



# Long Stock with Ratio Call Spread



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Explain the Strategy

Profit/Loss Table and Diagram

Mechanics at Expiration

Applications

Variations

Bonus Strategy – Ratio Spread with Puts

3 parts:      Long Stock (100 shares)  
                  Long 1 Call (lower strike)  
                  Short 2 Calls (higher strike)

This is a “ratio” spread, because there are a different number of long and short options.

# Long Stock with Ratio Call Spread

Example: XYZ @ 50 – target 10% higher to 55

Long 100 shares XYZ @ 50.00

Long 1 XYZ 50 Call @ 3.00

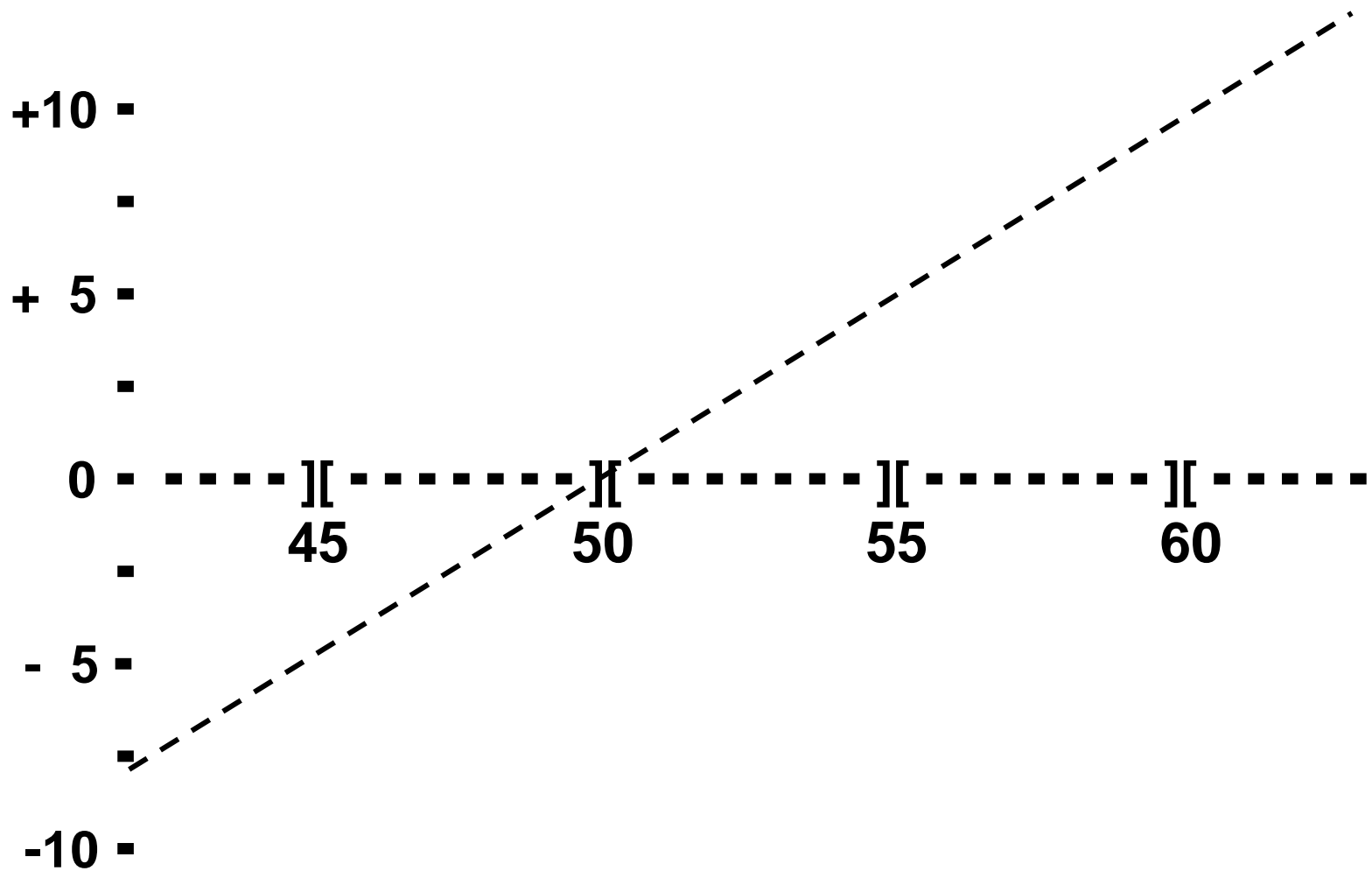
Short 2 XYZ 55 Calls @ 1.50 ea.

All options have the same expiration.

# Profit / Loss Table

Stock Price	Long Stk at 50.00	+1 50 Call at 3.00	-2 55 Calls at 1.50 ea.	P /(L)
56				
55				
54				
53				
52				
51				
50				
49				

# Long Stock with Ratio Call Spread



Add leverage over a limited range.

Below the “indifference point,” the ratio call spread adds profit to a long stock position.

Above the ‘indifference point, a simple long stock position will produce a larger profit.

The loss from a stock price decline is the same for both strategies (if ratio call spread is established for -0-).

# Variation 1 – Out-of-the-Money Calls

Example:

