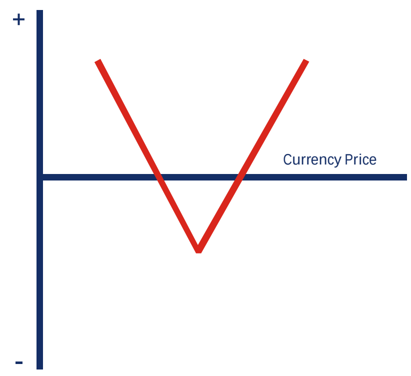
MCX SX
India's New Stock Exchange

OPTION SNIPPETS

CURRENCY UPDATE

APRIL JUNE 2010

Straddle



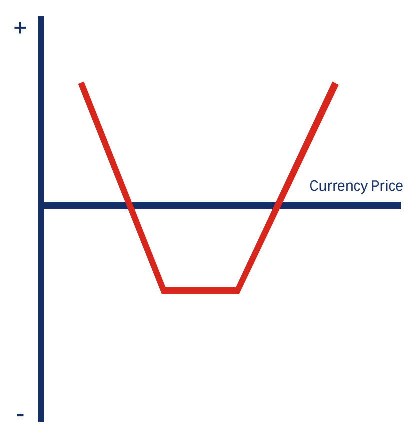
High volatility is preferable	Volatility
Direction Neutral	Outlook
Buy At the money puts and At the money calls with the same strike price and expiration date	Transaction legs
Unlimited	Maximum gain
Net debit transaction	Transaction
Even without knowing the direction one can participate in the market if the underlying is about to make an explosive move either side.	Advantage
Movement of the underlying should be large enough to cover the cost of the trade.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 46.0000 strike call for Rs.1.50. Buy the June 2010 46.0000 strike put for Rs.2.00.

Net Debit	Premiums Bought	2.00 + 1.50 = 3.50
Maximum Risk	Net Debit	3.50
Maximum Reward	Unlimited	
Breakeven Down	Strike - Net Debit	46.00 - 3.50 = 42.50
Breakeven Up	Strike + Net Debit	46.00 + 3.50 = 49.50

Strangle



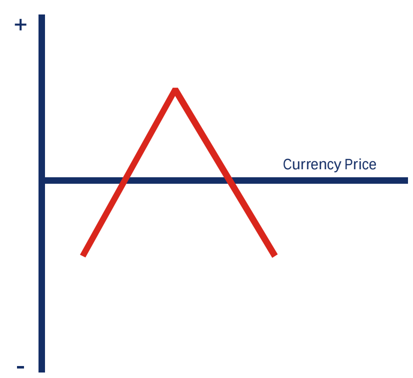
High volatility is preferable	Volatility
Direction Neutral	Outlook
Buy lower strike OTM puts and higher strike OTM calls with the same expiration date	Transaction legs
Unlimited	Maximum gain
Net debit transaction	Transaction
Even without knowing the direction one can participate in the market if the underlying is about to make an explosive move either side.	Advantage
Low volatility required for entry whereas high volatility required once you are in.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 45.0000 strike put for Rs. 1.50. Buy the June 2010 47.0000 strike call for Rs. 2.00.

Net Debit	Premiums Bought	2.00 + 1.50 = 3.50
Maximum Risk	Net Debit	3.50
Maximum Reward	Unlimited	
Breakeven Down	Lower Strike - Net Debit	45.00 - 3.50 = 41.50
Breakeven Up	Higher Strike + Net Debit	47.00 + 3.50 = 50.50

Short Straddle



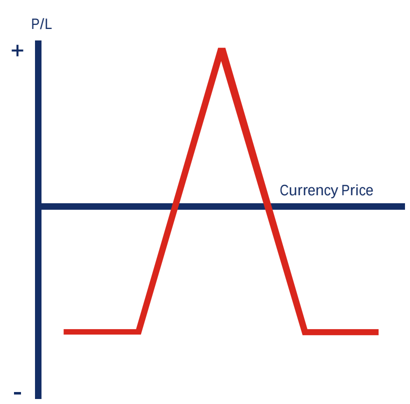
Low volatility is preferable	Volatility
Direction Neutral	Outlook
Short ATM Call and ATM Put with the same expiry.	Transaction legs
Uncapped maximum risk and capped maximum reward.	Maximum gain
Net Credit transaction	Transaction
Profitable strategy if Currency shows low volatility and does not move.	Advantage
Any surprise concerning the Currency could lead to a serious problem with uncapped risk on either side.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Sell the June 2010 46.0000 strike call for Rs. 1.50. Sell the June 2010 46.0000 strike put for Rs. 2.00.

