Class: Options Strategies in a Bull Market
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Class: Options Strategies in a Bull Market

"Options Strategies in a Bull Market" (Options 302) has been designed to illustrate some of the most common strategies to take advantage of a bull market. This course, which explores option strategies in a bull market, is the first in a series designed to help you identify what may be an appropriate strategy in specific market environments, why you use options, and potential risks or rewards they offer. At the completion of the chapters and prior to the final quiz the student should know and understand all of the components in the conclusion.

Chapter 1 - Introduction
In the introduction an overview of strategies is given along with how these strategies can differ in terms of difficulty to understand and their risk / reward profiles.

Chapter 2 - Buying Calls
This chapter covers buying calls as a Bull strategy. The topics covered in this chapter include the sell vs. exercise decision, figuring actual return, the stock price option price relationship, and the components that make buying calls an effective strategy in a bull market.

Chapter 3- LEAPS®
In this chapter LEAPS®, or Long Term Equity AnticiPation Securities are introduced as another tool in order to take advantage of a specific market. LEAPS® allow the investor to use options that expire further out in time than regular cycle options.

Chapter 4 - Selling Puts
For this chapter selling puts is explained and illustrated for the student. Unlike chapter 2 which involved buying calls this chapter discusses selling puts and the ramifications for a short position including maximum gain, loss potential, and early exercise.

Chapter 5 - Hedging with Puts
This chapter discusses the purchase of puts in order to hedge a stock position. The concept behind hedging a stock position with puts is explained. It is further explained how a hedged put can be traded either independently of the stock purchase, or simultaneously as a married put.

Chapter 6 - Covering Calls
In this chapter the use of selling calls while maintaining or introducing a long stock position are explained. The benefits of stock ownership in a bull market are described and the tertiary ability to sell calls and collect premium are described.

Chapter 7 - Spreads
Bull market spreads are introduced in this chapter. The two types of bull market spreads introduced are the bull call spread and the bull put spread. These two types of spreads are compared and the differences of the spreads are explained. The correct decisions that go into making a bull spread a profitable trade are also explained. In addition the factors effecting spread values are explained along with maximum gain and maximum loss.

Chapter 8 - Conclusion and Quiz
Review of key topics and final quiz.
Introduction

Options provide versatility in any market, and a way to help you meet your investment goals. But you need a strategy — or a number of strategies — to take advantage of the investment opportunities that a particular market offers.

In a rising market you may use options to lock in the price you'll pay for a stock, protect yourself from missing a market rally, and use leverage without significantly increasing risk. In a falling market, you may be able to insure your portfolio against market losses or moderate losses that do occur. And in a neutral market, where prices change relatively slowly, you may be able to add a source of income.

But you can't accomplish all these goals at the same time or with the same purchase or sale. In each case, you must determine what you want to accomplish, which type of option — a call or a put — is best suited to your ends, and whether the situation requires purchasing or writing the option or a combination of options.

Some investment goals and the option strategies you may use to achieve them are straightforward and relatively simple. For example, you may be confident that a particular stock will increase in price but uneasy about committing the full purchase price.

Others goals require more complex strategies. For example, you may be willing to make a commitment to sell stock at a specific exercise price only if you hedge that commitment with the opportunity to buy the stock at a lower price.

And because the underlying stock and the market in which it trades may be either volatile or stagnant, using leveraged investments wisely involves deciding whether to take on additional risk or adopt a protective stance — or attempt to do both at the same time.

This course, which explores option strategies in a bull market, is the first in a series designed to help you identify what may be an appropriate strategy in specific market environments, why you use options, and potential risks or rewards they offer.

Buying Calls

The basic principle of equity investing is that you make money if the price of a stock you purchase goes up. That's because you can sell your shares for more than you paid for them. But there's another way you may be able to profit from an increase you expect in a stock's price, or its appreciation, without having to pay the full cost of purchasing the stock.
You could purchase call options on the stock. This strategy is commonly referred to as buying calls or long calls. The reason it’s attractive is that a typical option contract on 100 shares of stock costs less than 100 shares of stock itself — usually much less. If the stock price increases as you expect, the option gives you the right to buy the stock at or below its market price. However, if you were wrong, and the price doesn’t increase or even declines, much less of your capital is at risk.

