Various options hedging strategies

Business, Marketing

number company treasurer May 16 Various options hedging strategies The bull spread-A bull call spread is a hedging option strategy involving the purchase of call options at a given strike price and the sale of a similar number of calls of the individual asset with a matching expiry date at a higher strike price. The difference between the strike prices minus the net cost options of the long and short options gives the maximum profit (Hull 12)

Ratio spread-This is an option strategy that has the aim of reducing risks associated with the movement of the price of the underlying asset with short and long positions offsetting. This strategy relies on the change of the price of the option that has been caused by changes in the underlying security’s price (Jorion 287)

Butterfly spread- The butterfly spread normally uses four option contracts that have three strike prices that are different, although all the contracts have the same expiration date. This is in order to create price ranges that can aid this strategy to make profits. It involves the purchase of one call option at a given price while at the same time you sell two call options at a higher price and then buy one more call option at a price higher than the initial option.

Advantages-This strategy can be executed at far less low cost than that of the required one hundred shares. Secondly, there is an extremely good reward to risk ratio if the trader is attentive to what he pays in order to enter a trade (Jorion 287)

Disadvantage-The trader who applies this strategy needs to be correct on the market direction in order to avoid losses, something that is very hard to achieve.

Best,

Student

Works cited

Jorion, Philippe. Financial Risk Manager Handbook (5 Ed.). John Wiley and Sons. 2009. Print

Hull, John C. Options, Futures and Other Derivatives, Sixth Edition. Prentice Hall. 2006. Print