Net Credit	Premiums Sold	2.00 + 1.50 = 3.50
Maximum Risk	Uncapped	
Maximum Reward	Net Credit	3.50
Breakeven Down	Strike Price - Net Credit	46.00 - 3.50 = 42.50
Breakeven Up	Strike Price + Net Credit	46.00 + 3.50 = 49.50

Long Call Butterfly



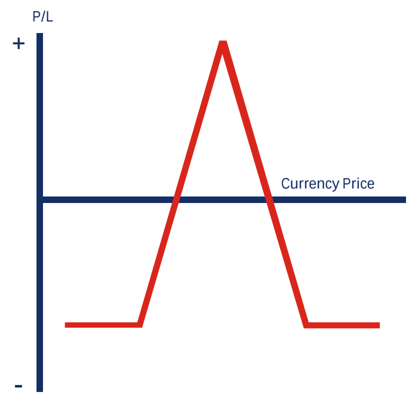
Low volatility is preferable	Volatility
Direction Neutral	Outlook
Buy one lower strike ITM call, Sell two middle strike ATM call, Buy one higher strike OTM call. All strikes evenly apart.	Transaction legs
Maximum profits occur if the Currency is at the middle strike price at expiration.	Maximum gain
Net Debit transaction	Transaction
Profit from a range bound Currency for very little cost	Advantage
The higher profit potential comes with a narrow range between the wing strikes.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 44.0000 strike call for Rs. 5.00. Sell 2 June 2010 46.0000 strike call for Rs. 3.00. Buy the June 2010 48.0000 strike call for Rs. 2.00.

Net Debit	Premiums Bought - Premiums Sold	7.00 - 6.00 = 1.00
Maximum Risk	Net Debit	1.00
Maximum Reward	Difference in adjacent strikes - Net Debit	2 .00 - 1.00 = 1.00
Breakeven Down	Lower Strike + Net Debit	44.00 + 1.00 = 45.00
Breakeven Up	Higher Strike - Net Debit	48.00 - 1.00 = 47.00

Long Iron Butterfly



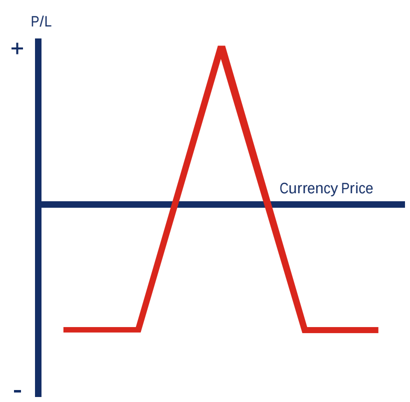
Low volatility is preferable	Volatility
Direction Neutral	Outlook
Buy one lower strike (OTM) put, Sell one middle strike (ATM) put, Sell one middle strike (ATM) call, Buy one higher strike (OTM) call.	Transaction legs
The Currency will remain between the lower and higher strikes, with the maximum profit occurring if the options expire when the Currency is priced at the central strike price.	Maximum gain
Net Credit transaction	Transaction
Cheap strategy that brings in a net credit to your account; capped risk; profitable if Currency doesn't move much.	Advantage
Capped reward; margin required. The higher profit potential only comes nearer expiration.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 44.0000 strike put for Rs.2.00. Sell the June 2010 46.0000 strike put for Rs.3.00. Sell the June 2010 46.0000 strike call for Rs. 2.75. Buy the June 2010 48.0000 strike call for Rs. 2.00

Net Credit	Premiums Sold - Premiums Bought	5.75 - 4.00 = 1.75
Maximum Reward	Net Credit	1.75
Maximum Risk	Difference in adjacent strikes - Net Credit	2 .00 - 1.75 = 0.25
Breakeven Down	Middle strike - Net Credit	46.00 - 1.75 = 44.25
Breakeven Up	Middle strike + Net Credit	46.00 + 1.75 = 47.75

Long Put Butterfly



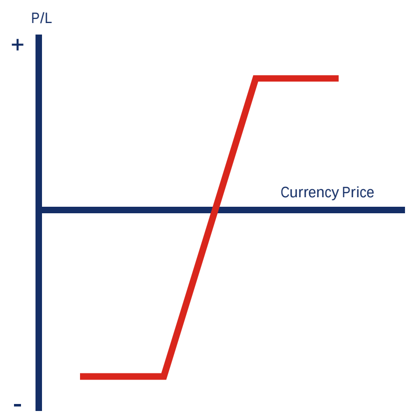
Low volatility is preferable	Volatility
Direction Neutral	Outlook
Buy one lower strike OTM put, Sell two middle strike ATM put, Buy one higher strike ITM put.	Transaction legs
Maximum profits occur if the Currency is at the middle strike price at expiration	Maximum gain
Net Debit transaction	Transaction
Capped risk and a cheap strategy to enter; can be very profitable if Currency shows low volatility after you are in.	Advantage
Capped reward	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 42.0000 strike put for Rs.1.00. Sell 2 June 2010 46.0000 strike put for Rs.3.00. Buy the June 2010 50.0000 strike put for Rs.6.00