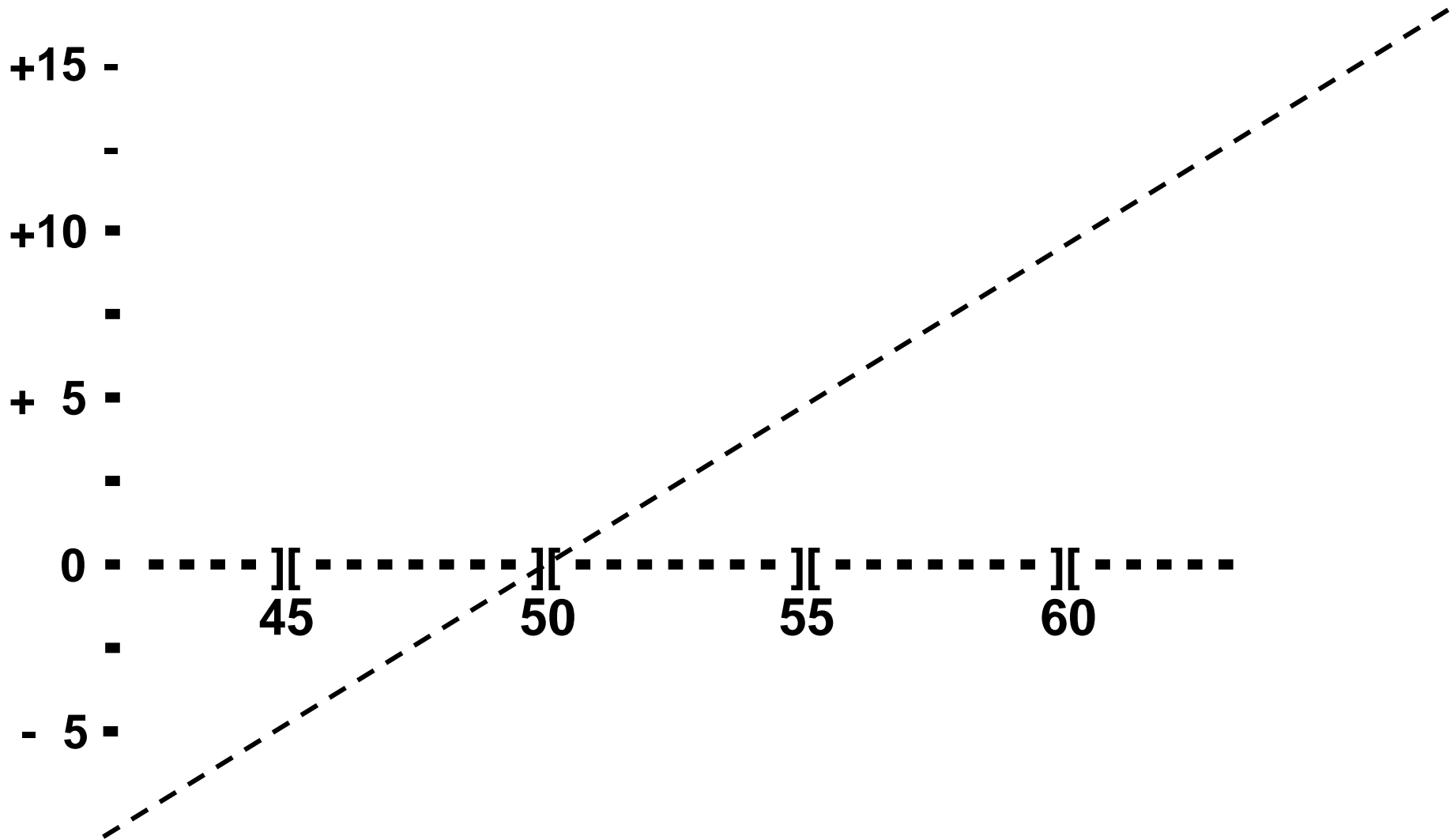
Long	100	shares XYZ	@	50.00
Long	1	XYZ 55 Call	@	1.50
Short	2	XYZ 60 Calls	@	0.75 ea.

All options have the same expiration.

# Profit / Loss Table

Stock Price	Long Stk at 50.00	+1 55 Call at 1.50	-2 60 Calls at 0.75 ea.	P /(L)
61				
60				
59				
58				
57				
56				
55				
50				

# Long Stock with Ratio Call Spread



## Variation 2 – I-T-M and A-T-M Calls

Example:

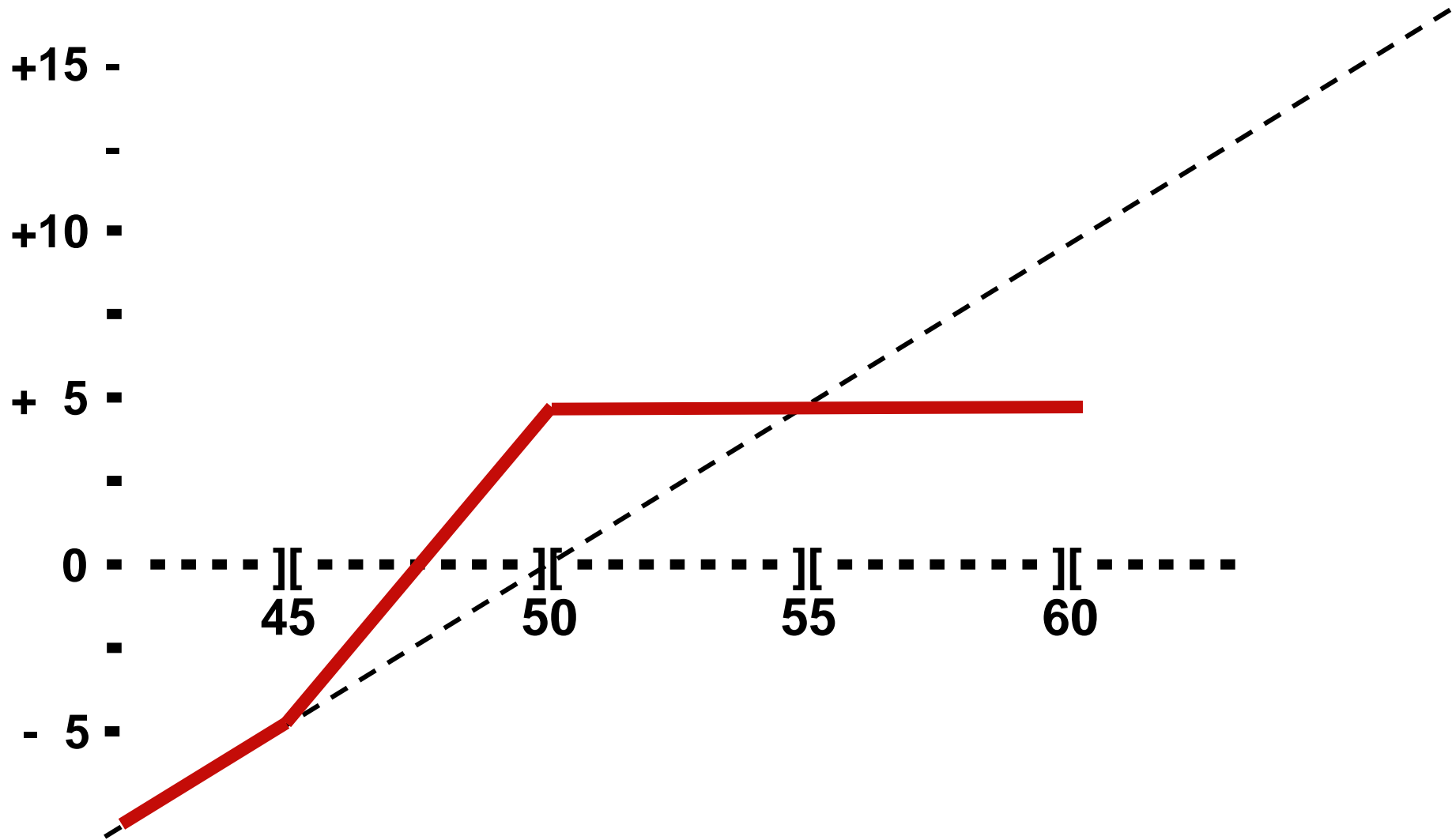
Long	100	shares XYZ	@	50.00	
Long	1	XYZ 45 Call	@	6.00	
Short	2	XYZ 50 Calls	@	3.00	ea.

