Trading options is a way for investors to take advantage of nearly any market condition. The strategies in this guide will let you trade, generate income, and limit risk whether you have a bullish or bearish outlook. There are strategies for beginning and experienced traders, with clear explanations, charts, minimum and maximum profit potentials, and guides to the market outlook each strategy might be most appropriate for. Fidelity.com/options
Trading options is one way to help you reach a variety of investing goals. You could be seeking income, targeting a specific buy or sell price, or hedging (protecting) positions you already own.

It’s important to view options trading in perspective. Most options strategies are not get-rich-quick strategies. They are better viewed as flexible investments that can enhance or protect your portfolio in rising, falling, and neutral markets.

This guide introduces some of the most popular options strategies for every level of options trading experience, and for every market outlook. Note: You must complete an Options Agreement before you can trade options at Fidelity.

**ANATOMY OF AN OPTIONS TRADE**

<table>
<thead>
<tr>
<th>BUY</th>
<th>to Open</th>
<th>1</th>
<th>XYZ</th>
<th>DEC</th>
<th>50</th>
<th>CALL</th>
<th>@ 2.30</th>
</tr>
</thead>
<tbody>
<tr>
<td>OPEN (create a new) or CLOSE (remove an existing) position</td>
<td>Number of contracts being purchased</td>
<td>Ticker symbol of the underlying stock</td>
<td>Expiration month (third Friday is the typical expiration day)</td>
<td>Strike price</td>
<td>Type of contract</td>
<td>Price per share of contract</td>
<td></td>
</tr>
</tbody>
</table>

Important note: Trading options can involve significant risk and may not be suitable for all investors. It’s important to understand risks associated with trading options before you include them in your investment portfolio. Also, you do not have to hold your positions to expiration. You can exit a position for a profit or a loss before expiration.
**GLOSSARY**

**Put:** An option contract that gives the buyer the right to sell the underlying security at a specified price for a certain, fixed period of time. The seller has an obligation to buy the underlying security at a specified price for a certain, fixed period of time.

**Call:** An option contract that gives the buyer the right to buy the underlying security at a specified price for a certain, fixed period of time. The seller has an obligation to sell the underlying security at a specified price for a certain, fixed period of time.

**In the money:** A call option is “in the money” if the strike price is less than the market price of the underlying security. A put option is in the money if the strike price is greater than the market price of the underlying security.

**Out of the money:** A call option is “out of the money” if the strike price is greater than the market price of the underlying security. A put option is out of the money if the strike price is less than the market price of the underlying security.

**Premium:** The price a put or call buyer must pay to a put or call seller (writer) for an option contract. Market supply and demand forces determine the premium.

**Break-even point (BEP):** The stock price(s) at which an option strategy results in neither a profit nor loss.

**Open/Close:** A buy or sell to “Open” an option trade represents the creation of a new position in your account. It implies that no position in this option currently exists or you are adding to an existing position. A buy or sell to “Close” implies that you are removing or closing out an existing position.

**Ratio spread:** A multi-leg option trade of either all calls or all puts whereby the number of long options to short options is something other than 1:1. Typically, to manage risk, the number of short options is lower than the number of long options (i.e., 1 short call: 2 long calls).

**Long position:** A position wherein an investor is a net holder in a particular options series.

**Short position:** A position wherein the investor is a net seller (writer) of a particular options series.

**Strike price or exercise price:** The stated price per share for which the underlying security may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

**Synthetic position:** A strategy involving two or more instruments that has the same risk/reward profile as a strategy involving only one instrument.

**Time decay or erosion:** A term used to describe how the time value of an option can “decay” or reduce with the passage of time.

**Volatility:** A measure of the fluctuation in the market price of the underlying security. Mathematically, volatility is the annualized standard deviation of returns.
MARKET STRATEGIES IN THIS GUIDE

**NEUTRAL STRATEGIES**
- Beginner: Covered Call
- Intermediate: Short Put—Cash Secured
- Advanced: Long Diagonal Spread with Calls
- Advanced: Long Diagonal Spread with Puts
- Advanced: Short Iron Condor Spread

**BEAR STRATEGIES**
- Intermediate: Bear Call Spread
- Intermediate: Bear Put Spread

**BULL STRATEGIES**
- Beginner: Long Call
- Beginner: Collar
- Intermediate: Bull Call Spread
- Intermediate: Bull Put Spread

Click for more
Example of COVERED CALL
(long stock + short call)
Buy 100 shares XYZ stock at 98.00
Sell to Open 1 XYZ 100 call at 3.50

A covered call position is created by buying (or owning) stock and selling to open call options on a share-for-share basis. In the example, 100 shares are purchased (or owned) and one call is sold to open. In return for the call premium received, which provides income in sideways markets and limited protection in declining markets, the investor is giving up profit potential above the strike price of the call. The call premium increases income in neutral markets, but the seller of a call assumes the obligation of selling the stock at the strike price at any time until the expiration date. In a covered call position, the risk of loss is on the downside. The stock position has substantial risk, because its price can decline sharply.