If your goal in using this strategy is to end up owning the stock, you would buy the number of call options that corresponds to the number of shares you want to hold. For example, if you would want to own 300 shares of XYZ Company if its price increased above the strike price, you would buy three XYZ call options. Options professionals describe this as participating in the movement of the 300 shares.

If the stock price goes up, as you would expect in a bull market, the call option price is likely to go up as well, possibly becoming an in-the-money call. If that happens, you may choose to do one of several things in order to profit from your call purchase.

- **Sell the option contract before it expires for more than you paid to purchase it.** If the option is trading above its intrinsic value, this may be the best course of action because it allows you to capture the time premium in the option.

- **Exercise the option to purchase the stock at the strike price, and simultaneously sell the stock in the market.** By doing this, you are effectively cashing out your position at the option’s intrinsic value.

- **Exercise the option and purchase the stock at the strike price, adding the shares you purchased to your portfolio.** You would generally do this the last day before expiration, because the money used to purchase the stock could be invested in T-bills and earn interest.

No matter which alternative you choose, you have until the option’s expiration date to make a final decision.
What are the advantages of buying calls as a strategy?

When buying calls, you limit your risk to the amount of the premium you pay. If the price of the stock falls rather than rises — perhaps because the market is sluggish or a company doesn’t meet expectations — you’re protected against significant loss. Your potential return on a long call is limited only by the price to which the underlying stock could ultimately rise minus the cost of the premium you paid.

Because you spend less to purchase an option contract than to purchase stock, you commit less capital. You can invest that money elsewhere. For example, you might choose conservative income-producing products if you would like the funds to be available should you decide to exercise the option. Or you might purchase a number of call contracts on different stocks to capitalize on the potential upward movement of a sector or the overall market.

Remember, though, it’s as important to consider diversifying your options as it is to diversify your stock portfolio. Buying calls on three companies in the same industry may expose you to greater potential risk than choosing three companies in different industries. Similarly, you may want to stagger your expiration dates to protect against sudden, temporary shifts in the market.

The potential for making money by buying a call depends on choosing the right option. Specifically, you need to purchase an option on a stock whose market price will exceed the exercise price before the expiration date.

Suppose you buy a February 35 call option on a stock currently trading at 30. At the end of trading on the third Friday of February the stock’s price reaches the high of only 34.75. As a result, the option expires worthless. But if the option’s market price tops what you paid for it any time in the period before the contract expires, you can realize a profit by selling the option.

Remember, in figuring your profit you do have to subtract the premium you paid to buy the contract plus trading costs from the amount you received for selling the option. But the higher the market price goes, the more you stand to make, or the greater your savings if you decide to purchase the stock.

In other words, to be successful in buying call options, you have to be right about three things.

- The potential for a particular stock to rise
- The amount that the stock will rise
- The time it will take to happen

Making that assessment requires careful research about the stock’s prospects.

The more Bull you are, the more willing you may be to purchase options that are significantly out-of-the-money. That means there might have to be substantial increases in the price of the underlying stock for you to break even or to realize gain by exercising your option or selling it.
LEAPS®

If you believe a bull market is on the horizon, you may want to buy long-term call options, otherwise known as LEAPS®, or Long Term Equity AnticiPation Securities. If your assessment is correct, and the call is in-the-money at any time before expiration, you may choose to purchase the underlying stock at the exercise price. You may also have the often more attractive alternative of selling the call for more than you paid to buy it. And, in fact, you have the right to exercise the call even if it’s out-of-the-money, if that’s what you prefer to do.

Unlike conventional call options, which expire within nine months, LEAPS® are listed with expirations up to three years. This extends the time during which the market can meet your expectations. It also gives you time to accumulate the money you’ll need to make the stock purchase.

As with all options, LEAPS® expose you to the risk of losing the entire amount of a purchase if your contract expires out-of-the-money. But because the option usually costs less than buying the underlying stock, it may offer an opportunity to take advantage of any appreciation in the stock’s price at a fraction of the cost of investing in the stock itself.

Selling Puts

Another strategy with the potential to take advantage of bull market conditions by using options is to write, or sell, puts. Writing a put obligates you to buy the underlying stock if the option buyer exercises the option.

At first glance, selling puts may seem like the polar opposite of buying calls. It might even seem to some people like a strategy better suited to a falling market. But selling puts may be a smart move in a strong bull market if there’s a stock you’d like to purchase but believe is currently overpriced, perhaps as the result of market exuberance or overreaction to a company announcement or press report.