All options have the same expiration.

# Profit / Loss Table

Stock Price	Long Stk at 50.00	+1 45 Call at 6.00	-2 50 Calls at 3.00 ea.	P /(L)
51				
50				
49				
48				
47				
46				
45				
44				

# Long I-T-M / Short A-T-M Calls



## Variation 3 – The Stock Repair

Background: A short while ago, you bought XYZ stock at \$60, but it declined to \$50. You do not want to “double up,” but you want to hold the stock with the goal of breaking even.

Action: Use a ratio call spread to lower the B-E

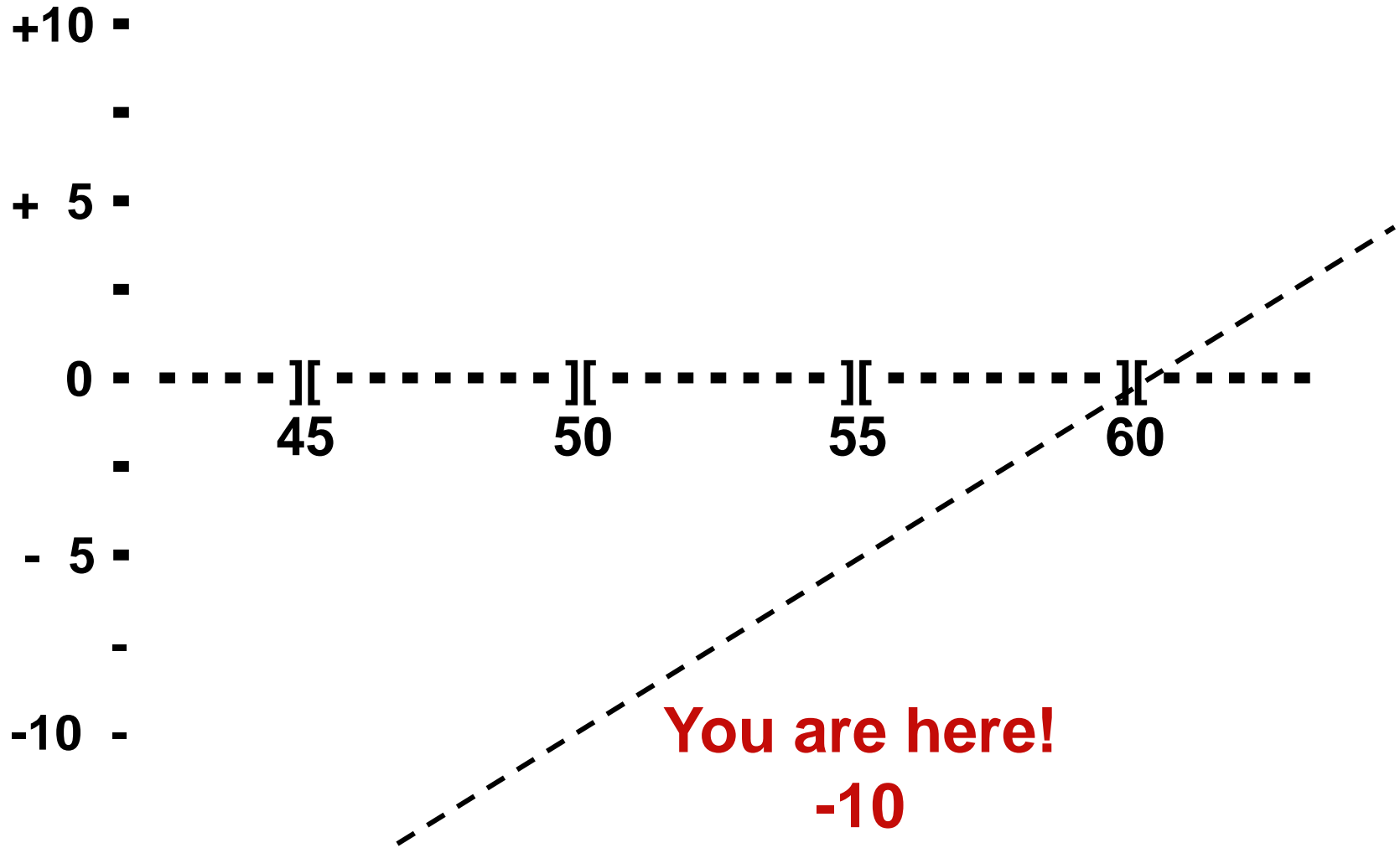
Own	100	shares XYZ	@	60.00	
Buy	1	XYZ 50 Call	@	6.00	
Sell	2	XYZ 55 Calls	@	3.00	ea.

Note: XYZ trading now at \$50

# Profit / Loss Table

Stock Price	Long Stk at 60.00	+1 50 Call at 3.00	-2 55 Calls at 1.50 ea.	P /(L)
56				
55				
54				
53				
52				
51				
50				
49				

# The Stock Repair



The break-even is lowered without investing more money.

“Doubling up” would increase risk.

The ratio call spread is established at little or not cost.

The negative is that upside profit potential is limited to the strike price of the short calls.

# Real World Prices – 8/11/09

				1x2 Ratio <u>Call Spd</u>
RIMM @ 72.11	Sep 75 Call	2.83		
(38 days to Sep)	Sep 80 Call	1.43		0.03 Cr
UNP @ 60.00	Nov 60 Call	4.65		
(101 days to Nov)	Nov 65 Call	2.60		0.55 Cr
DE @ 44.86	Sep 45 Call	2.75		
(38 days to Sep)	Sep 50 Call	0.90		0.95 Dr

Note: examples are presented for illustration only, not recommendations.

Background: For the short term, you are bearish on QRS, now \$70, but you are willing to buy some shares near \$60. You would like to generate some cash income.

