

Index

- Adaptive mesh model, 29–32
- Amgen (AMGN), 172–174
- Assignment, 5
- At-the-money (ATM) options, 9, 125, 127–128
 - defined, 7
 - effect of Greeks on, 43, 44, 45, 50
- Bear spread, 209–210, 227–230, 231–232
- Bear Stearns (BSC), 273–274
- Bell curve (Normal distribution), 21–25, 31, 35
- Binomial model, 26–28
- Black, Fisher, 26
- Black-Scholes model, 26–27
- Break down, 186–187
- Break-even point:
 - with butterfly, 302, 313
 - with call options, 15–16, 128
 - with condor, 318, 328–330
 - with put options, 17
 - with straddles, 267–271
 - with strangles, 285–288
- Breakout, 171–172
- Bristol Myers (BMJ), 159–160
- Bull spread, 209–210, 226–227, 230–231
- Butterfly, 297, 299–314
 - break-even point, 302, 313
 - condor compared to, 317, 321–323
 - construction of, 299–301, 313, 314
 - cost of, 305–306
 - iron butterfly, 309–312
 - key concepts of, 314
 - long vs. short, 299–300, 305–306, 311, 313–314
 - position of Greeks with, 307–309
 - potential profit/loss, 301–302, 313, 314
 - reasons for use, 301–303
 - simplifying, 303–304
 - synopses, 313–314
 - and synthetic positions, 303–305
 - when to use, 312–313, 314
- Buy-write strategy. *See* Covered call (buy-write) strategy
- Calendar spreads. *See* Time spreads
- Call options:
 - defined, 4
 - intrinsic and extrinsic values of, 11
 - naked, 120
 - naked call, 123
 - overview, 15–16
 - risk involved, 16, 128–130
 - synthetic, 96–106
 - and volatility, 12
- Call option strategies:
 - butterfly, 299–314
 - collar strategy, 193–205
 - condor, 315–333
 - covered call (buy-write) strategy, 131–146
 - diagonal spreads, 255–259
 - straddles, 261–277
 - strangles, 279–295
 - synthetic calls, 96–106
 - synthetic put (protective call) strategy, 106–115, 179–192

- Call option strategies (*Continued*)
 synthetic stock, 88–96
 time (calendar) spreads, 233–253
 vertical spreads, 209–231
- Collar strategy, 193–205
 construction of, 204
 down scenario, 196
 examples, 199–204
 foundations of, 193–194
 key concepts of, 205
 leaning, 197–198
 potential profit/loss, 205
 stagnant scenario, 195–196
 synopsis, 204–205
 up scenario, 194–195
 when to use, 205
- Condor, 297, 315–333
 break-even point, 318, 328–330
 compared to butterfly, 317, 321–323
 construction of, 320, 331, 332
 iron condor, 326–330
 key concepts of, 332, 333
 long vs. short, 315–320, 328–330, 331–333
 position of Greeks with, 323–326
 potential profit/loss, 332, 333
 reasons for use, 317–320
 synopses, 331–333
 when to use, 330–331, 332, 333
- Contracts, 3–4
- Corresponding, defined, 87
- Cost of carry, 34
- Covered call (buy-write) strategy, 131–146. *See also* Collar strategy
 construction of, 146
 down scenario, 137, 138
 examples, 141–146
 foundations of, 131–135
 key concepts of, 146
 leaning, 138–139
 potential profit/loss, 146
 profit and loss curve, 133
 rolling, 139–141
 stagnant scenario, 136–137, 138
 synopsis, 146
 up scenario, 135–136, 138
 when to use, 146
- Covered put (sell-write) strategy, 147–163
 construction of, 149–150, 163
 down scenario, 151–153
 effects of, 149
 examples, 157–162
 key concepts of, 163
 leaning, 154–157
 potential profit/loss, 163
 process of, 150–151
 rolling, 157
 stagnant scenario, 153
 synopsis, 163
 up scenario, 153–154
 when to use, 163
- Credit spread, 209, 220, 225
- Debit spread, 209, 220
- Dell Computer (DELL), 143–144
- Delta, 41, 42–52, 87. *See also* Greeks and butterflies, 307, 311–312
 of calls, 43–44
 changes in, 120–123
 and condors, 323
 definitions for, 256
 delta connection, 46–47
 and diagonal spreads, 256–257
 hedge ratio, 42
 percent chance, 42
 percent change, 42
 position delta, 48–49
 of puts, 44–46
 relationship to strike price, 42–46, 49
 and stock, 93–94
 and theta, 74, 75
 and time decay, 127
 time effect on, 50–51
 and volatility, 51–52
- Delta neutral, 48–49
- Diagonal spreads (stock replacement/covered call strategy), 255–259
 overview, 259
 rolling position, 259
 when to use, 257–259

