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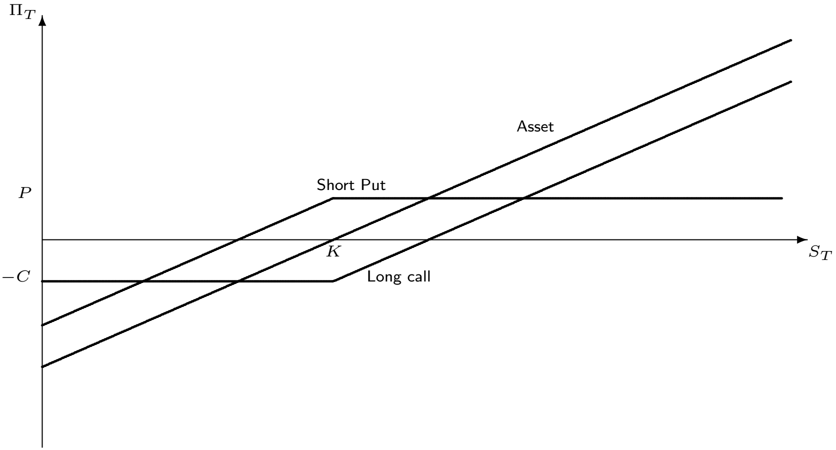
Investment strategies with options

Combining options

- We can combine options and generate different payoff profiles at maturity of the option
- We combine put and call options, long and short options, and options with different strike prices
- Such payoff profiles might suit the needs of specific investors

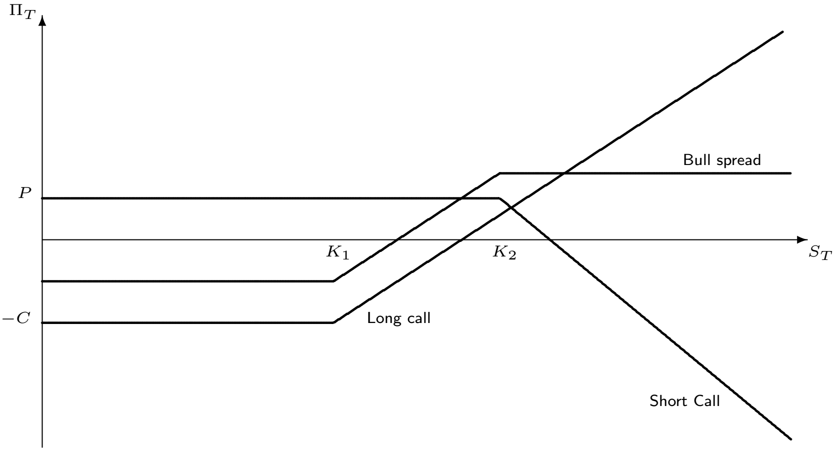
Synthetic asset



Reason to re-create the underlying asset

- The underlying asset might not be available to an investors, using options he can construct the same exposure
- Assets might not be available due to regulatory constraints, such as capital controls or limited access to assets seen as of national importance
- Investors might not want to obtain the asset directly, for example to avoid disclosing significant share holdings
- Using options can circumvent these restrictions, but in case of stocks without obtaining voting rights

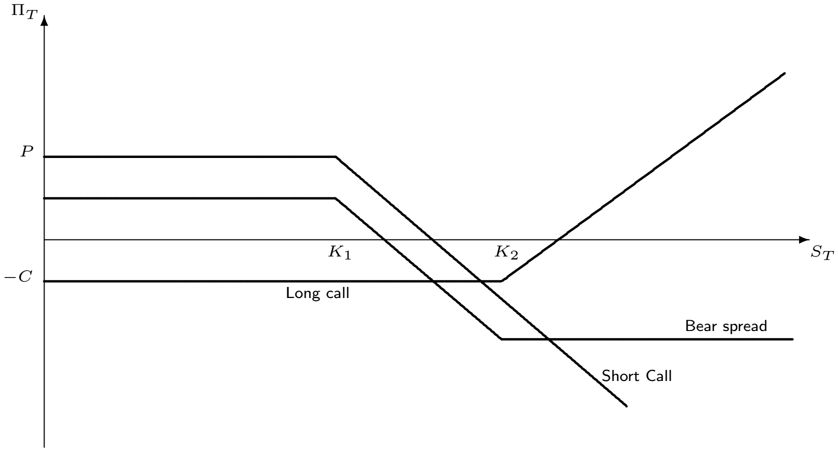
Bull spread



Limiting profits to reduce losses

- Investors might believe the asset to increase in value, but want to protect themselves against a fall in value
- By limiting their profits through selling a call, they gain additional revenue
- This limits the losses from the premium of the long call option, but also limits potential profits

