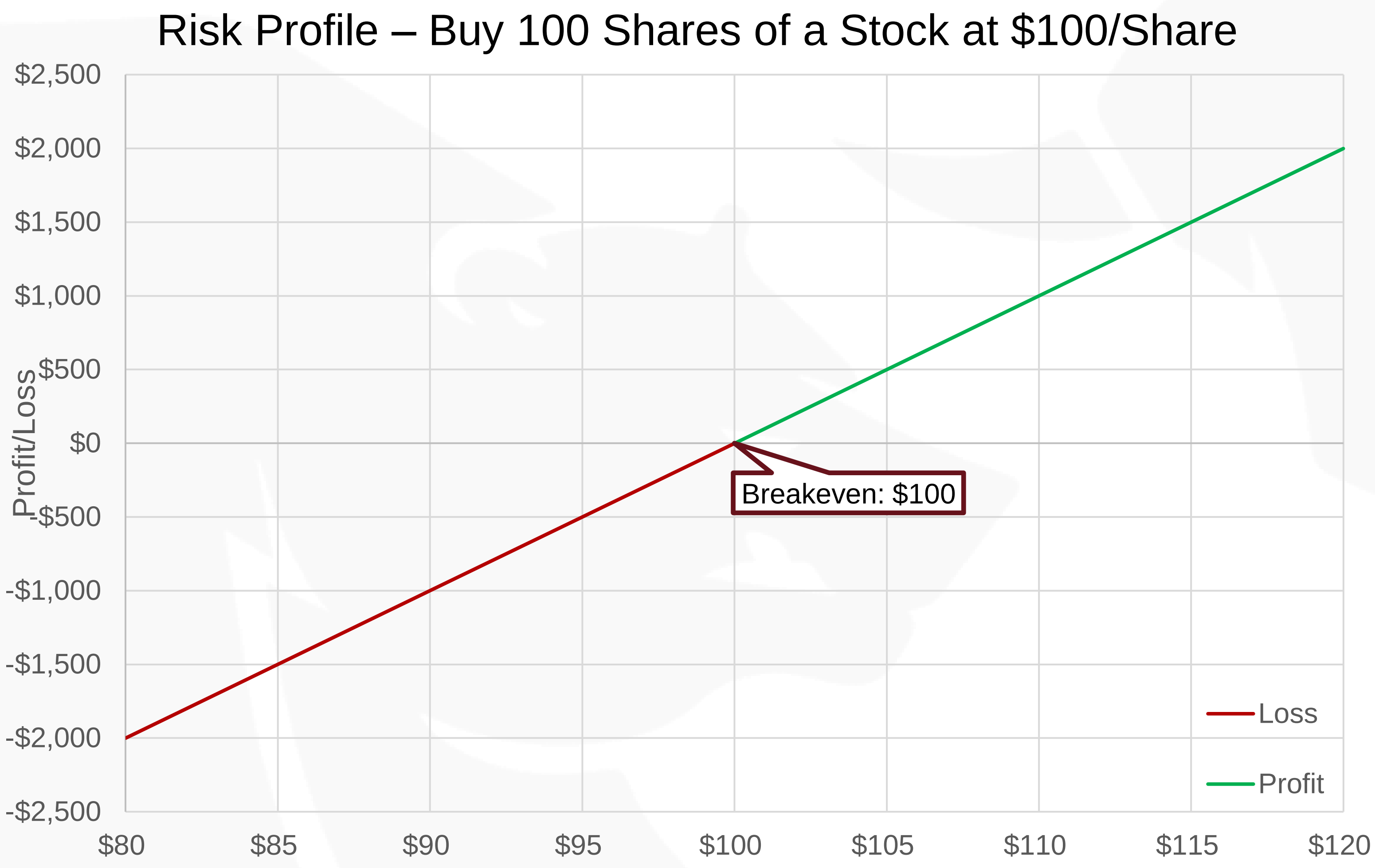
Purpose

Review the Risk Profiles of each basic option in order to understand the general risk and reward associated

Walk through examples to know where specific prices and inflection points exist

Think about how combining multiple contracts can alter the Risk Profile for strategies

Buying Stock



Linear Risk for Profit and Loss
Every $1 Change in Share Price
Equals Additional $100 Change in
Unrealized Profit and Loss