Net Debit	Premiums Bought - Premiums Sold	7.00 - 6.00 = 1.00
Maximum Risk	Net Debit	1.00
Maximum Reward	Difference in adjacent strikes - Net Debit	4.00 - 1.00 = 3.00
Breakeven Down	Lower Strike + Net Debit	42.00 + 1.00 = 43.00
Breakeven Up	Higher Strike - Net Debit	50.00 - 1.00 = 49.00

Bull Call Spread



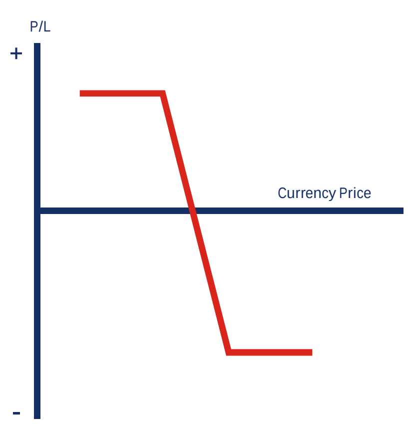
Not Applicable	Volatility
Bullish	Outlook
Buy lower strike calls either ATM or OTM, Sell the same number of higher strike calls with the same expiration date.	Transaction legs
Maximum gain is capped when the underlying rises to the level of the higher call strike price which is sold.	Maximum gain
Net Debit transaction	Transaction
Capped risk; lower breakeven point than simply buying a call.	Advantage
Farther away from expiration, the slower the maximum returns; AND higher yields arise if significantly higher strikes are selected and the underlying Currency price rises up to the higher of those two strikes.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 47.0000 strike call for Rs.5.00. Sell the June 2010 50.0000 strike call for Rs.3.25.

Net Debit	Premiums Bought - Premiums Sold	5.00 - 3.25 = 1.75
Maximum Risk	Net Debit	1.75
Maximum Reward	Difference in strikes - net debit	3.00 - 1.75 = 1.25
Breakeven	Lower Strike + Net Debit	47.00 + 1.75 = 48.75

Bear Put Spread



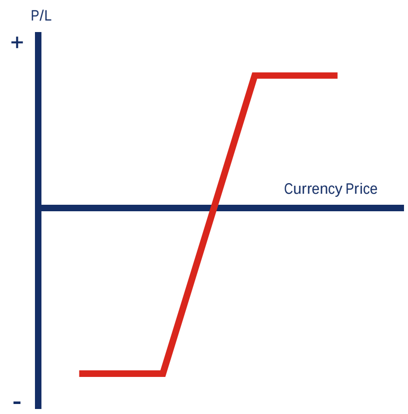
Not Applicable	Volatility
Bearish	Outlook
Sell lower strike puts; buy the same number of higher strike puts whether ATM or OTM with the same expiration date.	Transaction legs
Maximum gain is capped when the underlying falls to the level of the lower put strike price which is sold.	Maximum gain
Net Debit transaction	Transaction
Farther away from expiration, the more downside protection in the event of the Currency declining rapidly. Capped risk.	Advantage
Farther away from expiration, the slower the maximum returns; AND the higher yields arise if significantly lower strikes are selected and the underlying Currency price declines down to the lower of those two strikes. Capped reward.	Disadvantage

Example

ABCD is trading at Rs. 46.0000 on June 01, 2010. Sell the June 2010 40.0000 strike put for Rs. 3.00 Buy the June 2010 45.0000 strike put for Rs. 5.00

Net Debit	Premiums Bought - Premiums Sold	5.00 - 3.00 = 2.00
Maximum Risk	Net Debit	2.00
Maximum Reward	Difference in Strikes - Net Debit	5.00 - 2.00 = 3.00
Breakeven	Higher Strike - Net Debit	45.00 - 2.00 = 43.00

Bull Put Spread

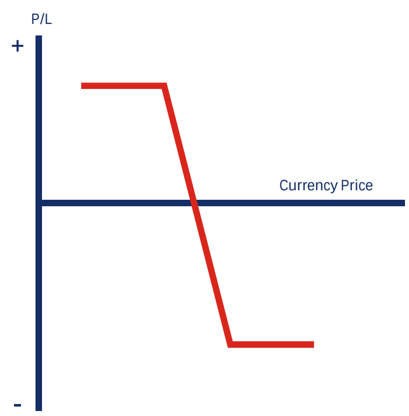


Not Applicable	Volatility
Outlook is Bullish or neutral to bullish	Outlook
Buy OTM lower strike puts, Sell the same no of higher strike OTM puts with the same expiration date.	Transaction legs
Net credit received	Maximum gain
Net credit transaction	Transaction
Short term income strategy not necessarily requiring any movement of the Currency.	Advantage
Maximum loss is typically greater than the maximum gain, despite the capped downside	Disadvantage

Example
ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 42.0000 strike put for Rs.3.50. Sell the June 2010 45.0000 strike put for Rs.5.00.

