SPREAD STRATEGY

Spread strategy is a strategy in which a trader earns profit by using price spreads:

Either call or put option used. Combination of both is not allowed.

Bullish spread strategy:

In this spread strategy the trader has a bullish price belief and his objective is to earn profit if price goes up.

Enter through Call Option

Since trader is bullish he will definitely buy a call option (C+)

Now since it is a spread strategy he is required to enter one more call option (since combination is not allowed in this strategy).

Explanation :- In this case the trader has only risk of losing the premium paid on C+ and that is his maximum loss so he will use his spread strategy to minimise the cost of premium, so to minimise the premium cost he will decide upon the quantum of bullish and set a ceiling point i.e. the point which is not expected to cross and he will Sell a call at this point (C-)

In this way he is able to enjoy the rise in price as well as keep his Net Cost of Premium low.

Summary

C+ at Lower Strike Price

C- at Higher Strike Price

Enter through put option:

Since trader is bullish he will definitely sell a put option (P-)

Now he is required to enter one more Put option since he is using spread strategy

In this case he enjoyed premium and if price definitely go up … he end up with the profit earned through P-. However he afraid of price falling so to hedge himself against price falling he will buy a put at a lower strike price.

In this way the trader will be able to enjoy a premium amount and hedged himself against price falling.

Summary

P- at a higher strike price

P+ at a lower strike price

Now by combining summary of both Call and Put option in case of Bullish Spread Strategy we conclude that

C+ or P+ at a lower Strike Price and

C- or P- at a Higher Strike Price

Think Opposite in case the Trader is Bearish

C+ or P+ at a Higher Strike Price and

C- or P- at a Lower Strike Price

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