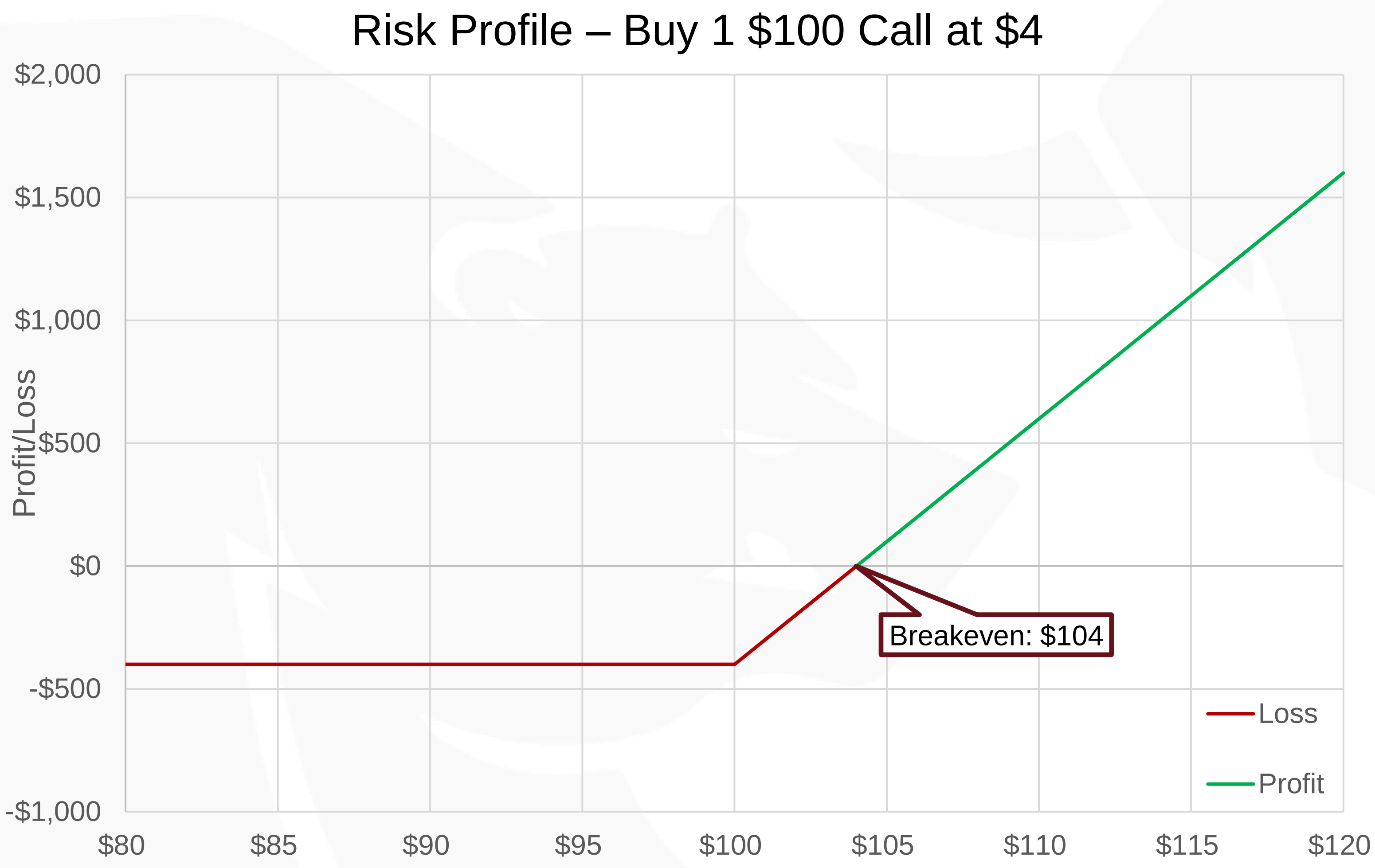
Max Risk = Capital Invested

= 100 Shares x $100/Share
$10,000 Max Risk

Requires Good Timing for Traders
and Time Invested for Investors

Stop Losses are based on amount
willing to lose