Net Credit	Premiums Sold - Premiums Bought	5.00 - 3.50 = 1.50
Maximum Risk	Difference in strikes - Net Credit	3.00 - 1.50 = 1.50
Maximum Reward	Net Credit	1.50
Breakeven	Higher Strike - Net Credit	45.00 - 1.50 = 43.50

Bear Call Spread

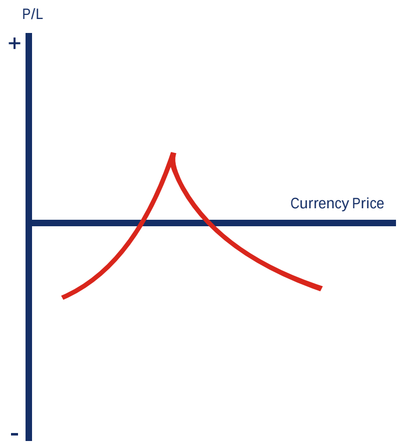


Not Applicable	Volatility
Outlook is Bearish or neutral to bearish	Outlook
Sell lower strike calls, Buy the same no of higher strike calls with the same expiration date.	Transaction legs
Net credit received	Maximum gain
Net credit transaction	Transaction
Short term income strategy not necessarily requiring any movement of the Currency.	Advantage
Maximum loss is typically greater than the maximum gain, despite the capped downside.	Disadvantage

Example
ABCD is trading at Rs.46.0000 on June 01, 2010. Sell the June 2010 48.0000 strike call for Rs.5.00. Buy the June 2010 52.0000 strike call for Rs.2.50.

Net Credit	Premiums Sold - Premiums Bought	5.00 - 2.50 = 2.50
Maximum Risk	Difference in strikes - Net Credit	4.00 - 2.50 = 1.50
Maximum Reward	Net Credit	2.50
Breakeven	Lower Strike + Net Credit	48.00 + 2.50 = 50.50

Calendar Call



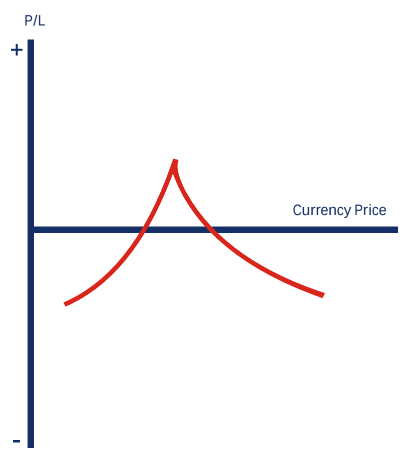
Volatility is not applicable	Volatility
Outlook is bullish or rangebound	Outlook
Buy a long term expiration call with a near the money strike price, Sell a short term call monthly expiry with the same strike price	Transaction legs
[Long call value at the time of the short call expiration, when the Currency price is at the strike price] - [net debit]	Maximum gain
Net debit transaction	Transaction
Generate monthly income and can profit from range bound Currencys	Advantage
Capped upside if the Currency rises and can lose on the upside if the Currency rises significantly	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the December 2010 46.0000 strike call for Rs. 12.00. Sell the June 2010 46.0000 strike call for Rs.2.50.

Net Debit	Premiums Bought - Premiums Sold	12.00 - 2.50 = 9.50
Maximum Risk	Net Debit	9.50
Maximum Reward	[Long call value at the time of the short call expiration, when the Currency price is at the strike price] - [net debit]	
Breakeven Down	Depends on the value of the long call option at the time of the short call expiration	

Calendar Put



Volatility is not applicable	Volatility
Outlook is Bullish or range bound	Outlook
Buy a long term expiration put with a near the money strike price, Sell a short-term put (say monthly) with the same strike price	Transaction legs
[Long put value at strike price at first expiration] - [net debit]	Maximum gain
Net debit transaction	Transaction
Capped risk and can sell the shorter term calls on a monthly basis in order to generate income.	Advantage
The reward is capped and can become loss making if the underlying asset rises too much.	Disadvantage

Example

ABCD is trading at Rs.46.0000 on June 01, 2010. Buy the June 2010 48.0000 strike put for Rs.9.00. Sell the June 2010 52.0000 strike put for Rs.3.00.

Net Debit	Premiums Bought - Premiums Sold	9.00 - 3.00 = 6.00
Maximum Risk	[Put strike] - [maximum value of long put at the first expiration] + [net debit]	
Maximum Reward	[Long put value at strike price at first expiration] - [net debit]	
Breakeven Down	Depends on the value of the long put option at the time of the short put expiration	
Breakeven Up	Depends on the value of the long put option at the time of the short put expiration	