Action: Ratio put spread targets buy price of \$60

Buy 1 QRS 70 Put @ 4.50

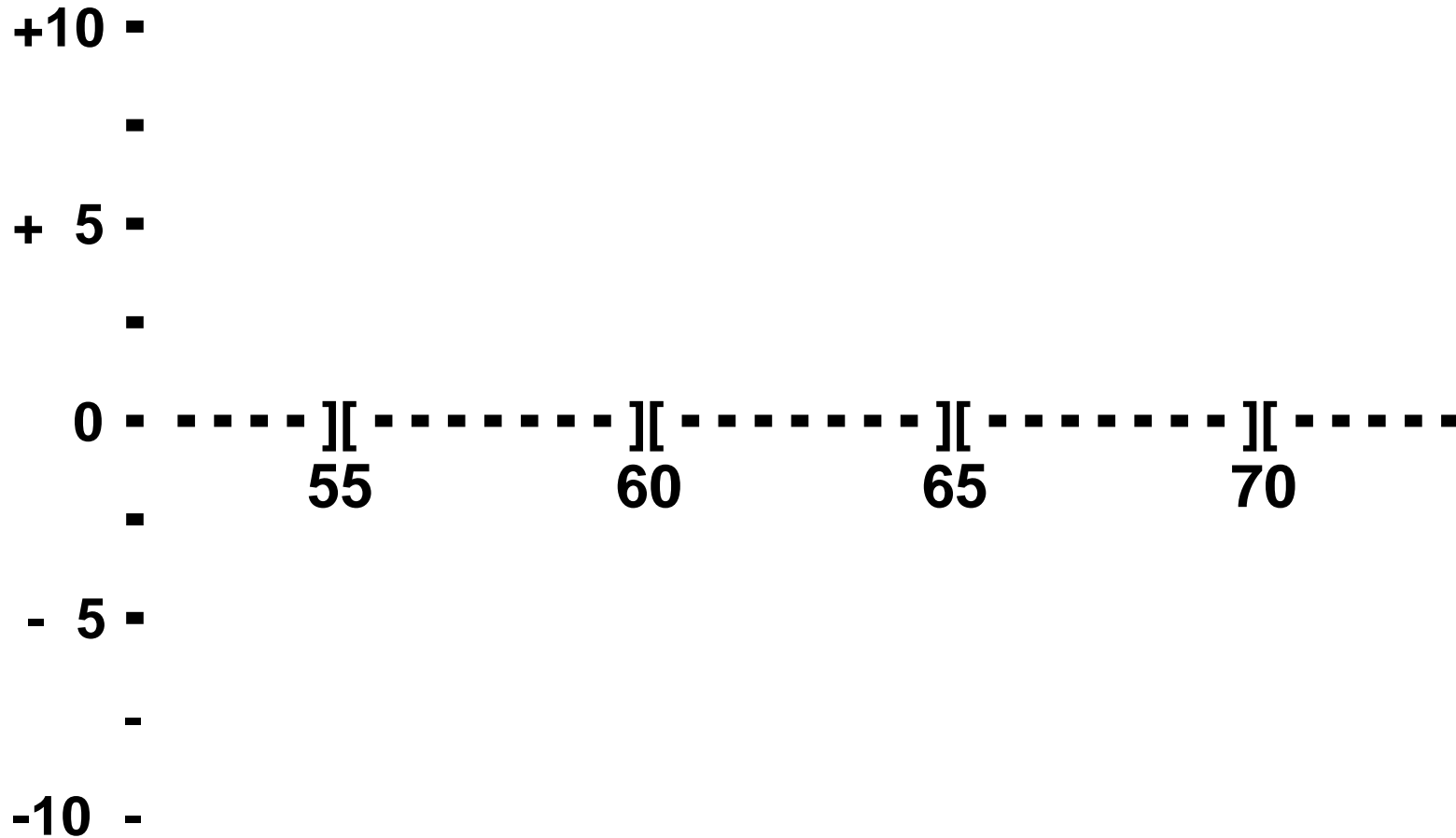
Sell 2 QRS 65 Puts @ 2.60 ea.

Deposit \$6,000 for each ratio spread

# Profit / Loss Table

Stock Price	+1 70 Put at 4.50	-2 65 Puts at 2.60 ea	P /(L)
75			
70			
65			
60			
55			