Buying Call Options



Call Option Strike at $100

Maximum Risk = Premium Paid
$4.00 x 100 Shares = $400

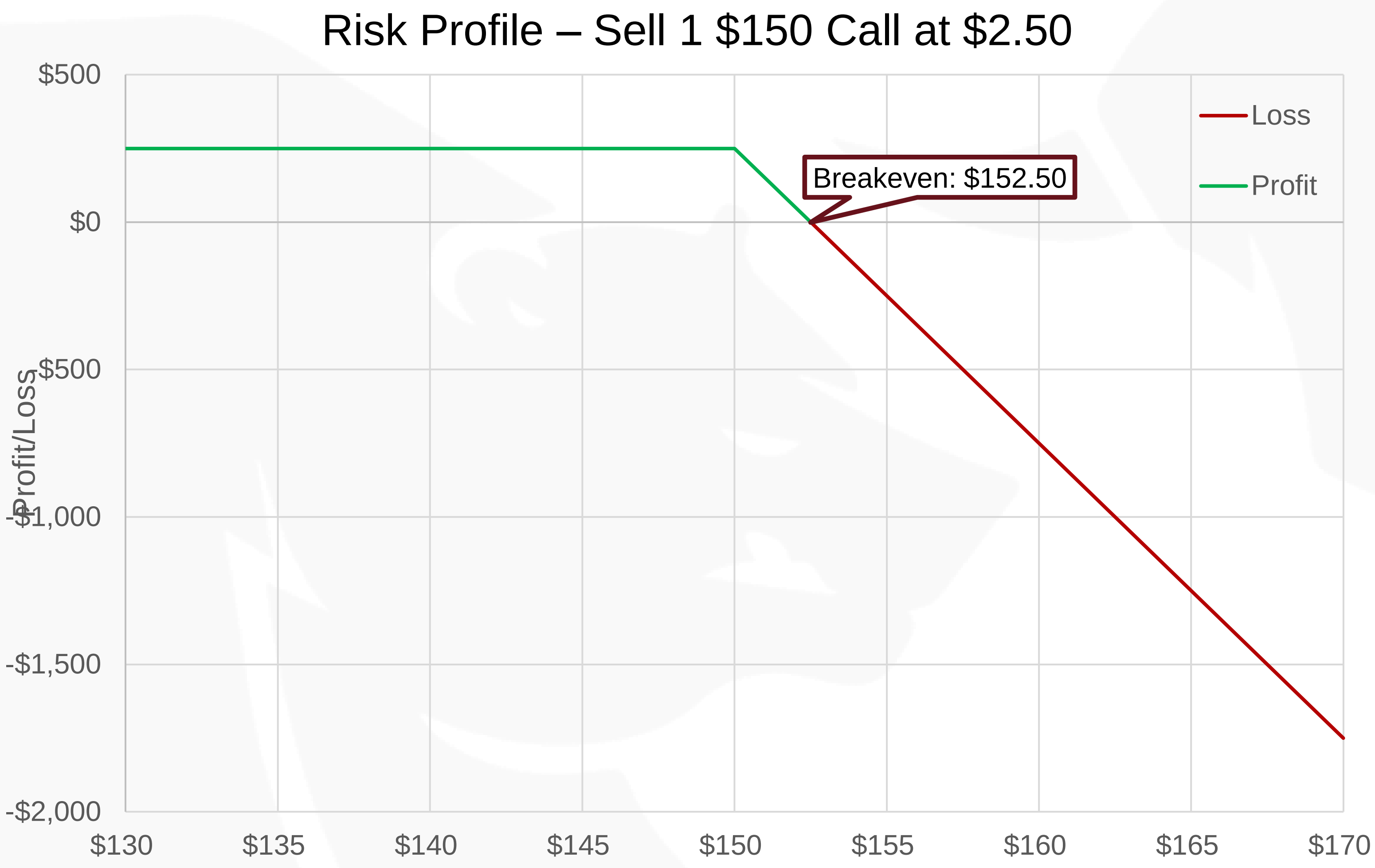
Premium at Expiration with $120/Share
= Stock Price - Strike Price
$120 - $100 = $20

