



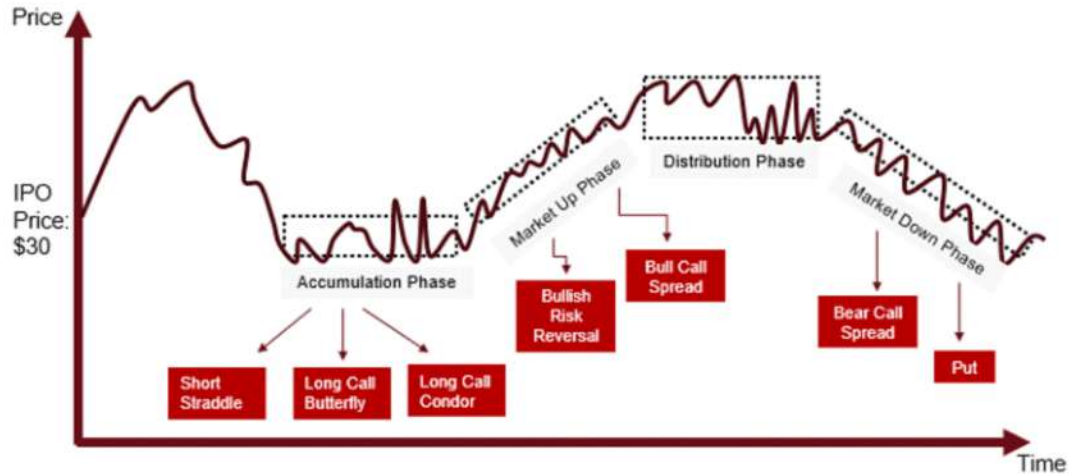
Options

— PLAY BOOK —

Options Play Book

Stock phases and options

There are options strategies for each stage of the market. Whether you are trading in the bull market, a bear market, or the market is consolidating, you can always find a scenario in which you can plan a trade and then profit from its execution.



Options framework

Step 1: Form your thesis

- Are you bullish, bearish, no direction, hedging?

Step 2: What is the ideal strategy?

- What is the expected move? 10% to the next resistance? 20% to the next resistance? To your price target based on your fundamental work?

Step 3: Conduct marginal benefit analysis

- What strategy yields the highest return but is also the cheapest to set up?

Step 4: Use an XLS file for sensitivity analysis

- What if implied volatility changes? What if the interest rate changes?

Step 5: Execute and monitor closely for results

Bullish Plays

Strategy 1: Bullish Risk Reversal

What is it?

- When a stock is oversold, you go long for a reversal
- A cheaper alternative to buying stock with similar exposure

When to use it?

- For oversold stock that you are looking for a reversal in

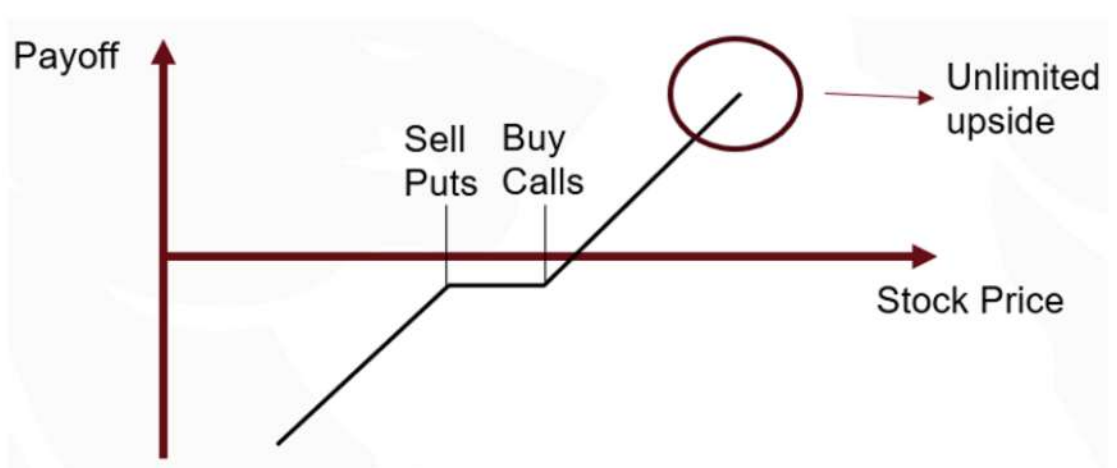
How to use it?