Potential goals
The covered call strategy is versatile. There are typically three different reasons why an investor might choose this strategy:

Income-oriented investors use covered calls with the goal of enhancing cash returns. In return for the call premium received, which increases income in neutral markets, the investor accepts a limit on upside profit potential. Whether the shares are purchased at the same time a covered call is sold or purchased previously, the investor should believe that the stock price will trade in a neutral-to-bullish range during the life of the call. If the call expires worthless, then a decision has to be made whether (a) to sell another call, (b) to continue holding the stock without selling another call, or (c) to sell the stock and invest the funds elsewhere. If the stock price rises above the strike price of the call, then a decision has to be made whether (a) to let the stock be called away, or (b) to buy the call and close out the obligation. Note that the call price may increase when the stock price rises, and buying back the call can result in a loss. If the stock price declines, then a decision has to be made whether (a) to hold the stock and risk further declines or (b) to close the covered call position, possibly at a loss.
Investors who have a target selling price for a stock can sell a covered call hoping that the stock will be called away, thus achieving the target selling price. The “effective selling price” of a covered call equals the strike price of the call plus the premium received. (See graph at top left.) In the example at left in which a 100-strike call is sold for 3.50 per share, the effective selling price is $103.50 (100.00 + 3.50) if the call is assigned. If the stock price rises above the strike price and the call is assigned, then the target selling price is achieved. If the stock price trades sideways or down, then the call expires and the call premium is kept as income. In this outcome, while the investor did not sell the stock as hoped, the investor benefited from the call premium received. (See graph on middle left.)

Some investors sell covered calls to get a limited amount of downside protection when they expect a stock to decline in price. A covered call provides only limited downside protection, because the stock price can decline much more than the call premium. (See graph on bottom left.)

**Maximum profit**

Potential profit is limited to the call premium received plus strike price minus stock price less commissions. In the example above, the call premium is 3.50 per share, and strike price minus stock price equals 100.00 − 98.00 = 2.00 per share. The maximum profit, therefore, is 5.50 per share less commissions. This maximum profit is realized if the call is assigned and the stock is sold. Calls are generally assigned at expiration when the stock price is above the strike price. However, there is a possibility of early assignment.

**Maximum risk**

Risk is substantial if the stock price declines. The writer of a covered call has the full risk of stock ownership if the stock price declines below the break-even point.

**Break-even stock price at expiration**

Stock price minus call premium received
In this example: 98.00 − 3.50 = 94.50

**Appropriate market forecast**

The covered call strategy requires a neutral-to-bullish forecast. Writers of covered calls typically forecast that the stock price will not fall below the break-even point before expiration.
SHORT PUT — CASH SECURED

Market outlook
Neutral to bullish

Goal
To buy stock below the current price, or to earn a reasonable return on the cash deposit without taking risk greater than owning stock.

Explanation
Investors who sell cash-secured puts generally are willing to buy the underlying shares of stock. Rather than buy the shares at the current price, however, they hope the put will be assigned and the shares will be purchased at a lower price.

In return for receiving a premium, the seller of a put assumes the obligation to buy the underlying stock at the strike price at any time until the expiration date. Stock options in the U.S. typically represent 100 shares. Therefore, in the example above, the investor receives $3.00 per share ($300 less commissions) and assumes the obligation to buy 100 shares of XYZ stock at $100 per share until the expiration date (usually the third Friday of the month). The net premium received can be used to purchase the shares, so the investor also deposits $97 per share ($9,700) cash in a money market account, along with the $300 option premium, to pay for the 100 shares of stock if the put is assigned.

Example of SHORT PUT — CASH SECURED

Sell to Open 1 XYZ 100 Put at 3.00 per share ($300 less commissions)
Hold cash of $97.00 per share ($9,700 for 100 shares)

If the stock price is below the strike price at expiration, then the put will be assigned. As a result, the investor will buy the shares and pay for them with the cash held in the money market account, plus the option premium. If the investor still wants to own the stock, then the investor need do nothing. However, if the investor no longer wants to own the shares, then the stock must be sold. Alternatively, the investor could close the obligation to buy shares by buying the put to close in the market place prior to expiration and before an assignment notice is received.

If the stock price is above the strike price of the put at expiration, then the put expires worthless and the premium is kept as income. The investor must then decide whether to buy the stock at the current price, sell another put, or invest the cash elsewhere.
Maximum potential profit if unassigned
Limited to the net premium received.

Maximum potential profit if assigned
The potential profit is unlimited, because the price of the underlying stock can rise infinitely.

Maximum potential risk
Risk is substantial, because the stock price can fall to zero.

