



Examination Study Guide Futures and Options (Module 14)

**[Applicable to Examination Study Guide
Module 14 - First Edition, 2013]**

UPDATES

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(This document consists of six (6) pages including the cover page)

1. The following is to replace the existing write up on Topic 7: Trading Strategies with Options.
 - A. Topic 7.04 - Bull put spread (Page 7-5); and
 - B. Topic 7.04 - Bear put spread (Page 7-7).

A. Topic 7.04 - Bull put spread

A bull put spread employs two puts on the underlying instrument, buying the lower strike put and selling the higher strike put. The downside to this strategy is the width of the put spread minus the net premium and this occurs when the underlying spot expires below the far strike. The maximum upside to the strategy is limited to the net premium outlay (cost of put bought minus premium received from put sold).

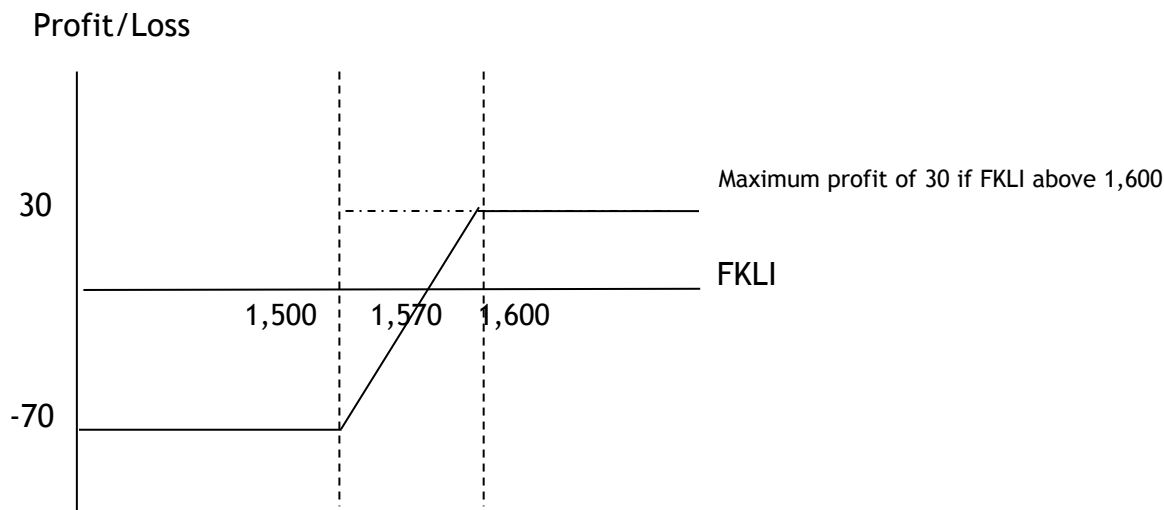
An example of a bull put spread is given below:

Buy 1-month 1,500 OKLI put for 30 points
 Sell 1-month 1,600 OKLI put for 60 points

The combined payoff for this strategy is given below:

FKLI	1,350	1,400	1,450	1,500	1,550	1,600	1,650	1,700	1,750
Payoff: 1,500 OKLI	120	70	20	-30	-30	-30	-30	-30	-30
Payoff: 1,600 OKLI	-190	-140	-90	-40	10	60	60	60	60
Combined payoff	-70	-70	-70	-70	-20	30	30	30	30

Diagram 6: 1,500-1,600 OKLI bull put spread payoff



From the example you will conclude:

- (i) Maximum loss of this strategy is the width of spread that is bought minus the net premium outlay. The width of the spread is 100 (1,600 minus 1,500) and the net premium outlay is 30, then the maximum loss is 70 (100 minus 30). Maximum loss occurs when FKLI is below the lower strike (1,500) at expiry of the bull put spread;
- (ii) Maximum profit is the net premium outlay which is 30 (60 - 30) and this occurs when the FKLI is above the higher strike (1,600) at the expiry of the options; and
- (iii) Break even for this strategy occurs within the put spread (1,570). It is calculated by deducting the net premium outlay from the higher strike (1,600 - 30).