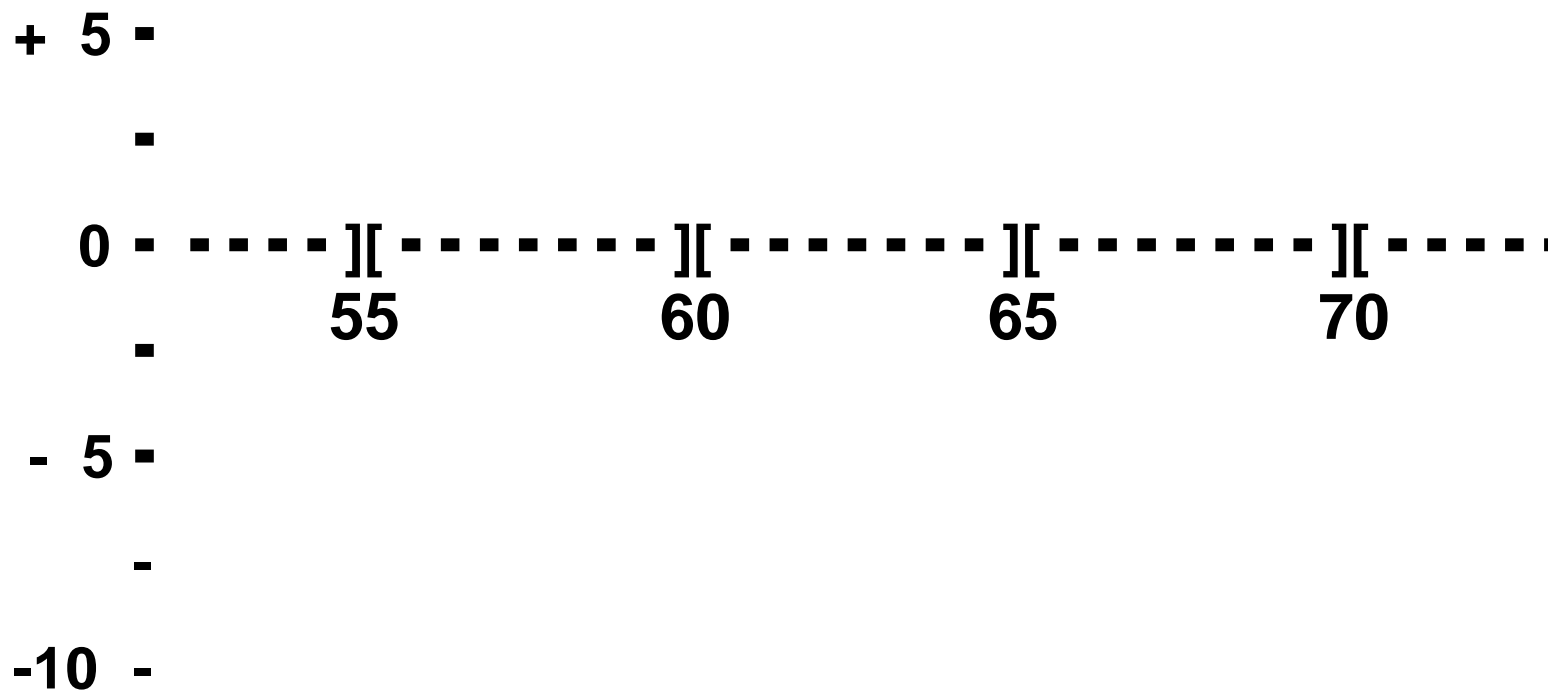
# The Ratio Put Spread



# Bonus Bonus Strategy

+1 65 Put @ 2.60

-2 60 Puts @ 1.25 ea. Net Debit (0.10)



Target a stock purchase price 10-20% below the current market price.

Bring in some option premium for income (in this example, \$70 income on \$6,000 for 60 days amounts to approximately 7% per yr.

Create an opportunity to make considerably more than the initial credit received.

The negative is the full risk of stock ownership below the break-even point.

# Real World Prices – 8/11/09

			1x2 Ratio <u>Put Spd</u>
IBM @ 117.79	Oct 115 Put	4.00	
(66 days to Oct)	Oct 110 Put	2.45	0.90 Cr
BA @ 45.32	Sep 45 Put	1.80	
(38 days to Sep)	Sep 42 Put	0.90	-0-
CAT @ 46.28	Sep 46 Put	2.70	
(38 days to Sep)	Sep 43 Put	1.53	0.36 Cr

Note: examples are presented for illustration only, not recommendations.

Ratio spreads with calls offer stock investors some unique risk profiles:

- add leverage over a limited
- an alternative to covered calls
- stock repair

Ratio spreads with puts also offer stock investors unique alternatives

THANK YOU FOR ATTENDING.

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# ANSWERS

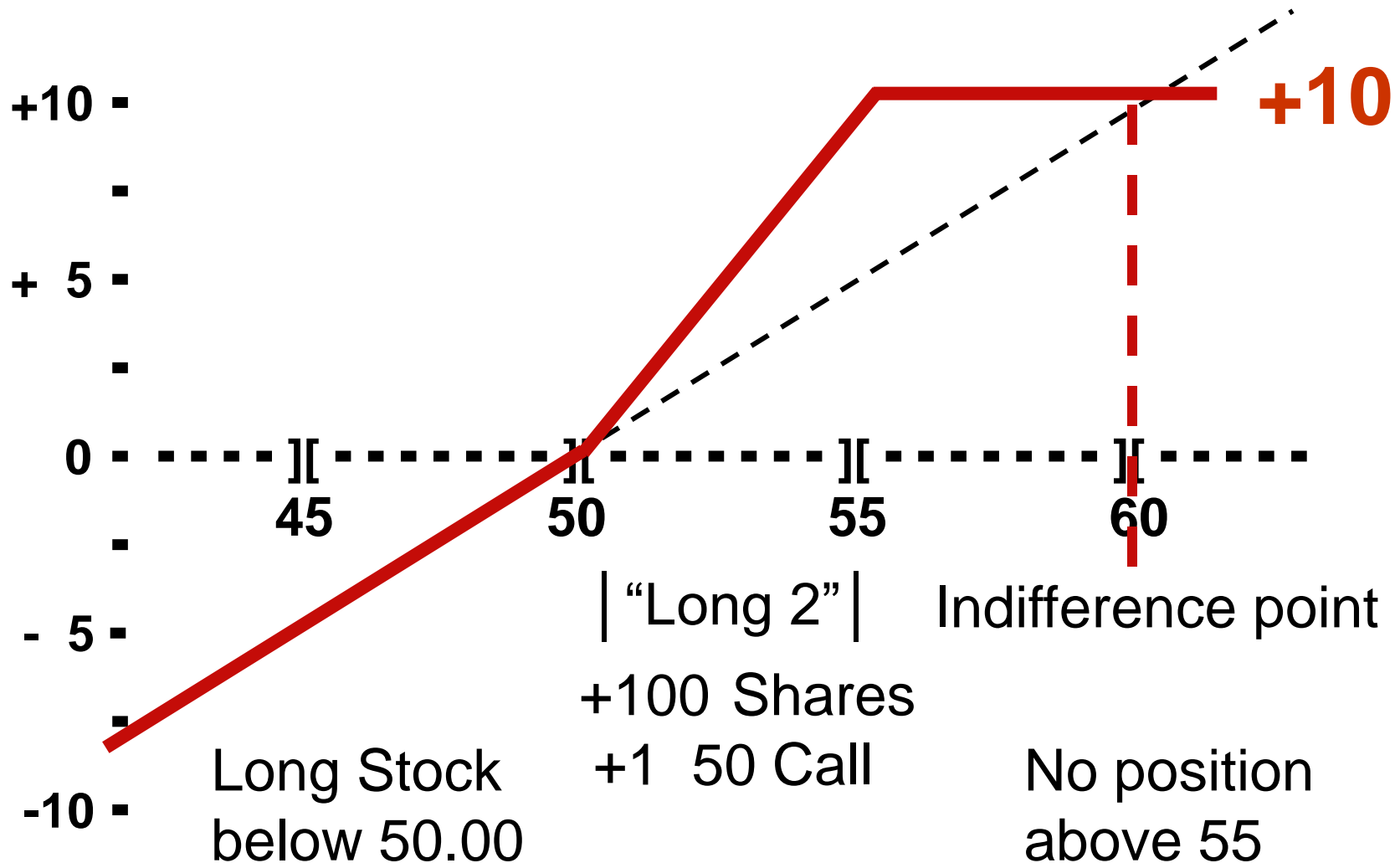


**Long Stock with Ratio Call Spread**

# Profit / Loss Table

Stock Price	Long Stk at 50.00	+1 50 Call at 3.00	-2 55 Calls at 1.50 ea.	P /(L)
56	<b>+6.00</b>	<b>+3.00</b>	<b>+1.00</b>	<b>+10.00</b>
55	<b>+5.00</b>	<b>+2.00</b>	<b>+3.00</b>	<b>+10.00</b>
54	<b>+4.00</b>	<b>+1.00</b>	<b>+3.00</b>	<b>+8.00</b>
53	<b>+3.00</b>	<b>-0-</b>	<b>+3.00</b>	<b>+6.00</b>
52	<b>+2.00</b>	<b>(1.00)</b>	<b>+3.00</b>	<b>+4.00</b>
51	<b>+1.00</b>	<b>(2.00)</b>	<b>+3.00</b>	<b>+2.00</b>
50	<b>-0-</b>	<b>(3.00)</b>	<b>+3.00</b>	<b>-0-</b>
49	<b>(1.00)</b>	<b>(3.00)</b>	<b>+3.00</b>	<b>(1.00)</b>