For example, suppose a stock is selling at $90 a share, but your target price is $75. By selling puts with a strike price of $75, you’re committing yourself to buy the stock if the contract is exercised. But that might not be as risky as it
sounds, provided you have done your homework on the stock's long-term potential to increase in value, and you have enough cash in your brokerage account to cover the purchase.

When you have the purchase money available to buy the stock underlying a put you write, you're selling what are known as cash-secured puts. Not only does that sound safer. It is.

Timing is a consideration in the cash-secured puts as it is with all option strategies. The shorter the time remaining until expiration, the more you're dependent on a dramatic price drop to make the stock available for purchase at your target price. Similarly, the closer the contract is to expiration, the smaller the premium you're likely to collect from selling the put.

Of course, you could simply wait until the underlying stock price drops to make your stock purchase rather than selling a put that obligates you to buy. But, when you sell a put, you collect a premium, which provides current income. The premium may also help offset the purchase price if the contract is assigned, and you must purchase the stock.

One risk of selling a cash-secured put is that the stock's price could drop substantially below the exercise price if the correction you were expecting is more dramatic than you had anticipated. Then you'd have to pay more than market value for the stock if the contract was assigned. That would produce an unrealized loss. Of course, any day before assignment occurs, you may buy back the put to close the position. It may be a losing trade, but it probably won't be as costly as if you had purchased the stock at the higher price.

It's strategically sound to sell the number of puts that would make available the number of shares you'd like to purchase, or that you can afford. A more speculative strategy is to sell more puts than the number of shares you want to own at a strike price that's low enough to be likely to expire out-of-the-money. Selling these puts increases your premium income. But it also increases your risk in the event of a significant decline and assignment.

Unlike buying a call, where your risk is limited to the price of the premium, your risk with a cash-secured put is similar to owning the stock itself.

If the exercise price is $75, you could lose up to the full $75 you're required to pay per share. That's because once the market price falls below the exercise price, the contract is virtually certain to be exercised. And if the price continues to drop, you could eventually lose your total investment.

You can limit your risk in response to such a drop, however, by making a tactical decision to buy an offsetting contract before the contract is assigned, thereby ending your responsibility to purchase the shares. That's probably also a recognition that your initial strategy didn't work. But it could reduce the amount of your loss.
Hedging with Puts

Some option strategies are slightly more sophisticated than buying calls or selling puts. Typically, they involve more than one element, such as combining the purchase or sale of an option with the purchase of the underlying stock.

For example, you can hedge against the possibility that a stock will drop in value by simultaneously purchasing put options on a stock when you buy shares of that stock. Because the puts give you the right to sell the underlying stock at the exercise price at any time before expiration, you limit potential losses that could result from a falling market price.

The alternative to buying a put if you want to protect yourself against a falling stock price is to place a stop loss limit order on your stock. However, the put option gives you much more control over the timing of any sale — since you determine when to exercise the option — and provides a guaranteed selling price.

When you use this strategy, described by option professionals as a **married put**, you purchase an offsetting number of puts — one put for every hundred shares you purchase. For example, you might buy 500 shares of XYZ stock and five puts on XYZ stock.

Buying the stock rather than a call option on the stock gives you the benefit of ownership, such as the right to collect dividends and vote at the annual meeting. And, by purchasing puts, you’re in a position to offset losses on the stock. If the stock price drops before the option expires, you can exercise the put option, and put the stock to another investor at the strike price.

The risks are limited, which is one reason the strategy can be appealing. The most you stand to lose if the underlying stock drops in value is the difference between the price you paid for the stock and the strike price at which you can sell it, plus the premium you paid for the put. On the other hand the only cap on your potential return is the price to which the stock increases minus the premium that you paid for the put.

It might help to clarify this hedging strategy by thinking of the put as insurance, and the premium you pay to purchase it as the equivalent of an insurance premium. In the best of circumstances, you won’t need the protection, but if you should need it, you’re covered.
And since you’d be likely to use this strategy when you expect the market to go up, you may consider it a small price to pay. You may even be able to sell the option before it expires despite an increase in the stock price. Or, if the stock price drops, and you are able to sell the option itself, you can offset some of your paper losses on the stock.