- Sell 1 OTM put (same expiry)
- Buy 1 OTM call (same expiry)
- You want to collect the premium from selling put to cover the cost of buying a call

Risk to reward

Max loss if net credit	$(\text{Put strike} - \text{net premium}) * 100$
Max loss if net debit	$(\text{put strike} + \text{net premium}) * 100$
Breakeven if net credit	Stock must close above: put strike - net credit
Breakeven if net debit	Stock must close above: call strike + net debit

Payoff Diagram



Strategy 2: Bull Call Spread

What is it?

- You are bullish on the stock, but you have a price target to hit while limiting the downside

When to use it?

- When you are bullish but you have an upside target

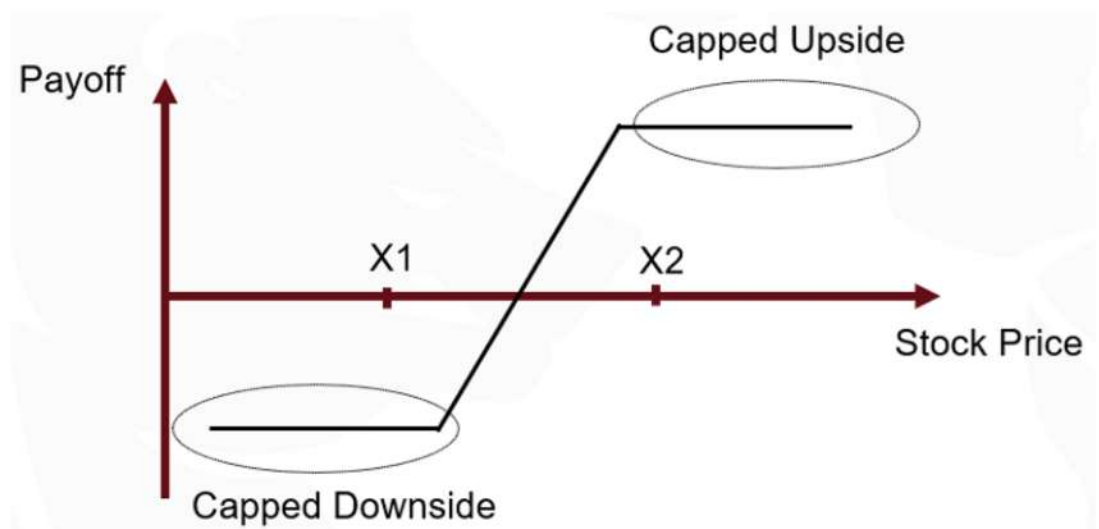
How to use it?

- Buy 1 call ITM or ATM (same expiry)
- Sell 1 call at the higher strike price (i.e., your price target) (same expiry)

Risk to reward

Max Loss	Net Premium Spent * 100
Max Upside	(Call spread width - premium spent) * 100
Breakeven	Lower strike + net premium spent

Payoff diagram



Strategy 3: Bull Ratio Spread

What is it?

- You want to buy more options than you sell by choosing a specific ratio
- The upside is not capped and the selling call option helps fund your other call option

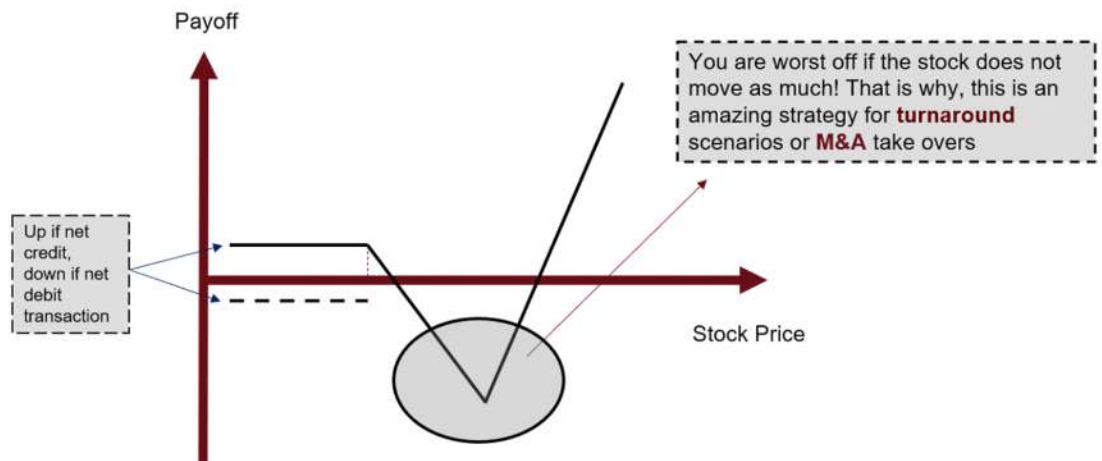
When to use it?