- Directional positions *See also* Leaning Positions
 - long/short, 5
- Directional stock play, 209
- Directional trading strategies, 119–123
- Dividend, as input, 34–35

- EBay (EBAY), 200–202
- Eli Lilly (LLY), 199–200
- Enbridge Energy Partners LP (EEP), 290–291
- Exhaustion models, 170, 185
- Expiration date, 4
- Extrinsic value, 9–11, 125–127
 - in butterflies, 304, 305
 - in covered call (buy-write) strategy, 134–136, 139
 - in covered put (sell-write) strategy, 150, 153, 156
 - theta and, 68–71
 - in vertical spreads, 217, 220–221, 234, 235, 246
 - and volatility, 12–13
 - v-theta and, 83
- Exxon Mobil (XOM), 250–251

- Gamma, 41, 52–56. *See also* Greeks
 - and butterflies, 307–308
 - and condors, 323–326
 - long vs. short, 55, 56
 - relationship to strike price, 53
 - and stock, 95–96
 - and theta, 74–79
 - and time, 53–55
 - and time spreads, 236
- General Electric (GE), 227–228
- General Motors (GM), 175–177
- Goldman Sachs (GXCO), 289–290
- Greeks, 41–84
 - and butterflies, 307–309
 - and condors, 323–326
 - delta, 41, 42–52 (*See also* Delta; T-delta)
 - front-line, 42–79
 - gamma, 41, 52–56 (*See also* Gamma; V-gamma)
 - overview, 39
 - second-tier, 80–84
 - strike-based, 87 (*See also* Gamma; Theta; Vega)
 - and synthetic calls, 99–100, 103–104
 - and synthetic puts, 108–110, 113–114
 - T-delta, 81
 - T-gamma, 82–83
 - theta, 11, 41, 68–79 (*See also* Theta; Time decay)
 - V-delta, 80–81
 - vega, 41, 57–68 (*See also* Implied volatility; Vega; Volatility)
 - V-gamma, 81–82
 - V-theta, 83–84
- Hedge ratio, 42

- Imclone Systems Inc. (IMCL), 292–293
- Implied volatility. *See also* Vega
 - defined, 13
 - in straddles, 264–265
 - in strangles, 284
 - in time spreads, 222, 244–246
- Inputs, 32–39
 - dividend, 34–35
 - interest rate, 34
 - kurtosis, 35–39
 - skewness, 35–39
 - stock price, 33
 - volatility, 33
- Interest rate, as input, 34
- In-the-money (ITM) options, 123–124, 125, 127–128
 - defined, 8
 - effect of Greeks on, 43, 72, 74–76
 - and intrinsic value, 9
 - risk involved, 130
- Intrinsic value, 9–11, 121–122
 - in butterflies, 305
 - in corresponding call/put spreads, 215–216
 - in covered call (buy-write) strategy, 139
 - in covered put (sell-write) strategy, 156
 - in vertical spreads, 214–216, 217