Assignment
Obligation to purchase shares at strike price.

Break-even stock price at expiration
Strike price minus premium received
In this example: 100.00 – 3.00 = 97.00
LONG DIAGONAL SPREAD WITH CALLS

Market outlook
Neutral or modestly bullish

Goal
• To profit from neutral stock price action near the strike price of the short call with limited risk on the downside and limited profit potential on the upside.
• To profit from a bullish stock price move to the strike price of the short call with lower risk than a simple long call, but also with limited profit potential if the stock price rises beyond the strike price of the short call.

Explanation
A long diagonal spread with calls is created by buying one “longer-term” call with a lower strike price and selling one “shorter-term” call with a higher strike price. In the example a two-month (56 days to expiration) 95 Call is purchased and a one-month (28 days to expiration) 100 Call is sold. This strategy is established for a net debit, and both the profit potential and risk are limited. The maximum profit is realized if the stock price is equal to the strike price of the short call on the expiration date of the short call, and the maximum risk is realized if the stock price falls below the strike price of the long call.

Example of LONG DIAGONAL SPREAD WITH CALLS
Sell to Open 1 28-day XYZ 100 Call at 3.35
Buy to Open 1 56-day XYZ 95 Call at (7.60)
Net Debit = (4.25)

A long diagonal spread with calls realizes its maximum profit if the stock price equals the strike price of the short call on the expiration date of the short call. The forecast, therefore, can either be “neutral” or “modestly bullish,” depending on the relationship of the stock price to the strike price of the short call when the position is established.

If the stock price is at or near the strike price of the short call when the position is established, then the forecast must be for unchanged, or neutral, price action.

If the stock price is below the strike price of the short call when the position is established, then the forecast must be for the stock price to rise to the strike price at expiration (modestly bullish).

While one can imagine a scenario in which the stock price is above the strike price of the short call and a diagonal spread with calls would profit from bearish stock price action, it is most likely that another strategy would be a more profitable choice for a bearish forecast.

Maximum potential profit
The maximum profit is realized if the stock price is equal to the strike price of the short call on the expiration date of the short call. With the stock price at the strike price of the short call at expiration of the short call, the profit equals the price of the long call minus the net cost of the spread including commissions. This is the point of maximum profit because the long call has its maximum difference in price with the expiring short call. It is impossible to know for sure what the maximum profit potential is, because it depends of the price of long call, and that price is subject to the level of volatility, which can change.

At expiration of the shorter-term call the position can be closed by selling to close the longer-term call. If the outlook is now bullish for the underlying at this time the longer-term call can remain open and handled as a Long Call strategy. If the outlook is still neutral to modestly bullish another call can be sold creating a Long Diagonal Spread, Vertical Spread, or Calendar Spread depending on the chosen strike price and expiration.
LONG DIAGONAL SPREAD WITH CALLS (Continued)

Maximum potential risk

The maximum risk of a long diagonal spread with calls is equal to the net cost of the spread including commissions. If the stock price falls sharply below the strike price of the long call, then the value of the spread approaches zero; and the full amount paid for the spread is lost.

Assignment

While the long call in a long diagonal spread with calls has no risk of early assignment, the short call does have such risk. Early assignment of stock options is generally related to dividends, and short calls that are assigned early are generally assigned on the day before the ex-dividend date. In-the-money calls whose time value is less than the dividend have a high likelihood of being assigned.

If the short call is assigned, then 100 shares of stock are sold short and the long call remains open. If a short stock position is not wanted, it can be closed in one of two ways. First, 100 shares can be purchased in the market place. Second, the short 100-share position can be closed by exercising the long call. Remember, however, that exercising a long call will forfeit the time value of that call. Therefore, it is generally preferable to buy shares to close the short stock position and then sell to close the long call. This two-part action recovers the time value of the long call. One caveat is commissions. Buying shares to cover the short stock position and then selling the long call is only advantageous if the commissions are less than the time value of the long call.

Note, however, that whichever method is used (buying stock or exercising the long call), the date of the stock purchase will be one day later than the date of the short sale. This difference will result in additional fees, including interest charges and commissions. Assignment of a short call might also trigger a margin call if there is not sufficient account equity to support the short stock position.

Break-even stock price at expiration

There is one break-even point, which is below the strike price of the short call. Conceptually, the break-even point at expiration of the short call is the stock price at which the price of the long call equals the net cost of the spread. It is impossible to know for sure what the break-even stock price will be, however, because it depends on the price of the long call, which depends on the level of volatility.
LONG DIAGONAL SPREAD WITH PUTS

Market outlook
Neutral or modestly bearish

Goal
• To profit from neutral stock price action near the strike price of the short put with limited risk on the upside and limited profit potential on the downside.
• To profit from a bearish stock price move to the strike price of the short put with lower risk than a simple long put, but also with limited profit potential if the stock price falls beyond the strike price of the short put.