Profit at Expiration with $120/Share
= Stock Price - Strike Price – Premium

$120 - $100 - $4
= $16 x 100 Shares = $1,600

Breakeven = Strike Price + Premium
= $100 + $4 = $104

Selling Call Options



Call Option Strike at $150

Maximum Profit = Premium Collected
$2.50 x 100 Shares = $250

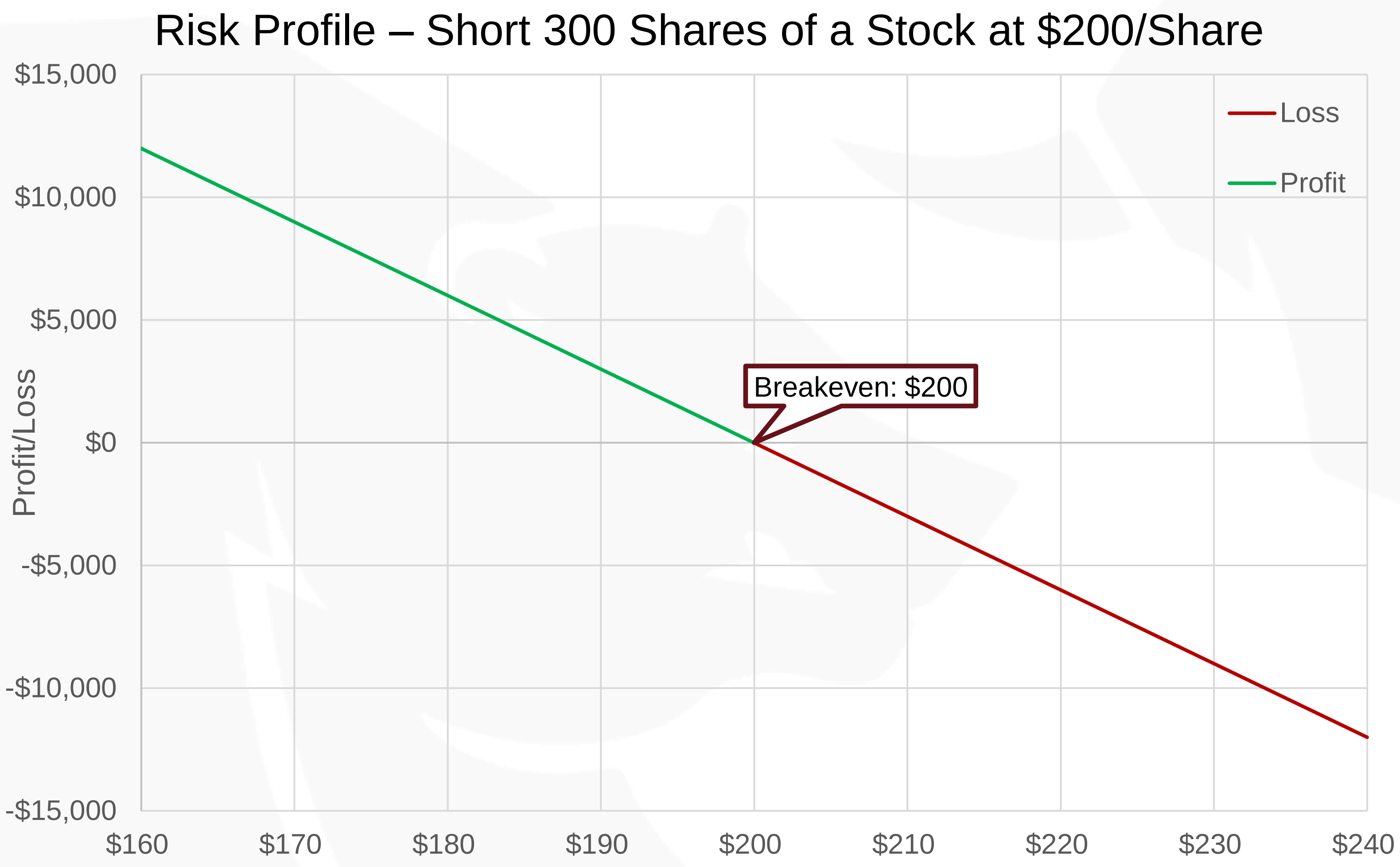
Potential Loss is Unlimited

Loss at Expiration with $165/Share
= Strike Price - Stock Price + Premium

$150 - $165 + $2.50
-$12.50 x 100 Shares = -$1,250

Breakeven = Strike Price + Premium
= $150 + $2.50 = $152.50

Shorting Stock



Linear Risk for Profit and Loss
Every $1 Change in Share Price
Equals Additional $300 Change in
Unrealized Profit