B. Topic 7.04 - Bear put spread

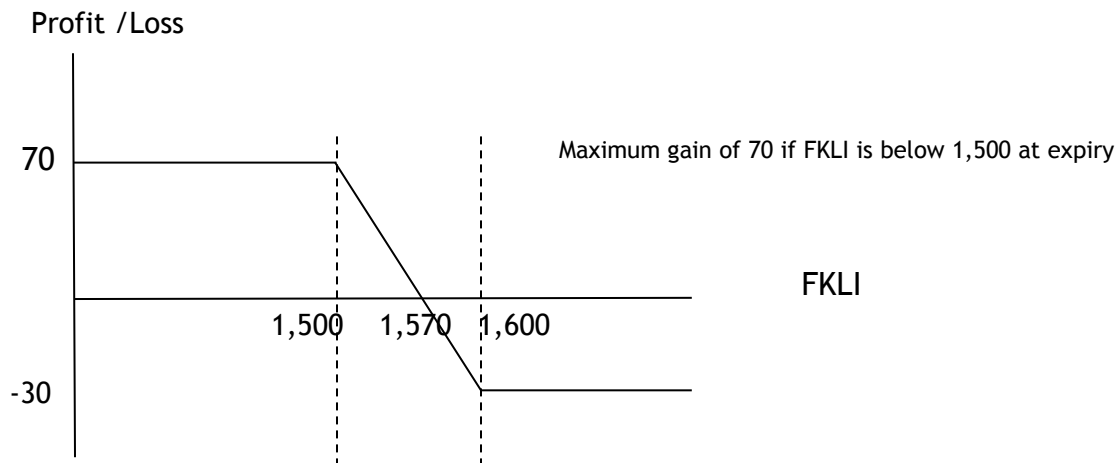
A bear put spread is the opposite of the bull put spread. This strategy involves buying the higher strike put option and selling the lower strike put option. The downside to this strategy is limited to the net premium outlay (cost of put bought minus premium received from put sold). The maximum upside is the width of the put spread minus the net premium and this occurs when the underlying spot expires below the lower strike. An example of a bear put spread is given below:

Buy 1-month 1,600 OKLI put for 60 points
 Sell 1-month 1,500 OKLI put for 30 points

The combined payoff for this strategy is given below:

FKLI	1,350	1,400	1,450	1,500	1,550	1,600	1,650	1,700	1,750
Payoff: 1,600 OKLI	190	140	90	40	-10	-60	-60	-60	-60
Payoff: 1,500 OKLI	-120	-70	-20	30	30	30	30	30	30
Combined payoff	70	70	70	70	20	-30	-30	-30	-30

Diagram 7: 1,600-1,500 OKLI bear put spread payoff



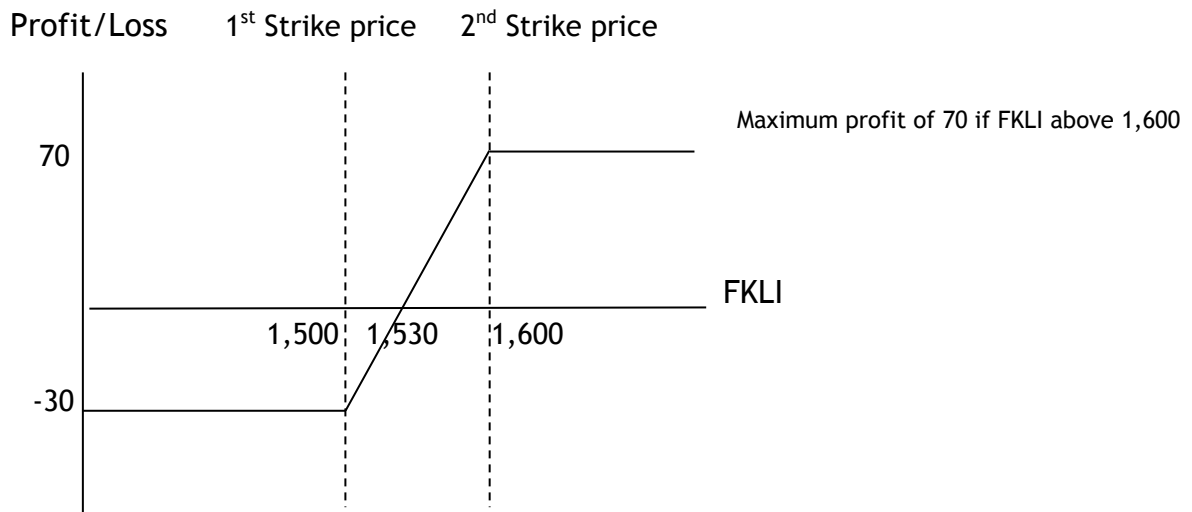
You will conclude the following:

- (i) Maximum loss of this strategy is the net premium received which is 30 ($60 - 30$). Maximum loss occurs when FKLI is above the higher strike (1,600) at expiry;
- (ii) Maximum profit is the width of the spread (100) that is sold minus the net premium received so maximum profit for this strategy is 70. This occurs when the FKLI is below the lower strike (1,500) at the expiry of the options; and
- (iii) Break even for this strategy occurs within the put spread (1,570). It is calculated by deducting the net premium received from the higher strike ($1,600 - 30$).