Explanation
A long diagonal spread with puts is created by buying one “longer-term” put with a higher strike price and selling one “shorter-term” put with a lower strike price. In the example, a two-month (56 days to expiration) 105 Put is purchased and a one-month (28 days to expiration) 100 Put is sold. This strategy is established for a net debit, and both the profit potential and risk are limited. The maximum profit is realized if the stock price is equal to the strike price of the short put on the expiration date of the short put, and the maximum risk is realized if the stock price rises above the strike price of the long put.

Example of LONG DIAGONAL SPREAD WITH PUTS
Sell to Open 1 28-day XYZ 100 Put at 3.25
Buy to Open 1 56-day XYZ 105 Put at (7.60)
Net Cost = (4.35)

A long diagonal spread with puts realizes its maximum profit if the stock price equals the strike price of the short put on the expiration date of the short put. The forecast, therefore, can either be “neutral” or “modestly bearish,” depending on the relationship of the stock price to the strike price of the short put when the position is established.

If the stock price is at or near the strike price of the short put when the position is established, then the forecast must be for unchanged, or neutral, price action.

If the stock price is above the strike price of the short put when the position is established, then the forecast must be for the stock price to fall to the strike price at expiration (modestly bearish).

While one can imagine a scenario in which the stock price is below the strike price of the short put and a diagonal spread with puts would profit from bullish stock price action, it is most likely that another strategy would be a more profitable choice for a bullish forecast.

Maximum potential profit
The maximum profit is realized if the stock price is equal to the strike price of the short put on the expiration date of the short put. With the stock price at the strike price of the short put at expiration of the short put, the profit equals the price of the long put minus the net cost of the spread including commissions. This is the point of maximum profit because the long put has its maximum difference in price with the expiring short put. It is impossible to know for sure what the maximum profit potential is, because it depends of the price of long put, and that price is subject to the level of volatility, which can change.

At expiration of the shorter-term put the position can be closed by selling to close the longer-term put. If the outlook is now bearish for the underlying at this time the longer-term put can remain open and handled as a Long Put strategy. If the outlook is still neutral to modestly bearish another put can be sold creating a Long Diagonal Spread, Vertical Spread, or Calendar Spread depending on the chosen strike price and expiration.
LONG DIAGONAL SPREAD WITH PUTS (Continued)

Maximum potential risk
The maximum risk of a long diagonal spread with puts is equal to the net cost of the spread including commissions. If the stock price rises sharply above the strike price of the long put, then the value of the spread approaches zero, and the full amount paid for the spread is lost.

Assignment
While the long put in a long diagonal spread with puts has no risk of early assignment, the short put does have such risk. Early assignment of stock options is generally related to dividends, and short puts that are assigned early are generally assigned on the ex-dividend date. In-the-money puts with little or no time value remaining in the options’ premium have a higher likelihood of being assigned.

If the short put is assigned, then 100 shares of stock are purchased and the long put remains open. If a long stock position is not wanted, it can be closed in one of two ways. First, 100 shares can be sold in the marketplace. Second, the long 100-share position can be closed by exercising the long put. Remember, however, that exercising a long put will forfeit the time value of that put. Therefore, it is generally preferable to sell shares to close the long stock position and then sell to close the long put. This two-part action recovers the time value of the long put. One caveat is commissions. Selling shares to close the long stock position and then selling the long put is only advantageous if the commissions are less than the time value of the long put.

Note, however, that whichever method is used, selling stock or exercising the long put, the date of the stock sale will be one day later than the date of the purchase. This difference will result in additional fees, including interest charges and commissions. Assignment of a short put might also trigger a margin call if there is not sufficient account equity to support the long stock position.

Break-even stock price at expiration
There is one break-even point, which is above the strike price of the short put. Conceptually, the break-even point at expiration of the short put is the stock price at which the price of the long put equals the net cost of the spread. It is impossible to know for sure what the break-even stock price will be, however, because it depends of the price of the long put which depends on the level of volatility.
SHORT IRON CONDOR SPREAD
(long put + short put + short call + long call)

Market outlook
Neutral, modestly bullish, or modestly bearish

Goal
To profit from neutral stock price action between the strike price of the short options with limited risk.

Explanation
A short iron condor spread is a four-part strategy consisting of a bull put spread and a bear call spread in which the strike price of the short put is lower than the strike price of the short call. All options have the same expiration date.

In the example, one 95 Put is purchased, one 100 Put is sold, one 105 Call is sold and one 110 Call is purchased, so the four strike prices are equidistant. However, it is normal for the distance between the short call and short put to be greater than the distance between the long and short options of the same type. For example, an 85–90 Bull Put Spread might be combined with a 105–110 Bear Call Spread to create a short iron condor in which the distance between the strike prices of the short options is 15 points while the distance between the strike prices of the bull and bear spreads are 5 points.