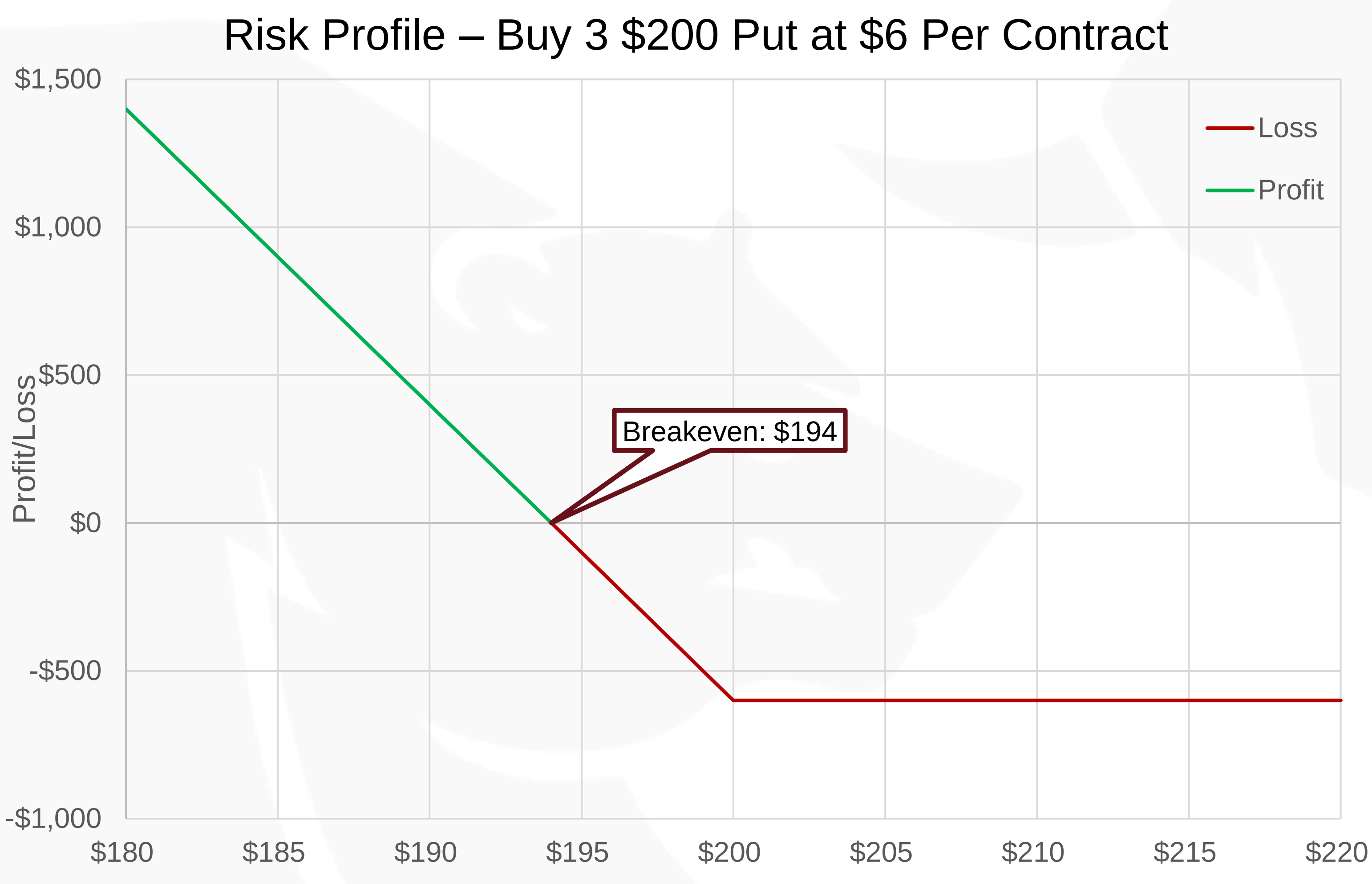
Max Risk = Unlimited (Margin Call)
Capital Required = $60,000