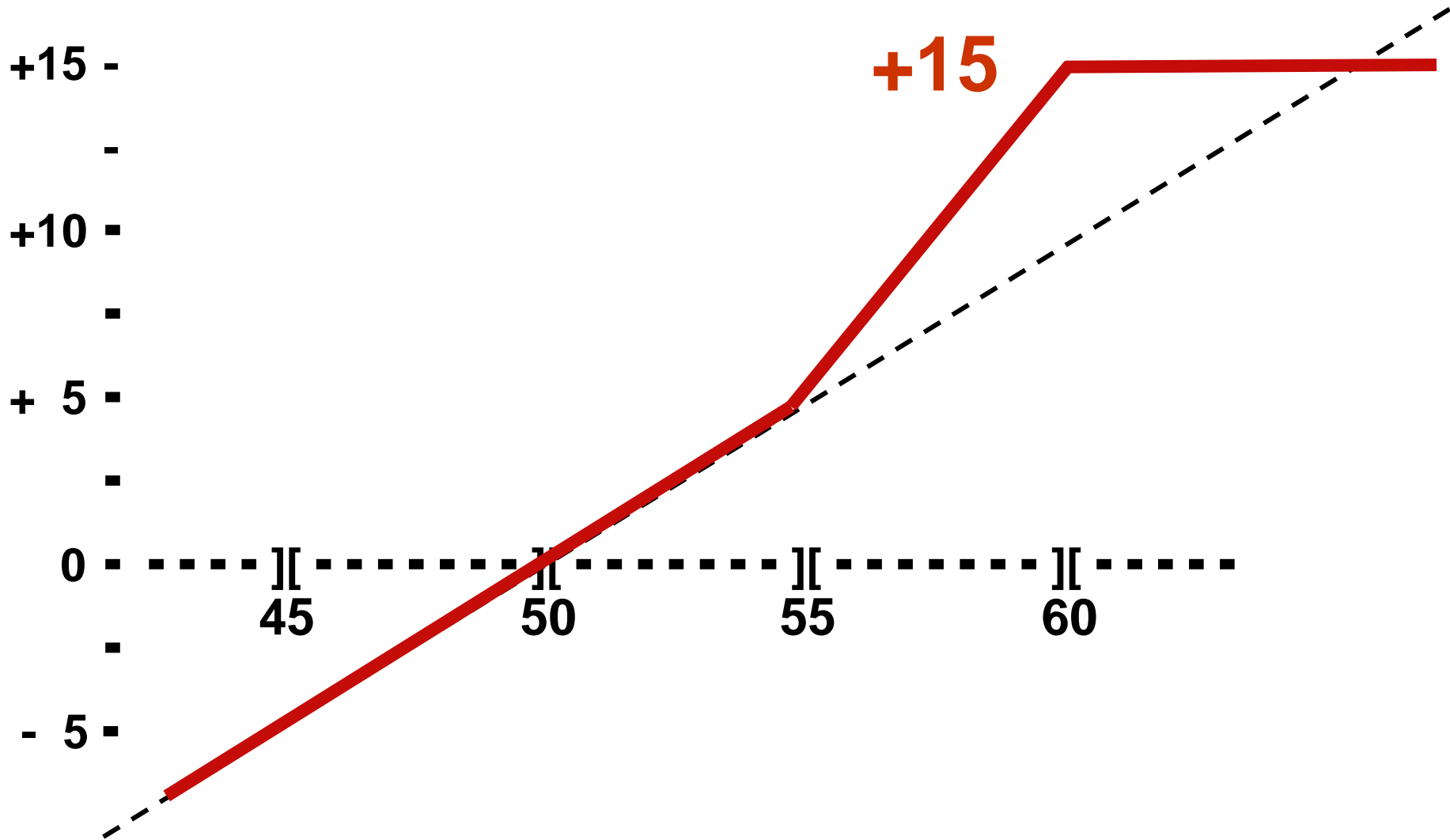
# Long Stock with Ratio Call Spread



# Profit / Loss Table

Stock Price	Long Stk at 50.00	+1 55 Call at 1.50	-2 60 Calls at 0.75 ea.	P /(L)
61	<b>+11.00</b>	<b>+4.50</b>	<b>(0.50)</b>	<b>+15.00</b>
60	<b>+10.00</b>	<b>+3.50</b>	<b>+1.50</b>	<b>+15.00</b>
59	<b>+9.00</b>	<b>+2.50</b>	<b>+1.50</b>	<b>+13.00</b>
58	<b>+8.00</b>	<b>+1.50</b>	<b>+1.50</b>	<b>+11.00</b>
57	<b>+7.00</b>	<b>+0.50</b>	<b>+1.50</b>	<b>+9.00</b>
56	<b>+6.00</b>	<b>(0.50)</b>	<b>+1.50</b>	<b>+7.00</b>
55	<b>+5.00</b>	<b>(1.50)</b>	<b>+1.50</b>	<b>+5.00</b>
50	<b>-0-</b>	<b>(1.50)</b>	<b>+1.50</b>	<b>-0-</b>