(continued on next page)

Example of SHORT IRON CONDOR SPREAD (long put + short put + short call + long call)
Buy to Open 1 XYZ 95 Put at (0.70)
Sell to Open 1 XYZ 100 Put at 2.10
Sell to Open 1 XYZ 105 Call at 2.35
Buy to Open 1 XYZ 110 Call at (0.95)
Net Credit = 2.80

A short iron condor spread realizes its maximum profit if the stock price is equal to or between the strike prices of the short options on the expiration date. The forecast, therefore, can either be “neutral,” “modestly bullish” or “modestly bearish,” depending on the relationship of the stock price to range of maximum profit when the position is established.

If the stock price is in the range of maximum profit when the position is established, then the forecast must be for unchanged, or neutral, price action.

If the stock price is below the range of maximum profit when the position is established, then the forecast must be for the stock price to rise into the range of maximum profit at expiration (modestly bullish).

If the stock price is above the range of maximum profit when the position is established, then the forecast must be for the stock price to fall into the range of maximum profit at expiration (modestly bearish).
A short iron condor spread is established for a net credit, and both the potential profit and maximum risk are limited. The maximum profit is realized if the stock price is equal to or between the strike prices of the short options on the expiration date. The maximum risk is the difference between the prices of the bull put spread (or the bear call spread) less the net credit received. The maximum risk is realized if the stock price is above the highest strike price or below the lowest strike price at expiration.

This is an advanced strategy because the profit potential is small in dollar terms and because “costs” are high. Given that there are four options and four strike prices, there are multiple commissions in addition to four bid-ask spreads when opening the position and again when closing it. As a result, it is essential to open and close the position at “good prices.” It is also important to consider the per-contract commission rate since commissions will impact the return on investment.

**Maximum potential profit**

The maximum profit potential is equal to the net credit received less commissions, and this profit is realized if the stock price is equal to or between the strike prices of the short options at expiration. In this outcome, all options expire worthless and the net credit is kept as income.

**Maximum potential risk**

The maximum risk is equal to the difference between the strike prices of the bull put spread (or the bear call spread) less the net credit received. In the example above, the difference between the strike prices of the bull put spread (and also the bear call spread) is 5.00, and the net credit received is 2.80, not including commissions. The maximum risk, therefore, is 2.20 less commissions.

There are two possible outcomes in which the maximum loss is realized. If the stock price is below the lowest strike price at expiration, then the calls expire worthless, but both puts are in the money. With both puts in the money, the bull put spread reaches its maximum value and maximum loss. Also, if the stock price is above the highest strike price at expiration, then the puts expire worthless, but both calls are in the money. Consequently, the bear call spread reaches its maximum value and maximum loss.

**Assignment**

Stock options in the United States can be exercised on any business day, and holders of short stock option positions have no control over when they will be required to fulfill the obligation. Therefore, the risk of early assignment is a real risk that must be considered when entering into positions involving short options.

**Break-even stock price at expiration**

There are two break-even points. The lower break-even point is the stock price equal to the strike price of the short put minus the net credit received. The upper break-even point is the stock price equal to the strike price of the short call plus the net credit received.
The bear call spread is a strategy that collects option premium and limits risk at the same time. It profits from both time decay and falling stock prices. A bear call spread is the strategy of choice when the forecast is for neutral to falling prices and there is a desire to limit risk.

**Maximum potential profit**
Potential profit is limited to the net premium received less commissions, and this profit is realized if the stock price is at or below the strike price of the short call (lower strike) at expiration and both calls expire worthless.

**Maximum potential risk**
The maximum risk is equal to the difference between the strike prices minus the net credit received including commissions. In the example above, the difference between the strike prices is 5.00 (105.00 – 100.00 = 5.00), and the net credit is 1.80 (3.30 – 1.50 = 1.80). The maximum risk, therefore, is 3.20 (5.00 – 1.80 = 3.20) per share less commissions. This maximum risk is realized if the stock price is at or above the strike price of the long call (higher strike) at expiration.

**Assignment**
Short calls are generally assigned at expiration when the stock price is above the strike price. However, there is a possibility of early assignment.

**Break-even stock price at expiration**
Strike price of short call (lower strike) plus net premium received. In this example: 100.00 + 1.80 = 101.80
BEAR PUT SPREAD
(long put + short put)

Market outlook
Bearish

Goal
To profit from a gradual price decline in the underlying stock.

Explanation
A bear put spread consists of one long put with a higher strike price and one short put with a lower strike price. Both puts have the same underlying stock and the same expiration date. A bear put spread is established for a net debit (or net cost) and profits as the underlying stock declines sufficiently in price. Profit is limited if the stock price falls below the strike price of the short put (lower strike), and potential loss is limited if the stock price rises above the strike price of the long put (higher strike).

