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JSE

DERIVATIVE MARKET

Equity Derivatives

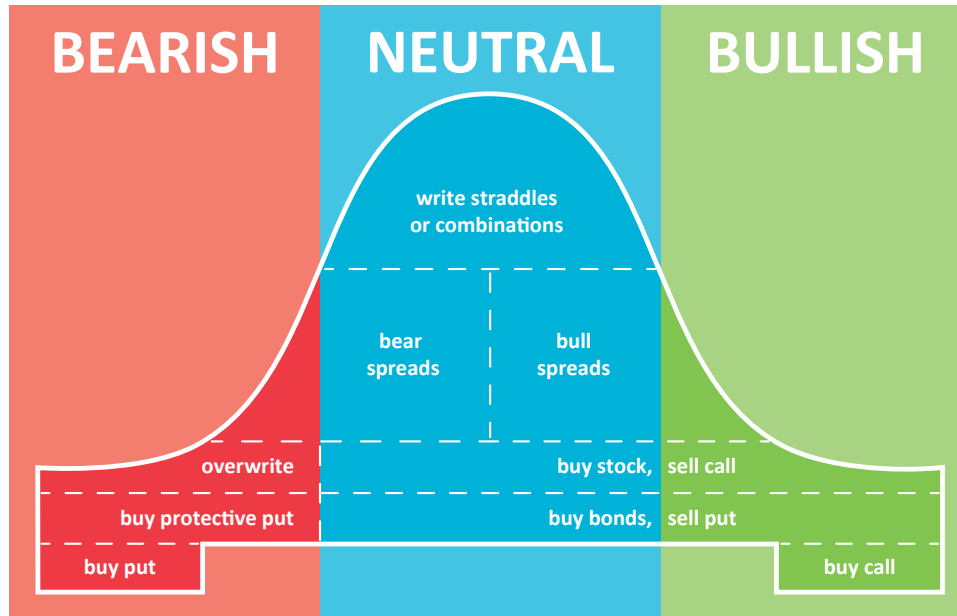
Style Options

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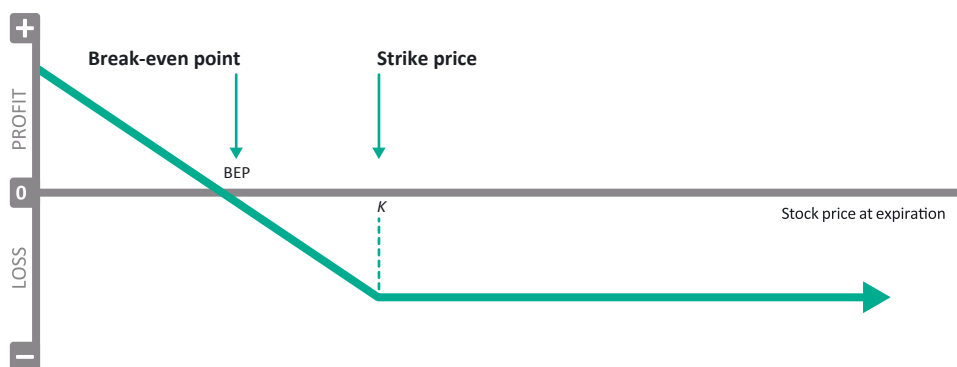


Johannesburg
Stock Exchange

The Options Strategy Spectrum



Reading a Profit Diagram



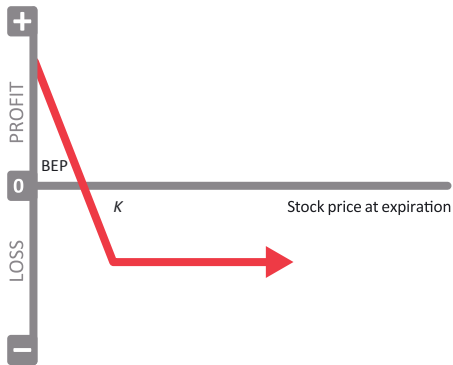
- ▶ **Risk:** This indicates how much loss the trader can experience if the market moves against the strategy. It is mainly described as limited or unlimited.
- ▶ **Reward:** This indicates how much profit the trader can experience if the market moves favour the strategy. It is mainly described as limited or unlimited.
- ▶ **Break-even point (BEP):** BEP is the asset price on expiration at which your profit is equal to the cost paid for the position.

You can trade Style Options on: Equities, Indices, Bonds, Currencies, Commodities, International "blue chip" Companies.