- To take over targets and rumors, or for a strong move up
- As a hedge for a short position you might have
- For meme stocks

How to use it?

- Buy N amount of call option (usually ATM) (same expiry)
- Sell a call option at the lower strike price (same expiry)
- Ideal timeline is 6 months to a year to get full advantage of the time premium you sell

Payoff Diagram



Strategy 4: Strap Straddle (Bullish)

What is it?

- Like the straddle, but with more emphasis on one direction than another
- Protects your downside and limits upside gain

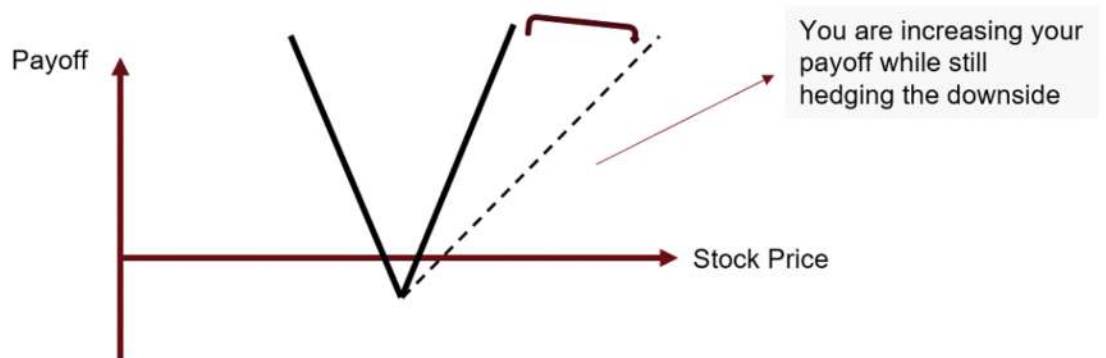
When to use it?

- Prior to earnings or major news
- Overall a bullish strategy but with a hedge on the downside

How to use it?

- Buy 2 or 4 ATM call (same expiry)
- Buy 1 ATM put option at the same strike price (same expiry)

Payoff Diagram



Bearish Plays

Strategy 1: Bear Ratio Spread

What is it?

- The opposite of the bull ratio spread
- You want to buy more options than you sell by choosing a specific ratio
- Limited upside, limited downside

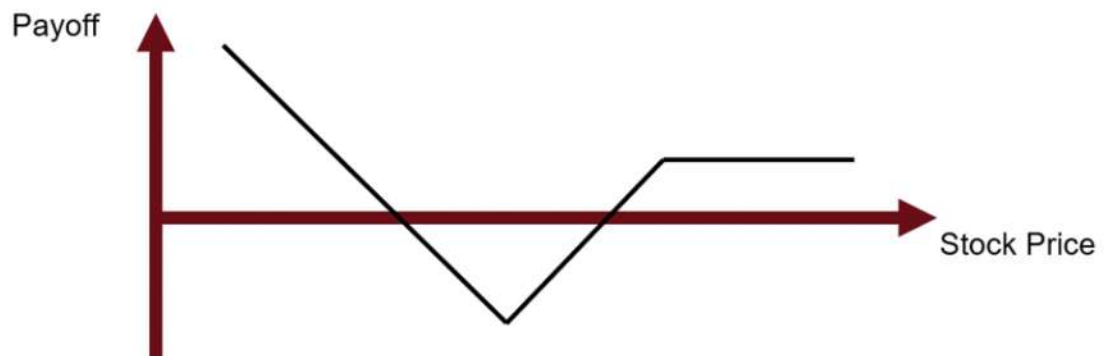
When to use it?

- As a hedge for a long position you might have
- For shorting meme/cult stocks like Tesla or Palantir

How to use it?

- Buy N number of ATM put options (same expiry)
- Sell a put option at the higher strike price (same expiry)

Payoff Diagram



Strategy 2: Bear Call Credit Spread

What is it?

- A bearish bet that the stock is going to go down soon

When to use it?