Example of BEAR PUT SPREAD
(long put + short put)

Buy to Open 1 XYZ 100 Put at (3.20)
Sell to Open 1 XYZ 95 Put at 1.30
Net Cost = (1.90)

Bear put spreads have limited profit potential, but they cost less than buying only the higher strike put. Since most stock price changes are “small,” bear put spreads, in theory, have a greater chance of making a larger percentage profit than buying only the higher strike put. In practice, however, choosing a bear put spread instead of buying only the higher strike put is a subjective decision. Bear put spreads benefit from two factors, a falling stock price and time decay of the short option. A bear put spread is the strategy of choice when the forecast is for a gradual price decline to the strike price of the short put.

Maximum potential profit
Potential profit is limited to the difference between the strike prices minus the net cost of the spread including commissions. In the example above, the difference between the strike prices is 5.00 (100.00 – 95.00 = 5.00), and the net cost of the spread is 1.90 (3.20 – 1.30 = 1.90). The maximum profit, therefore, is 3.10 (5.00 – 1.90 = 3.10) per share less commissions. This maximum profit is realized if the stock price is at or below the strike price of the short put (lower strike) at expiration.

Maximum potential risk
The maximum risk is equal to the cost of the spread including commissions. A loss of this amount is realized if the position is held to expiration and both puts expire worthless because the stock price at expiration is above the strike price of the long put (higher strike).
Assignment
Short puts are generally assigned at expiration when the stock price is below the strike price. However, there is a possibility of early assignment.

Break-even stock price at expiration
Higher strike price less net debit.
In this example: 100 – 1.90 = 98.10
LONG CALL

Market outlook
Bullish

Goal
To buy stock on or before the expiration date with limited downside risk, or participate in an upside market move.

Explanation
In return for paying a premium, the buyer of a call gets the right (not the obligation) to buy the underlying stock at the strike price at any time until the expiration date. Stock options in the U.S. typically represent 100 shares. Therefore, in the example provided, the investor pays $4.00 per share ($400 plus commissions) for the right to buy 100 shares of XYZ stock at $100 per share until the expiration date (usually the third Friday of the month). In the event that a long call ends up expiring in the money, the holder will need to have cash in the account to cover the purchase of 100 shares of XYZ at the strike price.

Example of LONG CALL
Buy to Open 1 XYZ 100 Call at 4.00 per share
($400 plus commissions)

Buying a call to limit the risk of buying stock requires a two-part forecast. First, the forecast must be bullish, which is the reason for wanting to buy the stock. Second, there must also be a reason for the desire to limit risk. Perhaps there is a pending earnings report that could send the stock price sharply in either direction. In this case, buying a call gives the investor control over 100 shares at the current price if the report is positive, and it limits the risk of a negative report. Alternatively, an investor could believe that a downward trending stock is about to reverse upward. In this case, buying a call limits the risk of the judgment about the change in trend being wrong.

Potential Goals
Buying a call allows the holder to limit the short-term risk of buying stock and has two advantages and one disadvantage. The first advantage is that risk is limited during the life of the call. Second, buying a call to limit risk is different than using a stop-loss order on the stock. Whereas a stop-loss order is price sensitive and can be triggered by a sharp fluctuation in the stock price, a long call is limited by time, not stock price. The disadvantage of buying a call is that the total cost of the stock is increased by the premium paid.

If the stock price is above the strike price of the call at expiration and if the investor still wants to buy the stock, then the call is exercised and stock is purchased at the strike price and paid for with the cash held in the money market account.

If the stock price is below the strike price at expiration, then the call expires and the premium paid plus commissions are lost. The investor must then decide whether to buy the stock at the current price or to invest the cash elsewhere.
Maximum potential profit
The potential profit is unlimited, because the price of the underlying stock can rise infinitely. If the stock moves higher ahead of expiration, boosting the value of the long call, the call can be sold for a profit.

Maximum potential risk
Limited to the premium paid plus commissions, and a loss of this amount is realized if the call is held until expiration and expires worthless.

Break-even stock price at expiration
Strike price plus premium paid
In this example: 100.00 + 4.00 = 104.00
COLLAR
(long stock + long put + short call)

Market outlook
Bullish, but concerned

Goal
• To limit risk at a “low cost” and to have some upside profit potential at the same time when first acquiring shares of stock.
• To protect a previously-purchased stock for a “low cost” and to leave some upside profit potential when the short-term forecast is bearish but the long-term forecast is bullish.

Explanation
A collar position is created by buying (or owning) stock and by simultaneously buying protective puts and selling covered calls on a share-for-share basis. Usually, the call and put are out of the money. In the example, 100 shares are purchased (or owned), one out-of-the-money put is purchased and one out-of-the-money call is sold. If the stock price declines, the purchased put provides protection below the strike price until the expiration date. If the stock price rises, profit potential is limited to the strike price of the covered call less commissions.