One drawback to this strategy is that options have relatively short terms, so your insurance may expire before you need it. You could continue to buy an offsetting put option, though you would have to anticipate whether the exercise prices that are available would provide the same level of insurance. And options do cost money. Maintaining a permanent insurance of this kind could reduce or even wipe out any long-term gains.

**Covering Your Calls**

If you write a call option and simultaneously purchase the underlying stock, you’re using an option strategy described as a covered call. Generally, for each contract you sell, you purchase 100 shares of the stock to hold in the same brokerage account. That way, you are hedging your risk that the option will be exercised. If it is, you have the stock available to meet your obligation to sell.

While the primary motivation for writing a call is usually collecting premium income, covering your exposed position protects you against the risk of having to buy the stock if the contract is exercised and you are assigned a short stock position. In that case, you’d have to cover the short position to meet the call — potentially at a price higher than the strike price.

Owning the stock also provides the potential for dividend income and for price appreciation if the market value of the stock rises as you anticipate a bull market. But remember that the two factors that are most likely to prompt the call owner to exercise the contract are a rising price or a good dividend.

Before you write a covered call, you want to be sure you’re willing to part with your stock. If exercise seems likely, but you’d prefer to hold onto the stock, you can close out your position by buying an offsetting call option (or as many options as you need to cover the number you wrote) with the same strike price and expiration date. That action cancels your obligation to sell and closes the position.
Of course, you’ll most likely have to pay a premium for those call options. So you’ll want to compare the net profit or loss on the transaction — subtracting the cost of the premium you pay from the premium you received for selling — with the tax consequences of selling the shares and the unrealized profit or loss of holding them.

For example, suppose you sold the call for a $500 premium and would have to pay $750 for an offsetting call. That would mean a loss of $250. However, if selling the underlying shares in response to assignment would result in a $3,000 short-term capital gain, you might decide to absorb the premium loss.

While a covered call can be a smart income strategy if you expect only modest gains or sideways movement in the stock’s price, you must be prepared to act if the price moves strongly higher.

If the option is in-the-money at any time before expiration, you can reasonably assume that the contract will eventually be exercised. If you’re prepared to sell, you can wait for it to be assigned. You also need to be prepared to have the stock called away if the call is at-the-money unless you close the position. That would mean you no longer own the stock.

In contrast, if the contract seems poised to expire out-of-the-money, you may choose to do nothing. There’s very little risk that it will be exercised, and you keep the premium. If the stock price continues to drop, the premium you received will reduce the potential loss you might realize if you sold. However, while very few out-of-the-money options are exercised, the option holder has the right to exercise at any time. In addition, in the case of a severe or continual drop in the value of the underlying stock, the premium may not be sufficient to cover the loss in stock value.

**Spreads**

A third category of options strategies, sometimes described as **vertical spreads**, may provide a modest profit in a bull market, with the added benefits of reduced risk and reduced investment cost.

To use these strategies, which professionals refer to as **bull call spreads** and **bull put spreads**, you simultaneously purchase one or more options — either call or puts — and write, or sell, an equal number of the same option on the same underlying stock with the same expiration date — but at different strike prices. For example, if you purchase a call option, you write a call. Or, if you sell three put options, you purchase three puts.

The key to these strategies is that the strike price on the options you purchase and those you sell are different, even though the expiration date is the same. If you purchase call options at one strike price, you write calls at a higher price. And if you sell put options, you purchase puts at a lower strike price.
In the case of calls, the contract you sell is out-of-the-money, and the contract you purchase is in-the-money. The opposite is true with puts. The put you sell is in-the-money, and the one you purchase is out-of-the-money.

As a result, you’re positioned to realize a profit with either vertical spread if the price of the underlying stock increases.

Vertical spreads are hedging strategies, or more precisely, double hedges. You use them to take advantage of the leverage that options provide while protecting yourself against the risk you take in writing either calls or puts.

In the case of calls, purchasing a call at a lower strike price than the strike price of the call you write hedges, or partially offsets, the financial risk of writing an uncovered call. If the contract is assigned, you can exercise your option to purchase the required number of shares at the lower strike price and use them to meet your obligation to sell.

However, if only the long call is in-the-money at expiration, you may decide to sell it to recover some of your cost, or exercise it and buy the underlying stock for less than the market price.

An added advantage of using the spread is that you actually pay less (net) for the long call and the potential to buy at a lower-than-market price because you reduce its premium by the amount of the premium you collect on the call you write.