- When you want to short a stock but have a price target at where you want to exit

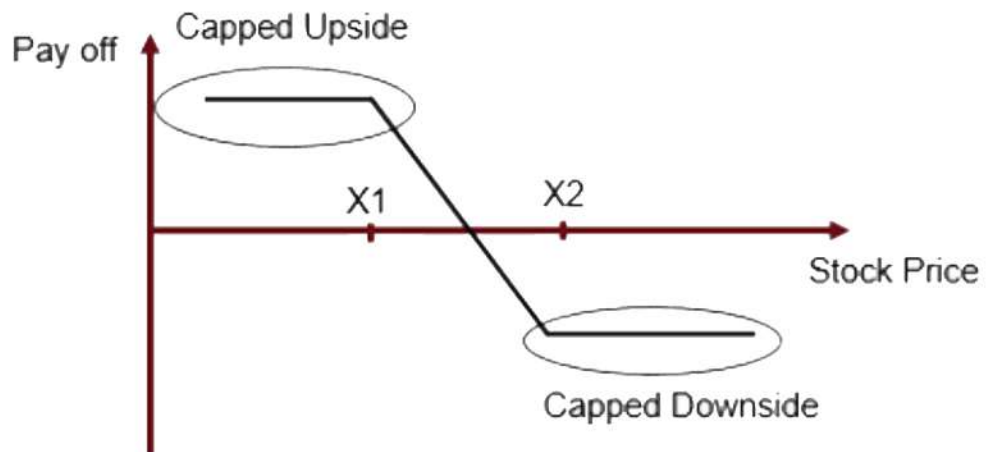
How to use it?

- Sell 1 ITM call (same expiry)
- Buy 1 call at a higher strike price (usually ATM) (same expiry)

Risk to reward

Max Loss	$(\text{Call spread width} - \text{premium earned}) * 100$
Max Upside	Premium earned * 100
Breakeven	Lower strike + net premium spent

Payoff diagram



Strategy 3: Strip Straddle (Bearish)

What is it?

- Like the straddle, but with more emphasis on one direction than another
- Protects your downside and limits upside gain

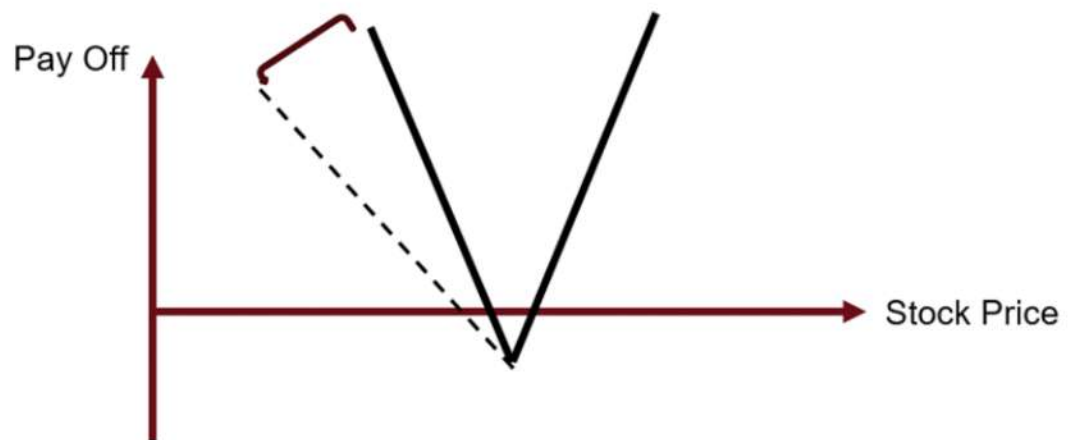
When to use it?

- Prior to earnings or major news
- Overall a bearish strategy but with a hedge on the upside

How to use it?

- Buy 1 ATM call (same expiry)
- Buy 2 or 4 ATM put options at the same strike price (same expiry)

Payoff diagram



Volatility Plays

Key points

- Strategies are mostly used by market makers for hedging
- When investment banks or market makers write options for institutions or hedge funds, they become short volatility plays
- To hedge their position, they open straddles for going long volatility plays

Strategy 1: Long Straddle

What is it?

- A bet on whether volatility will increase or decrease

When to use it?