Bear strategies

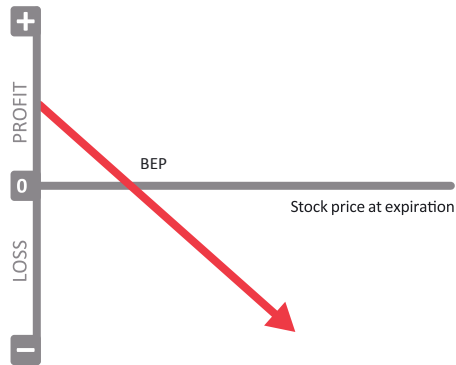
Overall, these positions will do better if the stock or index market falls.

Long Put



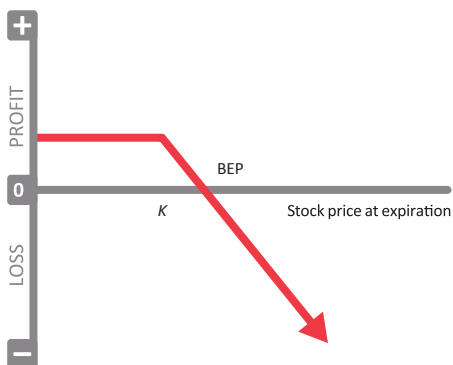
- ▶ **Market view:** Bearish
- ▶ **Construction:** Buy one put with strike K
- ▶ **Risk:** Limited
- ▶ **Reward:** Substantial
- ▶ **Increase in Volatility:** Strengthens position
- ▶ **Time Decay:** Weakens position
- ▶ **Break-even point (BEP):** Strike K minus premium for put option

Synthetic Short



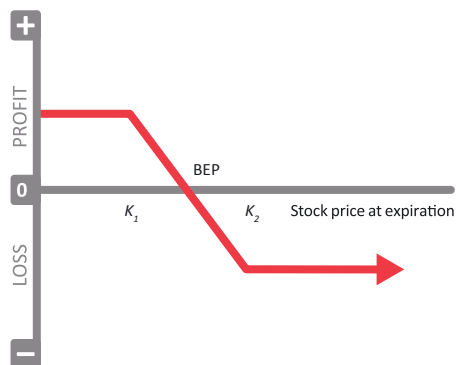
- ▶ **Market view:** Bearish
- ▶ **Construction:** Sell one call option with strike K and buy one put option with the same strike
- ▶ **Risk:** Unlimited
- ▶ **Reward:** Substantial
- ▶ **Increase in Volatility:** Neutral
- ▶ **Time Decay:** Neutral
- ▶ **Break-even point (BEP):** Strike K

Short Call



- ▶ **Market view:** Bearish
- ▶ **Construction:** Sell one call option with the strike
- ▶ **Risk:** Unlimited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Weakens position
- ▶ **Time Decay:** Strengthens position
- ▶ **Break-even point (BEP):** Strike K plus option's premium

Bear Put Spread

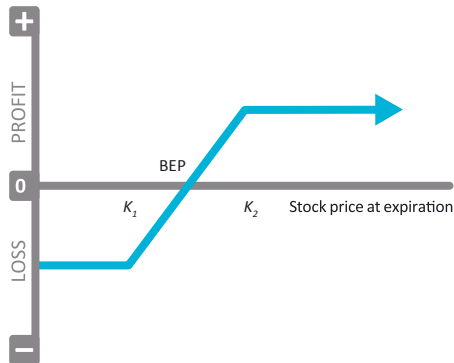


- ▶ **Market view:** Bearish
- ▶ **Construction:** Sell one put with strike K_1 and buy one put option with strike K_2 where $K_1 < K_2$
- ▶ **Risk:** Limited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Strengthens or weakens position depending on the strikes chosen
- ▶ **Time Decay:** Strengthens or weakens position depending on the strikes chosen
- ▶ **Break-even point (BEP):** Strike K_2 minus net premium

Neutral strategies

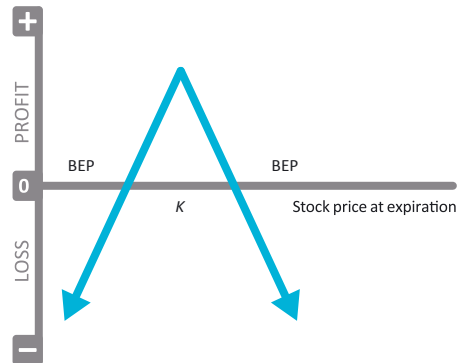
Overall, these positions will do better if the stock or index market does not move very much