In contrast, when you hedge with puts in a bull market, you purchase a lower-priced, out-of-the-money contract to reduce the risk of writing the higher-priced, potentially in-the-money put. You expect the underlying stock to increase in price, so you’ll realize a profit without having to take any further action.

If the price of the stock falls below the higher exercise price and you eventually receive an assignment to purchase shares under the terms of the put you’ve written, you have three choices:

- You can close out your new, long stock position
- You can sell the put you purchased, closing out the remaining half of the position
- You can exercise the put you purchased, and deliver your recently assigned stock, though you may choose not to if it’s out-of-the-money

Really Bull

The more Bull you are, the less likely you may be to use spread strategies. It will generally cost more to use a long call, but you won’t be putting a cap on your potential return.
Either way, the hedge provides financial protection. You can use the proceeds from the sale of the contract or the underlying shares to partially offset the cost of the shares you must purchase to fulfill the terms of the contract you've been assigned.

Remember, though, that you pay a commission when you sell stock as the result of exercising a put option. It’s possible that the commission for closing out your position with offsetting transactions would be less than the commission for exercising your option. Since each firm sets its own commission schedule, comparative cost is something you should clarify as part of making your decision.

Another way that a bull call strategy differs from a bull put strategy is that the former is a debit spread and the latter a credit spread.

A bull call spread transaction, which may be handled as a unit, always costs you money to open, creating what option professionals refer to as a net cash outflow or net debit. That’s because you’re buying an in-the-money call and selling one that’s out-of-the-money.

In contrast, a bull put spread transaction, also handled as a unit, results in a net cash inflow, or net credit. In this case, the premium you collect from the sale of the higher priced, in-the-money (or closer to the money) put option is greater than the cost of the out-of-the-money, lower priced put.

Despite their differences, you may choose either of these strategies as a way to realize a limited gain if the underlying stock price reacts as you anticipate — going up in a modest bull market.

To use spread strategies effectively you’ll want to keep in mind not only when you might realize the greatest gain, but also when you could experience the greatest loss.

Your opportunity for the most profit with a bull call spread occurs when both options expire in-the-money or at the higher strike price. But to capitalize on that opportunity, you must purchase the stock at the lower exercise price and sell it at the higher exercise price. You might also realize some profit if the contracts in the spread have value at some point before expiration, and you sell both sides in one transaction.

The situation is different with bull put spreads. The opportunity for greatest gain occurs when both options expire out-of-the-money because the price of the underlying stock rises above the higher strike price. In this case, you keep the net premium, or the premium you collect for selling minus the premium you pay to purchase minus commission and fees.

The most you can lose on a bull call spread if both options expire out-of-the-money is the net debit — the premium you received minus the premium you paid (plus commissions and fees).
The greatest potential loss on a bull put spread occurs when the stock price falls below exercise price of the put you purchased. That loss is the difference between the two strike prices minus the net credit. This may explain why put writing is mistakenly seen as posing a bigger risk than call writing, although with this spread, the maximum loss is capped.

As part of choosing a vertical spread strategy, you also need to take into account not only the direction that a stock's price is likely to move but:

- How much the change will be
- How quickly that change will take place

Your observations may help you determine not only the stocks on which to trade options, but the appropriate spread between exercise prices, the amount of time to allow before expiration, and whether to use a debit or credit spread.

Here’s one example. Correctly anticipating the relationship of the underlying stock’s price to the exercise prices of the two legs of the vertical spread as the time to expiration gets shorter may help to determine the extent of your profit (or loss). This phenomenon, described by option professionals as time decay, works differently with bull call spreads than it does with bull put spreads.

With the bull call spread, the closer the stock prices may come to the strike price of call you’ve sold — the higher priced option — the larger and the more quickly your potential for profit grows as expiration approaches.

With a bull put spread, however, you aren’t dependent on timing or a significant price change in the underlying stock to realize a profit. As long as the options expire out-of-the-money, you retain your net premium.

**Conclusion**

To identify the bull market strategy that’s most appropriate for meeting your investment goals with options, you must analyze the potential benefits — and the corresponding limitations — of several different approaches.

One of your initial decisions is whether to take a buy or sell position. Part of what you’re looking at this point is the risk/reward ratios of various strategies, since there are several alternatives with varying degrees of exposure. A related issue is how confident you are that underlying stock prices will increase within a specific period.