- For breakout or breakdown when a stock is going to move outside of a trading range

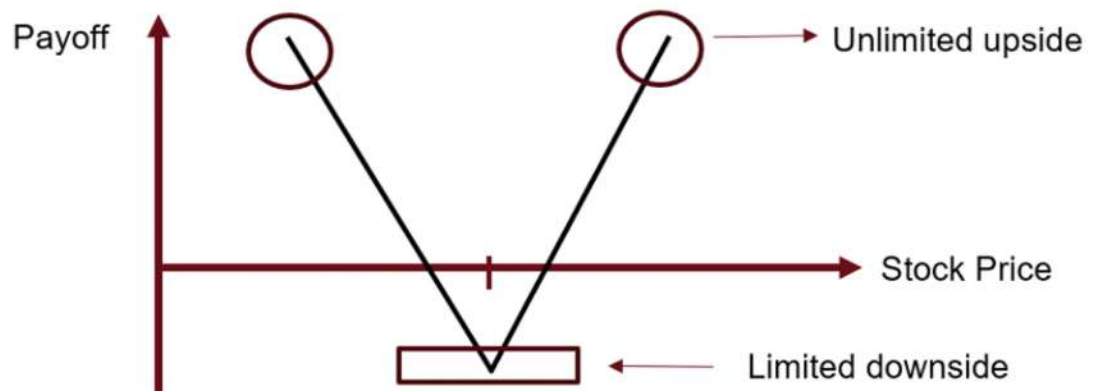
How to use it?

- Buy 1 ATM call (same expiry)
- Buy 1 ATM put at the same strike price (same expiry)

Risk to reward

Max Loss	Premium Spent *100
Max Upside	Unlimited
Breakeven Up	Call strike + total premium spent
Breakeven Down	Put Strike - premium spent

Risk to reward



Strategy 2: Long Strangle

What is it?

- A strategy for drastic swings

When to use it?

- When a big announcement is coming

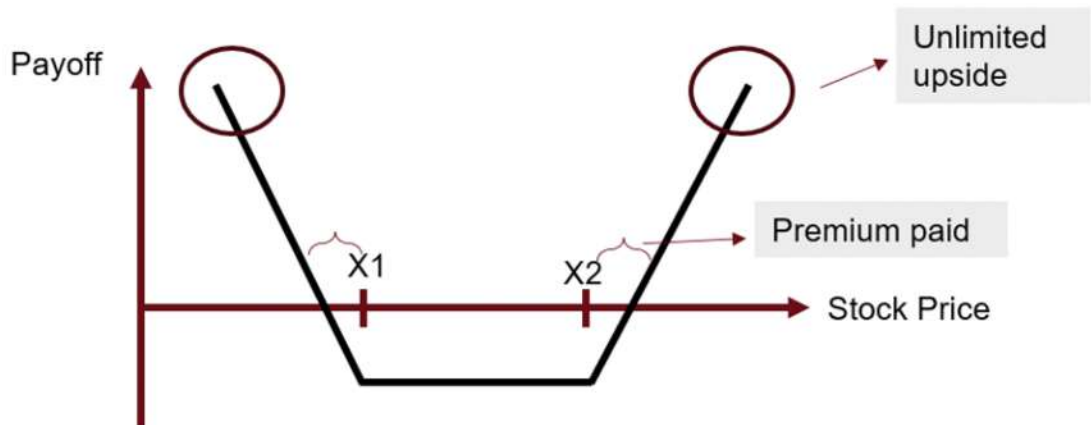
How to use it?

- Buy 1 OTM put (same expiry)
- Buy 1 OTM call at a different strike price (same expiry)

Risk to reward

Max Loss	Premium Spent *100
Max Upside	Unlimited
Breakeven Up	Call strike + total premium spent
Breakeven Down	Put Strike - premium spent

Payoff diagram



Range Plays

Key points

- Can be used to make profit during consolidation or when the market is in a range
- Ideal for when market volatility is low
- Work great in low-beta securities
- Work best on indices and ETFs

Strategy 1: Butterfly

What is it?

- A strategy for when the market is not moving as much as usual

When to use it?

- When you do not expect there to be any breaking news or catalysts
- When the market is not moving much
- When VIX is low

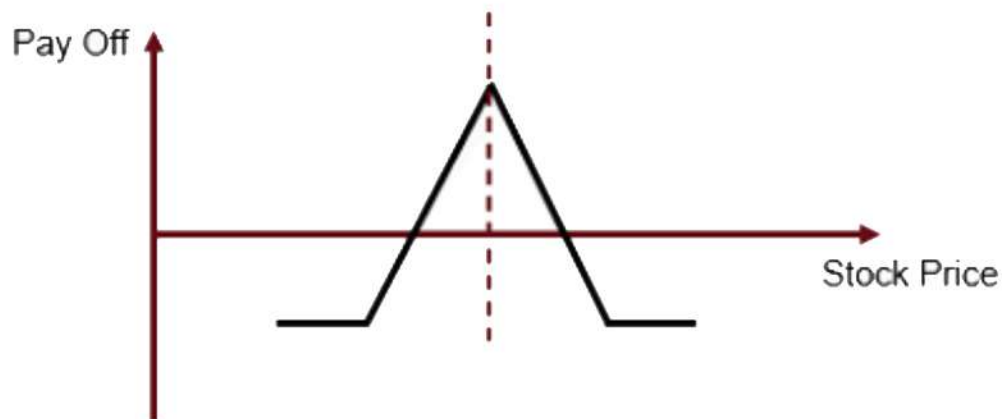
How to use it?