Hedging Strategy—Long Collar



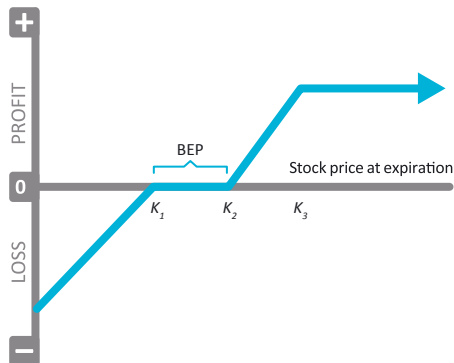
- ▶ **Market view:** Neutral hedging
- ▶ **Construction:** Own an asset or futures contract, buy one put option with strike K_1 and sell one call option with strike K_2 where $K_1 < K_2$
- ▶ **Risk:** Limited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Weakens position
- ▶ **Time Decay:** Strengthens position
- ▶ **Break-even point (BEP):** Current stock price minus the net premium

Short Straddle



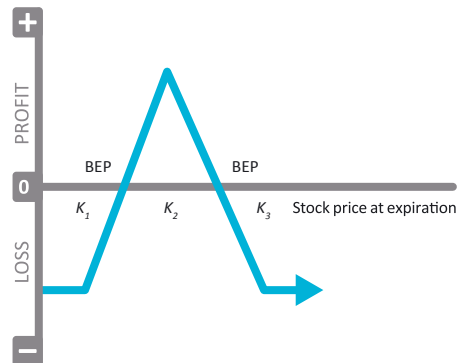
- ▶ **Market view:** Neutral
- ▶ **Construction:** Sell one call option with strike K and sell one put option with same strike
- ▶ **Risk:** Unlimited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Weakens position
- ▶ **Time Decay:** Strengthens position
- ▶ **Break-even point (BEP):** The two BEPs are
 - ▶ K strike minus net premium
 - ▶ K strike plus net premium

Hedging Strategy—Long Fence



- ▶ **Market view:** Bullish hedging
- ▶ **Construction:** Already own futures contract or asset, purchasing one put option with strike K_2 , sell one put option with strike K_1 and sell one call option with strike K_3 where $K_1 < K_2 < K_3$
- ▶ **Risk:** Limited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Strengthens or weakens position depending on the strikes chosen
- ▶ **Time Decay:** Neutral
- ▶ **Break-even point (BEP):** BEP is a range between strikes K_1 and K_2
- ▶ $K_1 < ST < K_2$

Long Call Butterfly

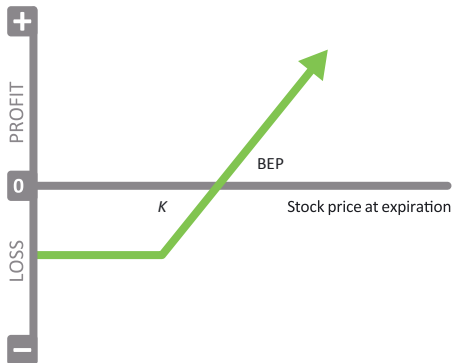


- ▶ **Market view:** Neutral
- ▶ **Construction:** Buy one call option with strike K_1 sell two call options with strike K_2 and buy one call option with strike K_3 where $K_1 < K_2 < K_3$, generally K_2 is equal to the current asset price
- ▶ **Risk:** Limited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Weakens position
- ▶ **Time Decay:** Strengthens position
- ▶ **Break-even point (BEP):** The two BEPs are
 - ▶ K_2 strike minus net premium
 - ▶ K_2 strike plus net premium

Bull strategies

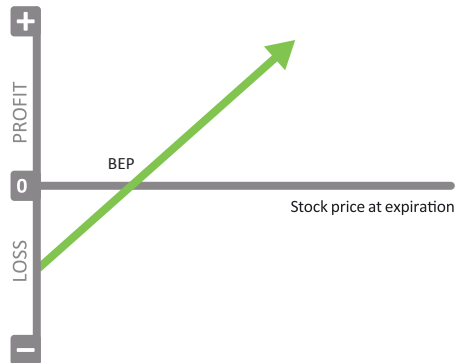
Overall, these positions will do better if the stock or index market rises.