= 300 Shares x $400/Share
$60,000 Potential Loss

Requires Good Timing for Traders
Most Investors avoid Short Selling

Stop Losses are based on amount willing to lose

Buying Put Options



Put Option Strike at $200

Maximum Risk = Premium Paid
$6.00 x 300 Shares = $1,800

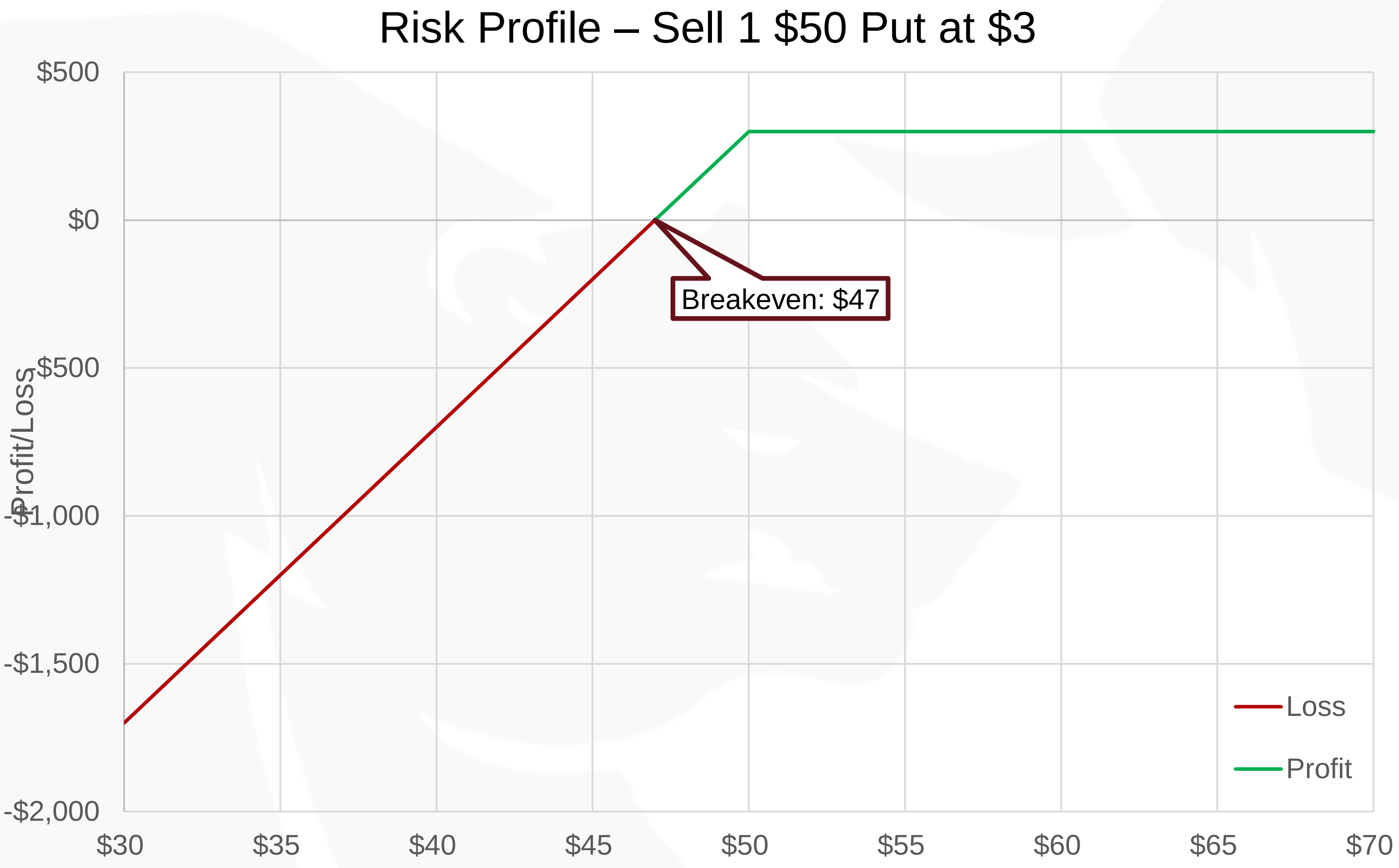
Premium at Expiration with $175/Share
= Strike Price - Stock Price
$200 - $175 = $25

Profit at Expiration with $175/Share
= Strike Price - Stock Price – Premium

$200 - $175 - $6
$19 x 100 Shares x 3 Contracts = $5,700

Breakeven = Strike Price - Premium
= $200 - $6 = $194/Share

Selling Put Options



Put Option Strike at $50

Maximum Profit = Premium Collected
$3.00 x 100 Shares = $300

Potential Loss is Capped

At $40/Share
= Stock Price - Strike Price + Premium

$40 - $50 + $3
-$7.00 x 100 Shares = -$700

Breakeven = Strike Price - Premium
= $50 - $3 = $47

Combining Profiles

Knowing the Risk Profiles of the basic options allows us to understand and form more complex Option 'Spreads' that use multiple contracts in a single trade.

Most Option Strategies involve multiple contracts to form the spread, which involves simultaneously buying and selling different option contracts of the same underlying asset.

- Calls and Puts (Long and Short)
- Different Strikes
- Different Amounts
- Different Series

The Risk Profiles of each of these strategies will be combinations of the basic Risk Profiles, all of which have interesting dynamics that make them useful.