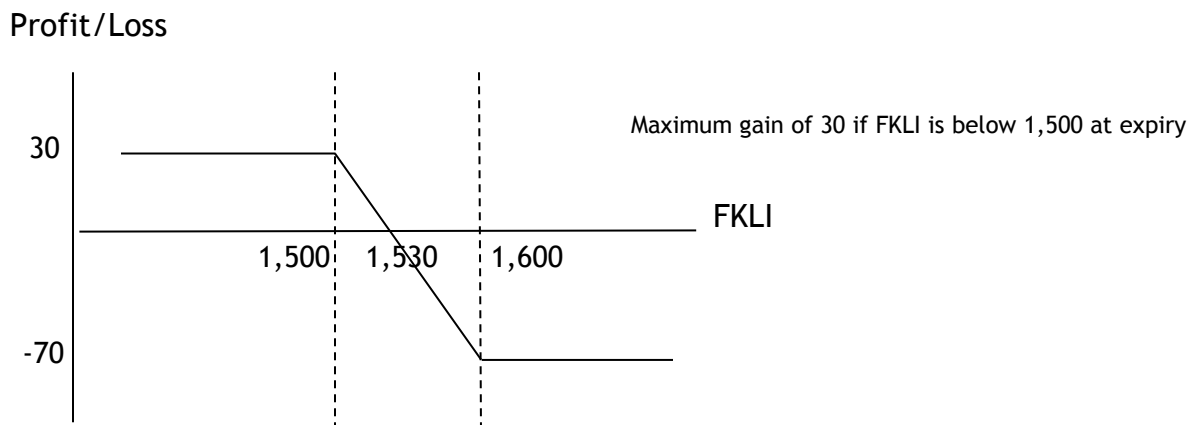
2. The following is to replace the existing payoff diagrams on Topic 7: Trading Strategies with Options due to misalignment of FKLI prices.

- A. Diagram 5: 1,500 - 1,600 OKLI bull call spread payoff (Page 7-4);
- B. Diagram 7: 1,500 - 1,600 OKLI bear call spread payoff (Page 7-6);
- C. Diagram 9: Long 1,600 OKLI straddle payoff (Page 7-9); and
- D. Diagram 10: Short 1,600 OKLI straddle payoff (Page 7-9).

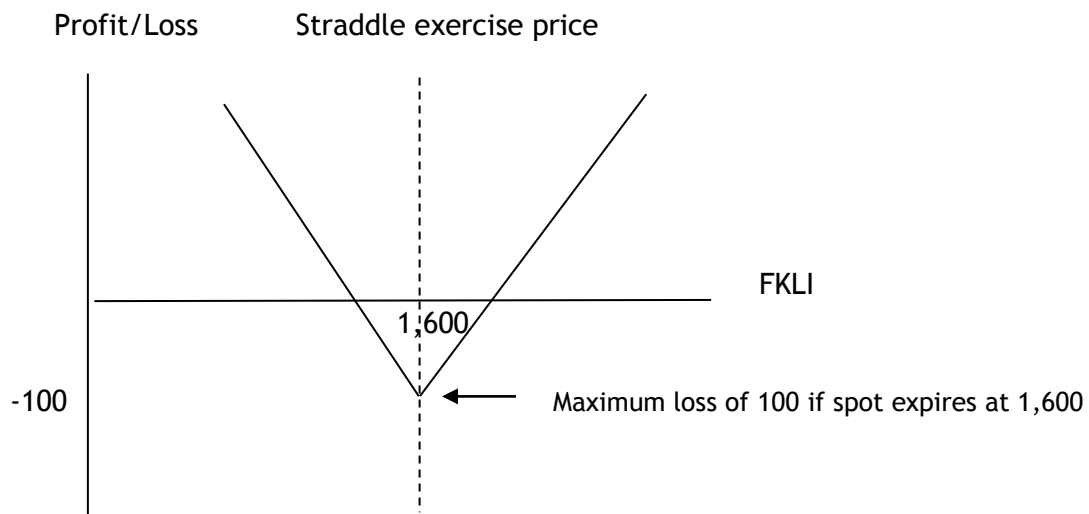
A. Diagram 5: 1,500-1,600 OKLI bull call spread payoff



B. Diagram 7: 1,500-1,600 OKLI bear call spread payoff



C. Diagram 9: Long 1,600 OKLI straddle payoff



D. Diagram 10: Short 1,600 OKLI straddle payoff