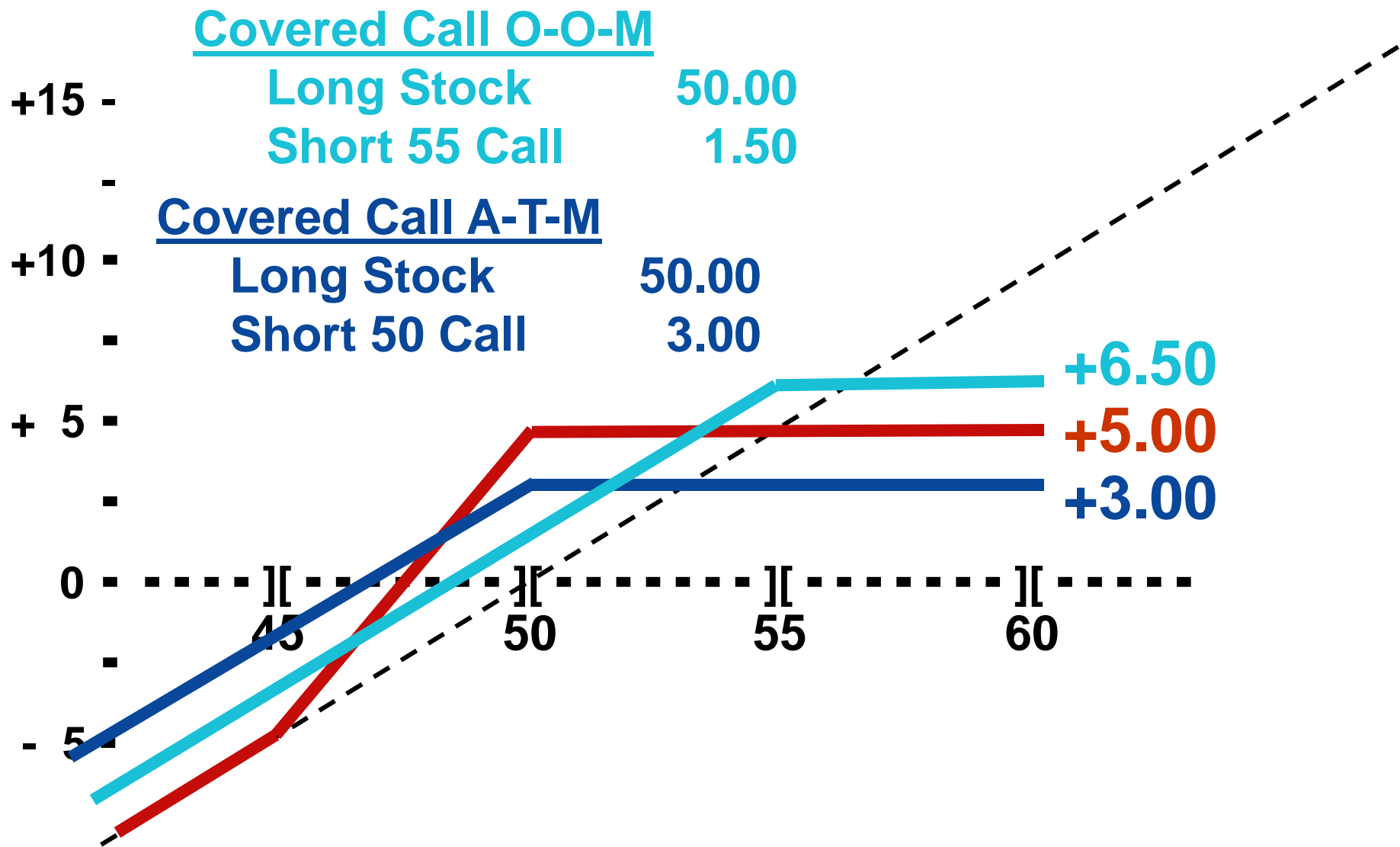
# Long Stock with Ratio Call Spread



# Profit / Loss Table

Stock Price	Long Stk at 50.00	+1 45 Call at 6.00	-2 50 Calls at 3.00 ea.	P /(L)
51	<b>+1.00</b>	<b>-0-</b>	<b>+4.00</b>	<b>+5.00</b>
50	<b>-0-</b>	<b>(1.00)</b>	<b>+6.00</b>	<b>+5.00</b>
49	<b>(1.00)</b>	<b>(2.00)</b>	<b>+6.00</b>	<b>+3.00</b>
48	<b>(2.00)</b>	<b>(3.00)</b>	<b>+6.00</b>	<b>+1.00</b>
47	<b>(3.00)</b>	<b>(4.00)</b>	<b>+6.00</b>	<b>(1.00)</b>
46	<b>(4.00)</b>	<b>(5.00)</b>	<b>+6.00</b>	<b>(3.00)</b>
45	<b>(5.00)</b>	<b>(6.00)</b>	<b>+6.00</b>	<b>(5.00)</b>
44	<b>(6.00)</b>	<b>(6.00)</b>	<b>+6.00</b>	<b>(6.00)</b>