- Sell 2 ATM call (same expiry)
- Buy 1 ITM call (same expiry)
- Buy 1 OTM call (same expiry)

Risk to reward

Max Loss	Premium spent
Max Upside	$(\text{ATM call strike price} - \text{ITM call strike price} - \text{total debit paid}) * 100$
Breakeven Up	OTM call strike price - total debit paid
Breakeven Down	ATM call strike price + total debit paid

Payoff diagram



Strategy 2: Short Straddle

What is it?

- Used to take advantage of a potential decrease in implied volatility

When to use it?

- When you expect a decrease in implied volatility

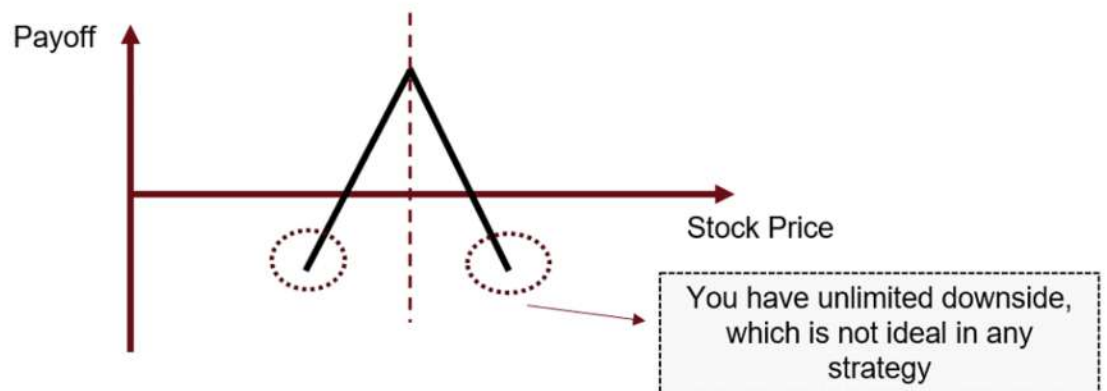
How to use it?

- Sell 1 ATM call (same expiry)
- Sell 1 ATM put (same expiry)

Risk to reward

Max Loss	Unlimited
Max Upside	Total premium collected
Breakeven Up	Put strike price + total premium collected
Breakeven Down	Call strike price - total premium collected

Payoff diagram



Strategy 3: Short Strangle

What is it?

- Ideal for low volatility scenarios

When to use it?

- When you expect the stock to trade in a range
- When the market has low volatility and no major catalysts are expected

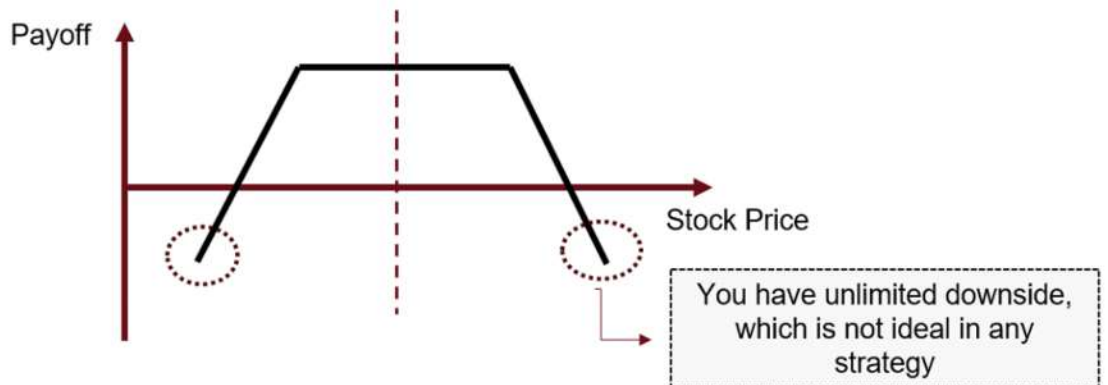
How to use it?