The appropriate forecast for a collar depends on the timing of the stock purchase relative to the opening of the options positions and on the investor’s willingness to sell the stock.

If a collar position is created when first acquiring shares, then a two-part forecast is required. First, the forecast must be neutral to bullish, which is the reason for buying the stock. Second, there must also be a reason for the desire to limit risk. Perhaps there is a concern that the overall market might begin a decline and cause this stock to fall in tandem. In this case, the collar – for a “low” net cost – gives the investor both limited risk and some limited upside profit.

Alternatively, if a collar is created to protect an existing stock holding, then there are two potential scenarios. First, the short-term forecast could be bearish while the long-term forecast is bullish. In this case, for a “low” net cost, the investor is limiting downside risk if the anticipated price decline occurs. Second, the investor could be near the “target selling price” for the stock. In this case, the collar would leave intact the possibility of a price rise to the target selling price and, at the same time, limit downside risk if the market were to reverse unexpectedly.

Maximum potential profit
Potential profit is limited because of the covered call. In the example above, profit potential is limited to 5.20, which is calculated as follows: the strike price of the call plus 20 cents minus the stock price and commissions. 20 cents is the net credit received for selling the call at 1.80 and buying the put at 1.60.
If selling the call and buying the put were transacted for a net debit (or net cost), then the maximum profit would be the strike price of the call minus the stock price and the net debit and commissions.

The maximum profit is achieved at expiration if the stock price is at or above the strike price of the covered call. Short calls are generally assigned at expiration when the stock price is above the strike price. However, there is a possibility of early assignment.

**Maximum potential risk**

Potential risk is limited because of the protective put. In the example above, risk is limited to 4.80, which is calculated as follows: the stock price minus 20 cents minus the strike price of the put and commissions. 20 cents is the net credit received for selling the call at 1.80 and buying the put at 1.60.

If selling the call and buying the put were transacted for a net debit (or net cost), then the maximum loss would be the stock price minus the strike price of the put, plus the net debit and commissions.

The maximum risk is realized if the stock price is at or below the strike price of the put at expiration. If such a stock price decline occurs, then the put can be exercised or sold.

**Assignment**

Possibility of early assignment.

**Break-even stock price at expiration**

Stock price plus put premium minus call premium.

In this example: $100.00 + 1.60 – 1.80 = 99.80
BULL CALL SPREAD
(long call + short call)

Market outlook
Bullish

Goal
To profit from a price rise in the underlying stock

Explanation
A bull call spread consists of one long call with a lower strike price and one short call with a higher strike price. Both calls have the same underlying stock and the same expiration date. A bull call spread is established for a net debit (or net cost) and profits as the underlying stock rises sufficiently in price. Profit is limited if the stock price rises above the strike price of the short call, and potential loss is limited if the stock price falls below the strike price of the long call (lower strike).

Example of BULL CALL SPREAD (long call + short call)

Buy to Open 1 XYZ 100 Call at (3.30)
Sell to Open 1 XYZ 105 Call at 1.50
Net Cost = (1.80)

Bull call spreads have limited profit potential, but they cost less than buying only the lower strike call. Since most stock price changes are "small," bull call spreads, in theory, have a greater chance of making a larger percentage profit than buying only the lower strike call. In practice, however, choosing a bull call spread instead of buying only the lower strike call is a subjective decision. Bull call spreads benefit from two factors, a rising stock price and time decay of the short option. A bull call spread is the strategy of choice when the forecast is for a gradual price rise to the strike price of the short call.

Maximum potential profit
Potential profit is limited to the difference between the strike prices minus the net cost of the spread including commissions. In the example above, the difference between the strike prices is 5.00 (105.00 – 100.00 = 5.00), and the net cost of the spread is 1.80 (3.30 – 1.50 = 1.80). The maximum profit, therefore, is 3.20 (5.00 – 1.80 = 3.20) per share less commissions. This maximum profit is realized if the stock price is at or above the strike price of the short call at expiration.
**Maximum potential risk**

The maximum risk is equal to the cost of the spread including commissions. A loss of this amount is realized if the position is held to expiration and both calls expire worthless. Both calls will expire worthless if the stock price at expiration is below the strike price of the long call (lower strike).

**Assignment**

Short calls are generally assigned at expiration when the stock price is above the strike price. However, there is a possibility of early assignment.

**Break-even stock price at expiration**

Strike price of long call (lower strike) plus net premium paid

In this example: 100.00 + 1.80 = 101.80
BULL PUT SPREAD  
(long put + short put)

Market outlook
Bullish (neutral if the higher strike is out of the money)

Goal
To profit from neutral to bullish price action in the underlying stock.

Explanation
A bull put spread consists of one short put with a higher strike price, and one long put with a lower strike price on the same underlying stock and with the same expiration date. A bull put spread is established for a net credit (or net amount received) and profits from a rising stock price, time erosion, or both. Potential profit is limited to the net premium received less commissions and potential loss is limited if the stock price falls below the strike price of the long put.