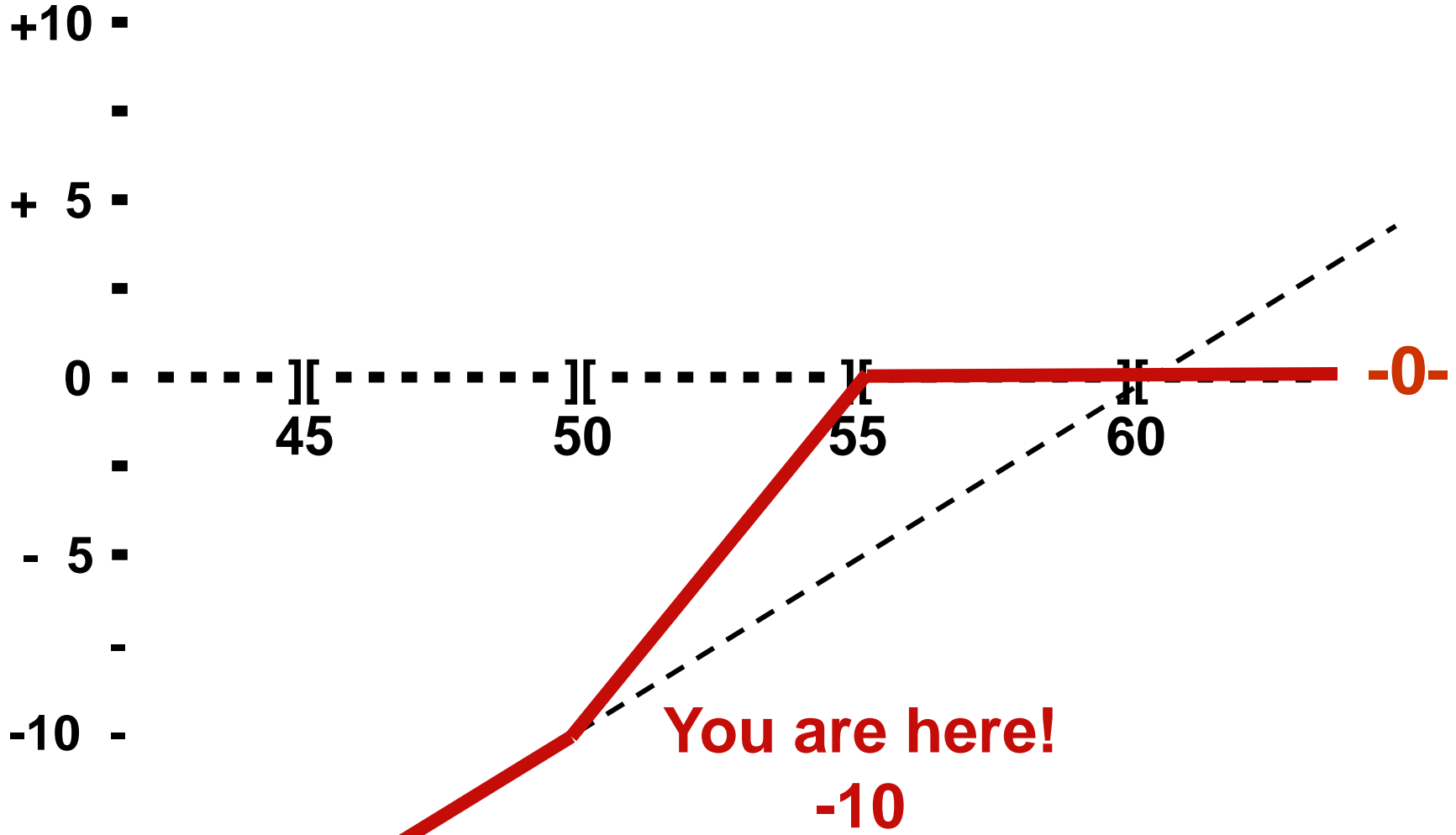
# Long I-T-M / Short A-T-M Calls



# Profit / Loss Table

Stock Price	Long Stk at 60.00	+1 50 Call at 3.00	-2 55 Calls at 1.50 ea.	P /(L)
56	(4.00)	+3.00	+1.00	-0-
55	(5.00)	+2.00	+3.00	-0-
54	(6.00)	+1.00	+3.00	(2.00)
53	(7.00)	-0-	+3.00	(4.00)
52	(8.00)	(1.00)	+3.00	(6.00)
51	(9.00)	(2.00)	+3.00	(8.00)
50	(10.00)	(3.00)	+3.00	(10.00)
49	(11.00)	(3.00)	+3.00	(11.00)

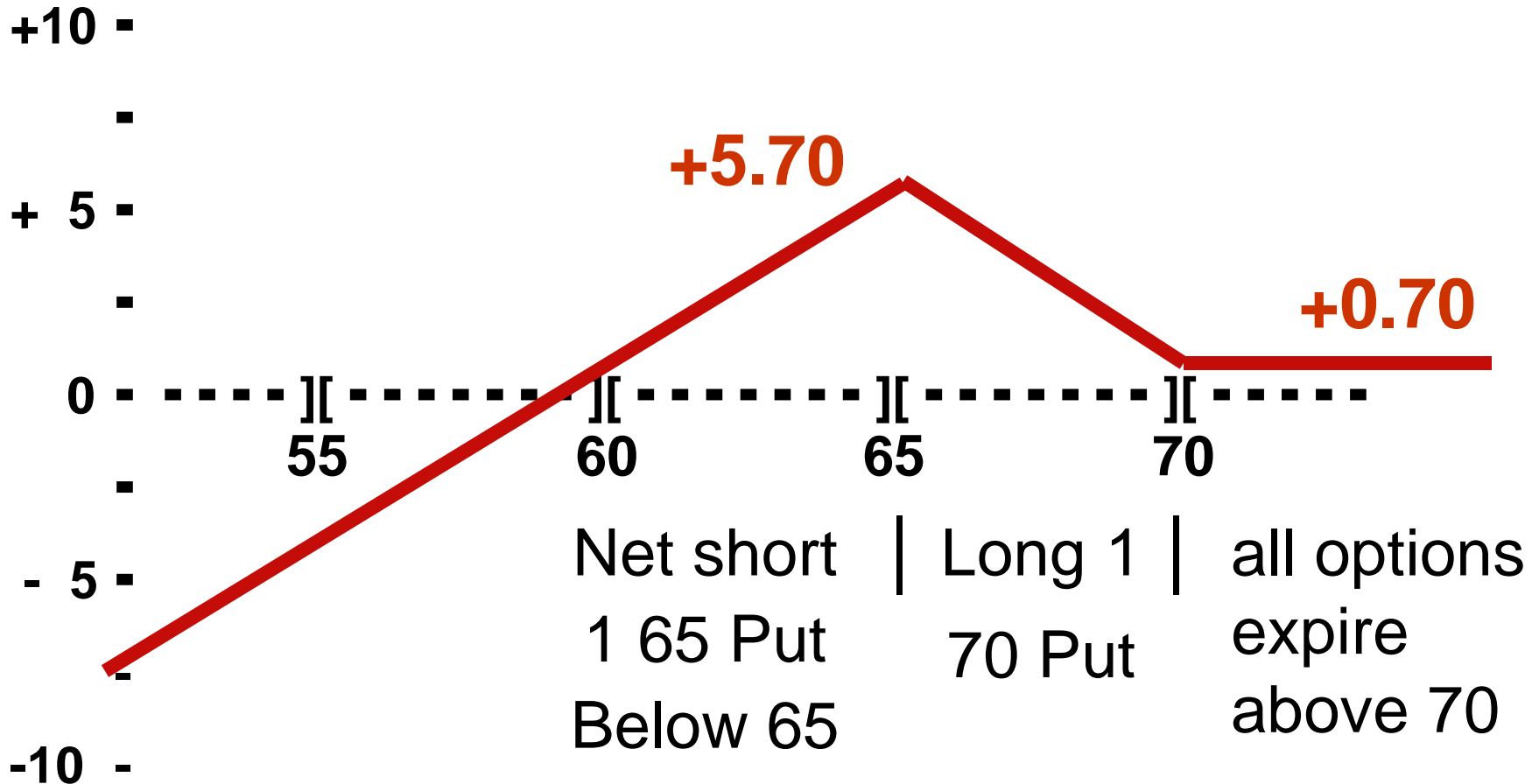
# The Stock Repair



# Profit / Loss Table

Stock Price	+1 70 Put at 4.50	-2 65 Puts at 2.60 ea	P /(L)
75	<b>(4.50)</b>	<b>+5.20</b>	<b>+0.70</b>
70	<b>(4.50)</b>	<b>+5.20</b>	<b>+0.70</b>
65	<b>+0.50</b>	<b>+5.20</b>	<b>+5.70</b>
60	<b>+5.50</b>	<b>(4.80)</b>	<b>+0.70</b>
55	<b>+10.50</b>	<b>(14.80)</b>	<b>(4.30)</b>

# The Ratio Put Spread



# Bonus Bonus Strategy

+1 65 Put @ 2.60  
 -2 60 Puts @ 1.25 ea. Net Debit (0.10)