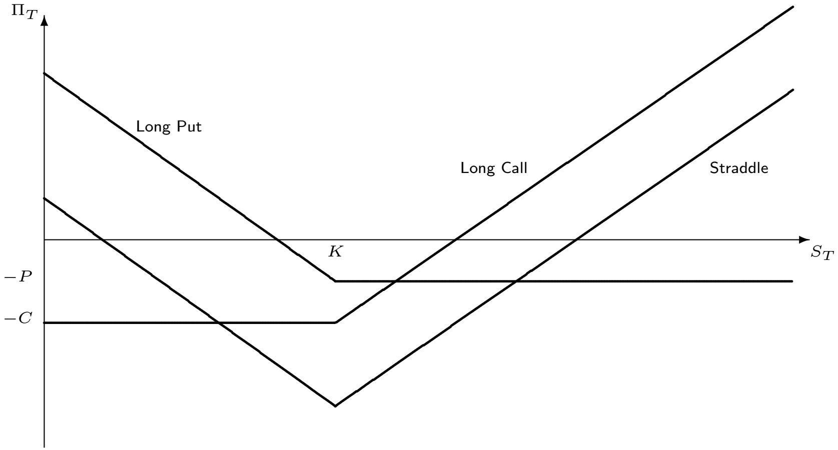
Bear spread



Limiting profits to reduce losses

- A bear spread is similar to a bull spread, only the profits are generated if the asset value falls
- Investors limit their profits from selling a call option by buying another call
- This limits the losses from the premium of the long call option in the case the asset value increases

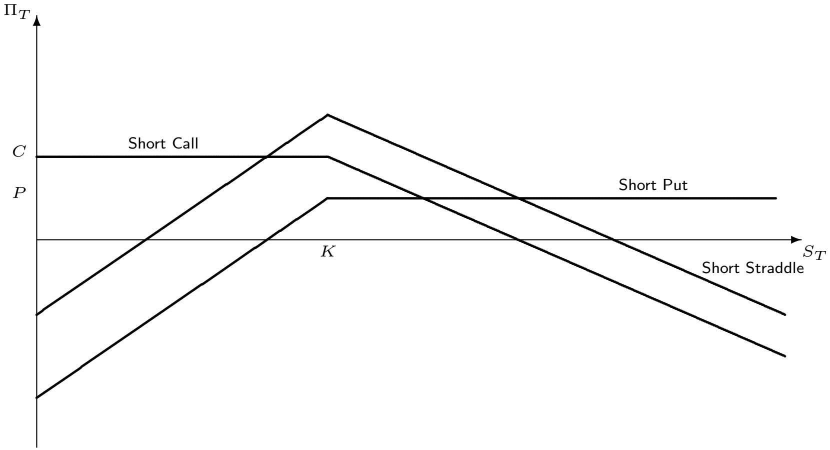
Straddle



Investing at times of high volatility

- If volatility is high, prices are moving more widely and at maturity are more likely to have moved further away from the current value
- If the strike price of the options chosen is the current asset value, investors make profits if asset prices move much
- Investors seeking to exploit times of high volatility could use a straddle if they do not have information on the direction of price movements

Short Straddle



Investing at times of low volatility

- If volatility is low, prices are moving less widely and at maturity are more likely to have stayed close to their current value
- If the strike price of the options chosen is the current asset value, investors make profits if stock prices do not move much
- Investors seeking to exploit times of low volatility could use a short straddle if they do not have information on the direction of price movement

Benefits of using option strategies

- Many more option strategies exist and can be exploited, some involving three or more options
- Many option strategies can also be achieved with different combinations of options
- Options strategies are often used to limit losses if price movements are adverse, but they often also limit profits
- As option premia are low compared to the underlying asset, considerable leverage can be achieved using option strategies

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