Long Call



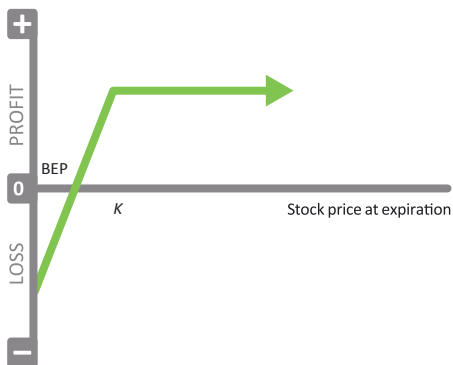
- ▶ **Market view:** Bullish
- ▶ **Construction:** Buy one call option with strike K
- ▶ **Risk:** Limited
- ▶ **Reward:** Unlimited
- ▶ **Increase in Volatility:** Strengthens position
- ▶ **Time Decay:** Weakens position
- ▶ **Break-even point (BEP):** Strike K plus premium paid for call option

Synthetic Long



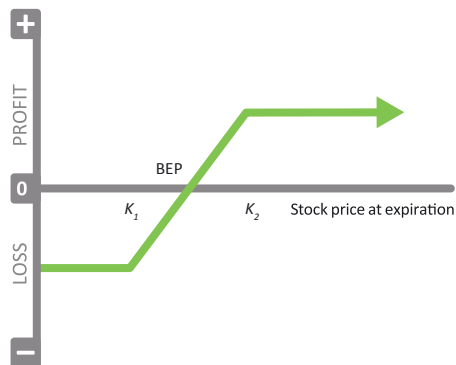
- ▶ **Market view:** Bullish
- ▶ **Construction:** Buy one call option with strike K and sell one put option with the same strike
- ▶ **Risk:** Substantial
- ▶ **Reward:** Unlimited
- ▶ **Increase in Volatility:** Neutral
- ▶ **Time Decay:** Weakens position
- ▶ **Break-even point (BEP):** Strike K

Long Covered Call



- ▶ **Market view:** Neutral to slightly bullish
- ▶ **Construction:** Buy asset or futures contract and sell one call option with strike K
- ▶ **Risk:** Substantial
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Weakens position
- ▶ **Time Decay:** Strengthens position
- ▶ **Break-even point (BEP):** Traded asset price minus call premium

Bull Call Spread

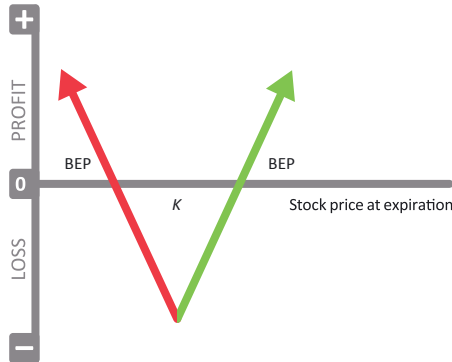


- ▶ **Market view:** Bullish
- ▶ **Construction:** Buy one call option with strike K_1 and sell one call option with strike K_2 where $K_1 < K_2$
- ▶ **Risk:** Limited
- ▶ **Reward:** Limited
- ▶ **Increase in Volatility:** Strengthens or weakens position depending on the strikes chosen
- ▶ **Time Decay:** Strengthens or weakens position depending on the strikes chosen
- ▶ **Break-even point (BEP):** Strike K_1 plus net premium for the call option

Combined strategies

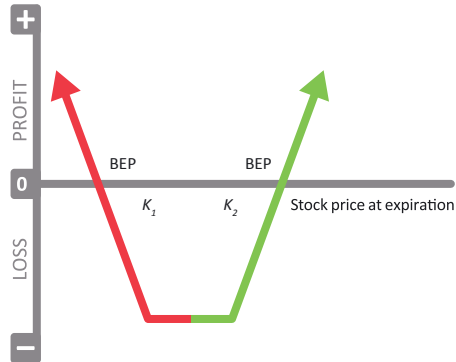
Strategies that combine both bullish and bearish outlooks

Long Straddle



- ▶ **Market view:** Bearish and Bullish
- ▶ **Construction:** Buy one call option with strike K and buy one put option with same strike
- ▶ **Risk:** Limited
- ▶ **Reward:** Unlimited
- ▶ **Increase in Volatility:** Strengthens position
- ▶ **Time Decay:** Weakens position
- ▶ **Break-even point (BEP):** The two BEPs are
 - ▶ K strike minus premiums
 - ▶ K strike plus premiums

Long Strangle



- ▶ **Market view:** Bearish and Bullish
- ▶ **Construction:** Buy one call option with strike K_2 and buy one put option with strike K_1 where $K_1 < K_2$
- ▶ **Risk:** Limited
- ▶ **Reward:** Unlimited
- ▶ **Increase in Volatility:** Strengthens position
- ▶ **Time Decay:** Weakens position
- ▶ **Break-even point (BEP):** The two BEPs are
 - ▶ K_1 strike minus premiums
 - ▶ K_2 strike plus premiums

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