Example of BULL PUT SPREAD  
(long put + short put)

Sell to Open 1 XYZ 100 Put at 3.20  
Buy to Open 1 XYZ 95 Put at (1.30)  
Net Credit = 1.90

The bull put spreads is a strategy that collects option premium and limits risk at the same time. They profit from both time decay and rising stock prices. A bull put spread is the strategy of choice when the forecast is for neutral to rising prices and there is a desire to limit risk.

Maximum potential profit
Potential profit is limited to the net premium received less commissions, and this profit is realized if the stock price is at or above the strike price of the short put (higher strike) at expiration and both puts expire worthless.

Maximum potential risk
The maximum risk is equal to the difference between the strike prices minus the net credit received including commissions. In the example above, the difference between the strike prices is 5.00 (100.00 − 95.00 = 5.00), and the net credit is 1.90 (3.20 − 1.30 = 1.90). The maximum risk, therefore, is 3.10 (5.00 − 1.90 = 3.10) per share less commissions. This maximum risk is realized if the stock price is at or below the strike price of the long put (lower strike) at expiration.

Assignment
Short puts are generally assigned at expiration when the stock price is below the strike price. However, there is a possibility of early assignment.

Break-even stock price at expiration
Strike price of short put (higher strike) minus net premium received. In this example: 100.00 − 1.90 = 98.10
PROTECTIVE PUT
(long put + long stock)

Market outlook
Bullish but concerned

Explanation
A protective put position is created by buying (or owning) stock and buying put options on a share-for-share basis. In the example, 100 shares are purchased (or owned) and one put is purchased. If the stock price declines, the purchased put provides protection below the strike price. The protection, however, lasts only until the expiration date. If the stock price rises, the investor participates fully, less the cost of the put.

Example of PROTECTIVE PUT (long put + long stock)
Buy 100 shares XYZ stock at 100.00
Buy to Open 1 XYZ 100 Put at 3.25
Net Debit is 103.25

The protective put strategy requires a two-part forecast. First, the forecast must be bullish, which is the reason for buying (or holding) the stock. Second, there must also be a reason for the desire to limit risk. Perhaps there is a pending earnings report that could send the stock price sharply in either direction. In this case, buying a put to protect a stock position allows the investor to benefit if the report is positive, and it limits the risk of a negative report. Alternatively, an investor could believe that a downward trending stock is about to reverse upward. In this case, buying a put when acquiring shares limits risk if the predicted change in trend does not occur.

Potential Goals
The protective put limits risk when first acquiring shares of stock. This is also known as a “married put.” It is also used to protect a previously purchased stock when the short-term forecast is bearish but the long-term forecast is bullish.

Buying a put to limit the risk of stock ownership has two advantages and one disadvantage. The first advantage is that risk is limited during the life of the put. Second, buying a put to limit risk is different than using a stop-loss order on the stock. Whereas a stop-loss order is price sensitive and can be triggered by a sharp fluctuation in the stock price, a long put is limited by time, not stock price. The disadvantage of buying a put is that the total cost of the stock is increased by the cost of the put.
If the stock price is below the strike price at expiration, then a decision has to be made whether to (a) sell the put to close and keep the stock position unprotected, (b) sell the put to close and buy another put to open, thus extending the protection, or (c) exercise the put and sell the stock and invest the funds elsewhere. There is no "right" or "wrong" choice; every investor must make a personal decision based on the forecast and the desire to hold the stock.

**Maximum potential profit**
Potential profit is unlimited, because the underlying stock price can rise indefinitely. However, the profit is reduced by the cost of the put plus commissions.

**Maximum potential risk**
Risk is limited to an amount equal to stock price minus strike price plus put price plus commissions. In the example above, the put price is 3.25 per share, and stock price minus strike price equals 0.00 per share (100.00 – 100.00). The maximum risk, therefore, is 3.25 per share plus commissions. This maximum risk is realized if the stock price is at or below the strike price of the put at expiration. If such a stock price decline occurs, then the put can be exercised or sold.

**Break-even stock price at expiration**
Stock price plus put price
In this example: 100.00 + 3.25 = 103.25
This guide covers some of the many options strategies available to you. Learn more about options trading and the tools, articles, courses, videos, and webinars available to you at Fidelity.com/options.

When you have questions, talk with experienced options trading specialists at 800.353.4881.

Options trading entails significant risk and is not appropriate for all investors. Certain complex options strategies carry additional risk. Before trading options, please read Characteristics and Risks of Standardized Options. Supporting documentation for any claims, if applicable, will be furnished upon request.

There are additional costs associated with option strategies that call for multiple purchases and sales of options, such as spreads, straddles, and collars, as compared with a single option trade.