- Sell 1 OTM put (same expiry)
- Sell 1 OTM call (same expiry)

Risk to reward

Max Loss	Unlimited
Max Upside	Total premium collected
Breakeven Up	OTM call strike price + total premium collected
Breakeven Down	OTM put strike – total premium collected

Payoff diagram



Strategy 4: Iron Condor

What is it?

- A market neutral strategy
- Provides a fixed risk and a capped profit

When to use it?

- When the market has low volatility
- When no major catalysts are expected

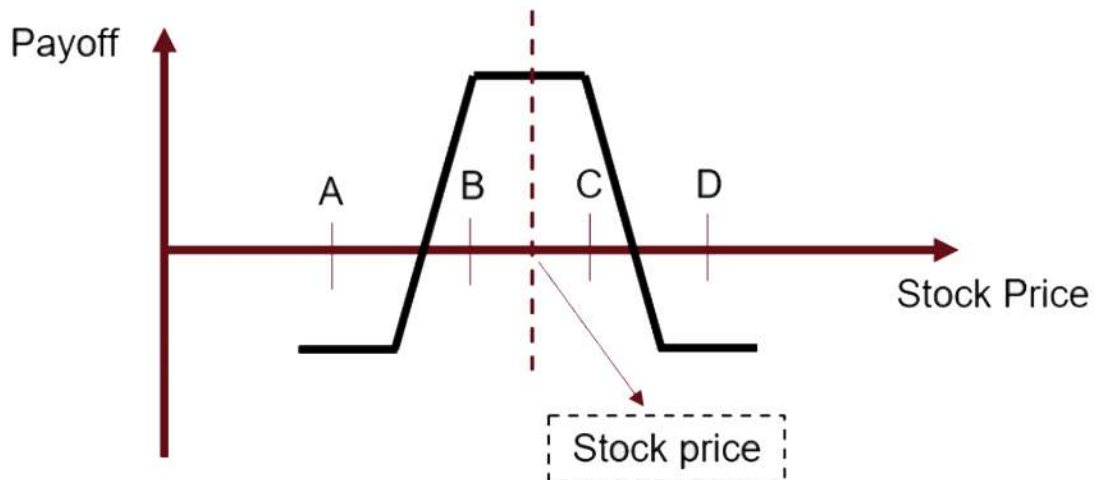
How to use it?

- Buy 1 OTM put (same expiry)
- Sell 1 OTM put (same expiry)
- Sell 1 OTM call (same expiry)
- Buy 1 OTM call (same expiry)

Risk to reward

Max Loss	$(\text{Strike B} - \text{strike A} - \text{total premium collected}) \times 100$
Max Upside	Total premium collected
Breakeven Up	Strike C + total premium collected
Breakeven Down	Strike B - total premium collected

Payoff diagram



Hedging Plays

Key points

- Delta Hedging and Protective Puts are the 2 most popular hedging play strategies
- Ideal for longer-term holds

Strategy 1: Delta Hedging

What is it?

- Aims to reduce directional risk
- Your goal is to reach a Delta neutral stage (no directional bias)

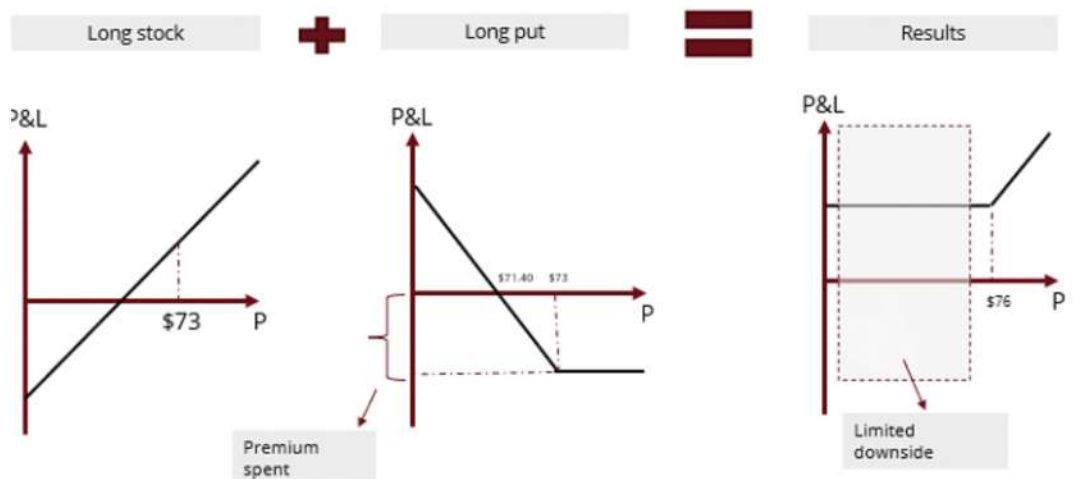
When to use it?