You’ll probably want to ask yourself how much capital you’re prepared to invest in each trade, and how much of that investment you’re willing to put at risk. That may help you choose between a single position, such as buying a call or selling a put, and a hedged position, such as a debit call spread or a credit put spread.
A related question is how many units of a buy strategy you can afford with the capital you're investing. That may help you choose between at-the-money options and out-of-the-money options. At-the-money options tend to cost more, which would reduce the number you could purchase and might limit your potential gain.

The bottom line is that before you invest in options you need a strategy appropriate for achieving the results you want — and a method of choosing that strategy.
Options Strategies in a Bull Market Quiz

(Answers on next page)

1. If you purchase a call in a bull market, where do you anticipate the option to be by expiration?
   - A. In-the-money
   - B. Out-of-the-money
   - C. Far out-of-the-money

2. The factors you need to consider in choosing to buy calls are:
   - A. Potential appreciation in stock price and intrinsic value
   - B. Time until expiration and potential premium on offsetting trade
   - C. Both A and B

3. Buying LEAPS® calls can be considered a bull market strategy because
   - A. The action assumes long term price appreciation
   - B. You have only a limited time to exercise your option
   - C. The price is always lower than the other options.

4. One reason to sell a cash-secured put is to
   - A. Protect your portfolio holdings from a drop in value
   - B. Reduce the purchase price of the underlying stock
   - C. Establish a price range for an offsetting contract to close out your position

5. When you purchase stock and put options on that stock at the same time, which of the following is NOT one of your motives?
   - A. Limiting potential losses from a falling stock price
   - B. Establishing the level of loss you’re willing to accept on the stock
   - C. Collecting a premium to offset the stock price

6. One reason you might consider closing out a covered call position before assignment is
   - A. You don’t want to have to buy the stock at the market price
   - B. You’d prefer to keep your stock
   - C. You can make more money on the offsetting call

7. Vertical bull call spread strategies are based on
   - A. Buying calls with a lower strike price and selling calls with a higher strike price
   - B. Buying calls with a higher strike price and selling calls with a lower strike price
   - C. Buying and selling calls with the same strike prices and different expiration dates

8. One advantage of using a bull spread strategy is that you’re protected against losses whichever way the market price of the underlying stock moves.
   - True
   - False

9. One potentially negative consequence of using a net credit spread is that you
   - A. Start out with a deficit
   - B. Must always exercise at least one leg of the transaction
   - C. Limit your potential gain

10. You’re in a position to make the greatest profit with a bull put spread if
    - A. Both puts expire out-of-the-money
    - B. Both puts expire in-the-money
    - C. The long option is out-of-the-money and the short option is in-the-money
Options Strategies in a Bull Market
Quiz Answers

1. A.
In you purchase a call in a bull market, you expect that the market price of the underlying stock will go higher than the exercise price so you can sell your option for more than you paid to buy it. A call option is in-the-money when the exercise price is lower than the market price.

2. C.
All four factors can have a potential impact on the effectiveness of a long call strategy. Potential price appreciation and time until expiration are core elements in any scenario, but intrinsic value and the potential cost of an offsetting trade can affect whether you make or lose money.

3. A.
Buying LEAPS® calls if you anticipate a bull market is coming within a year or two, and you want to allow enough time for the price of the underlying stock to rise to the level you project.

4. B.
With a cash-secured put, you commit yourself to buying the underlying stock at a price lower than the current market price and you also collect a premium. The premium lowers the net purchase price of the stock below the exercise price.

5. C.
You pay a premium when you purchase an option, whether that option is a call or a put. You don't collect a premium.

6. B.
If you anticipate future price appreciation in the underlying stock price or if selling it would produce a large capital gain, you may prefer not to have to sell at the exercise price.

7. A.
By selling call options at a higher price, you signal your expectation that the underlying stock price is going up at the same time you're hedging your risk against a drop in price by buying options on the same underlying stock at a lower price.
8. **False.**

While using a spread strategy may put you in a position to limit your losses, no Bull strategy guarantees protection against losses.

9. **C.**

While you begin with a credit, since you collect a larger premium than you pay, you limit your potential gain to the difference between the exercise prices plus the net credit.

10. **A.**

If both puts expire out-of-the-money, there is no risk that you’ll have to make good on your obligation to buy the underlying stock when assigned, in which case there’s no reason to exercise your long put. You keep the net credit.