Option Selling Strategy in Bullish Market:-

Bull call spread Strategy notes:-

Amongst all the spread strategies, the bull call spread is one the most popular one. The strategy comes handy when you have a moderately bullish view on the stock/index.

The bull call spread is a two leg spread strategy traditionally involving ATM and OTM options. However you can create the bull call spread using other strikes as well.

To implement the bull call spread –

1. Buy 1 ATM call option (leg 1)
2. Sell 1 OTM call option (leg 2)

When you do this ensure –

1. All strikes belong to the same underlying
2. Belong to the same expiry series
3. Each leg involves the same number of options

For example –

Date – 23rd November 2015

Outlook – Moderately bullish (expect the market to go higher but the expiry around the corner could limit the upside)

Nifty Spot – 7846

ATM – 7800 CE, premium – Rs.79/-

OTM – 7900 CE, premium – Rs.25/-

Bull Call Spread, trade set up –

1. Buy 7800 CE by paying 79 towards the premium. Since money is going out of my account this is a debit transaction
2. Sell 7900 CE and receive 25 as premium. Since I receive money, this is a credit transaction
3. The net cash flow is the difference between the debit and credit i.e 79 – 25 = **54**.

Generally speaking in a bull call spread there is always a 'net debit', hence the bull call spread is also called referred to as a 'debit bull spread'.

Bull put spread Strategy Notes:-

Similar to the Bull Call Spread, the Bull Put Spread is a two leg option strategy invoked when the view on the market is 'moderately bullish'.

The bull put spread is a two leg spread strategy traditionally involving ITM and OTM Put options. However you can create the spread using other strikes as well.

To implement the bull put spread –

1. Buy 1 OTM Put option (leg 1)
2. Sell 1 ITM Put option (leg 2)

When you do this ensure –

1. All strikes belong to the same underlying
2. Belong to the same expiry series
3. Each leg involves the same number of options

For example –

Date – 7th December 2015

Outlook – Moderately bullish (expect the market to go higher)

Nifty Spot – 7805

Bull Put Spread, trade set up –

1. **Buy 7700 PE** by paying Rs.72/- as premium; do note this is an OTM option. Since money is going out of my account this is a debit transaction
2. **Sell 7900 PE** and receive Rs.163/- as premium, do note this is an ITM option. Since I receive money, this is a credit transaction
3. The net cash flow is the difference between the debit and credit i.e 163 – 72 = **+91,** since this is a positive cashflow, there is a net credit to my account.

Option Selling Strategy in Bearish Market:-

Similar to the Bear Put Spread, the Bear Call Spread is a two leg option strategy invoked when the view on the market is 'moderately bearish'.

Bear Call Spread Strategy Notes:-

The Bear Call Spread is a two leg spread strategy traditionally involving ITM and OTM Call options. However you can create the spread using other strikes as well. Do remember, the higher the difference between the two selected strikes (spread), larger is the profit potential.

To implement the bear call spread –

1. Buy 1 OTM Call option (leg 1)
2. Sell 1 ITM Call option (leg 2)

Ensure –

1. All strikes belong to the same underlying
2. Belong to the same expiry series
3. Each leg involves the same number of options

Let us take up example to understand this better –

Date – February 2016

Outlook – Moderately bearish

Nifty Spot – 7222

Bear Call Spread, trade set up –

1. **Buy 7400 CE** by paying Rs.38/- as premium; do note this is an OTM option. Since money is going out of my account this is a debit transaction
2. **Sell 7100 CE** and receive Rs.136/- as premium, do note this is an ITM option. Since I receive money, this is a credit transaction
3. The net cash flow is the difference between the debit and credit i.e 136 – 38 = **+98,** since this is a positive cashflow, there is a net credit to my account.

Bear Put Spread Strategy notes

Similar to the Bull Call Spread, the Bear Put Spread is quite easy to implement. One would implement a bear put spread when the market outlook is moderately bearish, i.e you expect the market to go down in the near term while at the same time you don't expect it to go down much. If I were to quantify 'moderately bearish', a 4-5% correction would be apt. By invoking a bear put spread one would make a modest gain if the markets correct (go down) as expected but on the other hand if the markets were to go up, the trader will end up with a limited loss.

A conservative trader (read as risk averse trader) would implement Bear Put Spread strategy by simultaneously –

1. Buying an In the money Put option
2. Selling an Out of the Money Put option

There is no compulsion that the Bear Put Spread has to be created with an ITM and OTM option. The Bear Put spread can be created employing any two put options. The choice of strike depends on the aggressiveness of the trade. However do note that both the options should belong to the same expiry and same underlying. To understand the implementation better, let's take up an example and see how the strategy behaves under different scenarios.

As of today Nifty is at 7485, this would make 7600 PE In the money and 7400 PE Out of the money. The 'Bear Put Spread' would require one to sell 7400 PE, the premium received from the sale would partially finance the purchase of the 7600 PE. The premium paid (PP) for the 7600 PE is Rs.165, and the premium received (PR) for the 7400 PE is Rs.73/-. The net debit for this transaction would be –

73 – 165

= **-92**