- Before earnings or breaking news in order to limit the downside of extreme movements

How to use it?

- Buy as many ATM put contracts as necessary to reach Delta neutrality
- You have 100 shares of a stock trading at price \$X (this is Delta 100). You are looking to hedge your position in case of bad earnings or bad news.
- Look for options that will result in the Delta being as close to 0 as possible
- If 1 contract Delta is -0.50, then you would buy 2 contracts of puts to have Delta equal -100. You have now reached Delta neutrality.

Payoff diagram



Strategy 2: Protective Puts

What is it?

- An insurance trade to protect your already big gains
- You do not want to overpay for this insurance. Knowing how to calculate your effective sale price is key!
 - Effective Sale Price
 - Current share price – OTM/ATM put cost
 - Insurance Cost
 - How much profit are you keeping? What is your take rate?

When to use it?

- When your stock has a huge run in a short amount of time and you have a big unrealized profit
- When you do not want to sell yet because you want to participate in the upside

How to use it?

Buy ATM or OTM puts with a short-term expiration

Income Generating Plays

Key points

- Pick stocks with higher implied volatility
- Pick stocks you want to own
- Look for a bigger premium

Strategy 1: Covered Call

What is it?

- Generates extra income while holding a long-term position
- Generates income by selling OTM call option: it is like rental income
- Can reduce your average price if you are in a losing position

When to use it?

- For aggressive growth stocks which you are intending to keep for the long term
- For stocks which have already run up after the release of earnings
- When a strategy is not as important as your risk to reward and annualized rate of return

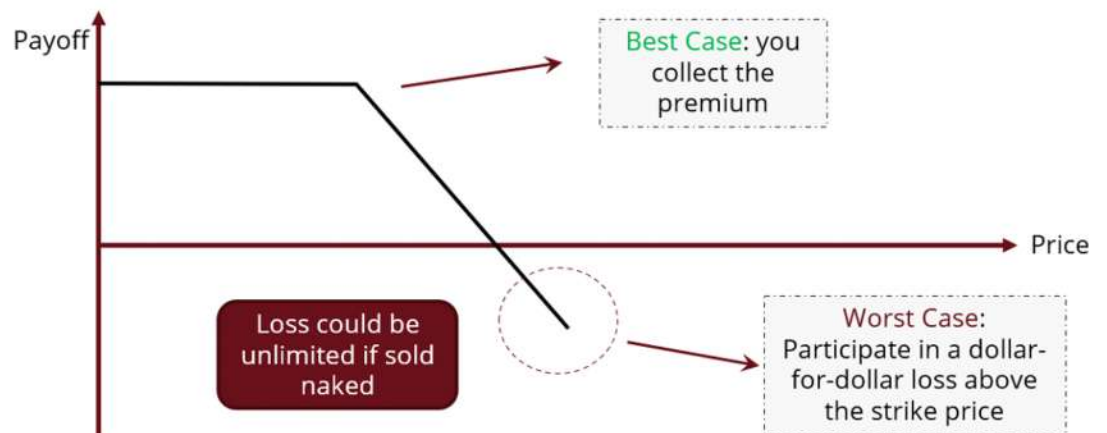
How to use it?

- If you have 200 shares, sell 2 OTM covered call contracts
- Choose an expiration date with up to 3 weeks remaining until the actual expiration in order to take advantage of the accelerated time decay toward the end of the expiration date

Rule of thumb

- Do not engage in anything lower than 2% annualized yields
- Sell covered calls for stocks that are overextended

Payoff diagram



Strategy 2: Selling Puts

What is it?

- A limit buy order, but you are getting paid for it
- A perfect strategy if you are looking to add a security at a certain price
- A fantastic way to generate income for an aggressive growth portfolio

When to use it?

- Could be used speculatively for a potential reversal at a price point
- Provides a better cost average for stocks as, if you do get assigned shares, you get exactly the price you want

How to use it?

- You want to buy 100 shares of a stock but only at price $\$X$
- Sell 1 contract of put at price $\$X$

Rule of thumb

- Do not engage in anything lower than 2% annualized yields
- Sell puts for stocks that are oversold

Payoff diagram