- Iron butterfly, 309–312
 Iron condor, 326–330
 ITT Industries (ITT), 226–227
- Johnson & Johnson (JNJ), 161–162,
 228–229
 J.P. Morgan (JPM), 142–143
- Kurtosis, 30, 35–39
- Leaning positions: *See also* Directional
 positions
 definition, 138
 in covered call (buy-write) strategy,
 138–139
 in covered put (sell-write) strategy,
 154–157
 in protective put strategy, 168–169
 in synthetic put (protective call)
 strategy, 183–184
- LEAPS, 6, 62–63
 Leverage, 128–130, 258, 259
 Log-normal distribution, 30, 32
 Long position, defined, 5
- Margin trading, 148
 Market perception, 122
 Married put. *See* Protective put
 strategy
- Martek Biosciences (MATK), 188–190
 McDonald's (MCD), 141–142
 Merck (MRK), 160–161
 Merrill Lynch (MER), 203–204
 Monte Carlo method, 26
- Naked, defined, 120
 Naked calls, 120, 123
 Naked puts, 120, 123
 Normal distributions (Bell curve),
 21–25, 35–36
- Option contract, overview, 3–4
 Option pricing models, 29–32
 Adaptive mesh model, 29–32
 Binomial model, 26–28
 Black-Scholes model, 26–27
 fundamentals, 21–25
 inputs of, 32–39
 Monte Carlo method, 26
 outputs of, 39
 Trinomial model, 28–29
 types of, 25–32
 VSK model, 37, 38
 Options. *See also* Call options; Put
 options; *specific strategies*
 defined, 3
 speed component of, 120
 terminology, 3–13
 value determination of (*See* Option
 pricing models)
- Options Clearing Corporation (OCC), 4
- Out-of-the-money (OTM) options,
 124–128
 defined, 8–9
 effect of Greeks on, 43, 44, 46, 50,
 74–76
 risk involved, 130
- Outputs:
 Greeks, 39, 41–84
 theoretical value, 39
- Over premium parity, 10–11. *See also*
 Extrinsic value
- Parity, 10
- Percent chance, 42
 Percent change, 42
 Perception of market, 122
- Potential profit/loss:
 butterfly, 301–302, 313, 314
 collar strategy, 196, 205
 condor, 332, 333
 covered call (buy-write) strategy,
 146
 covered put (sell-write) strategy, 163
 diagonal spreads, 259
 protective put strategy, 168, 171,
 177–178
 straddles, 276, 277
 strangles, 294, 295
 synthetic put (protective call)
 strategy, 182, 183, 192

- time spreads, 244, 246, 253
- vertical spreads, 211–214, 224, 225, 231
- Premium, defined, 9
- Pride International (PDE), 274–275
- Profit/loss potential:
 - butterfly, 301–302, 313, 314
 - collar strategy, 205
 - condor, 332, 333
 - covered call (buy-write) strategy, 146
 - covered put (sell-write) strategy, 163
 - protective put strategy, 177–178
 - straddles, 276, 277
 - strangles, 294, 295
 - synthetic put (protective call) strategy, 192
 - time spreads, 253
 - vertical spreads, 211–214, 231
- Protective call strategy. *See* Synthetic put (protective call) strategy
- Protective put strategy, 165–178.
 - See also* Collar strategy
 - construction of, 177
 - vs. covered call (buy-write) strategy, 165
 - down scenario, 167–168
 - examples, 172–177
 - foundations of, 165–166
 - key concepts of, 178
 - leaning, 168–169
 - potential profit/loss, 177–178
 - stagnant scenario, 167, 168
 - synopsis, 177–178
 - up scenario, 166–167, 168
 - when to use, 170–171, 177
- Put options:
 - defined, 4
 - intrinsic and extrinsic values of, 11
 - naked put, 120, 123
 - overview, 16–18
 - risk involved, 17–18, 128–130
 - synthetic put, 106–115
 - and volatility, 13
- Put option strategies:
 - butterfly, 299–314
 - collar strategy, 193–205
 - condor, 315–333
 - covered put (sell-write) strategy, 147–163
 - diagonal spreads, 255–259
 - protective put strategy, 165–178
 - rolling put spread, 248
 - straddles, 261–277
 - strangles, 279–295
 - synthetic put (protective call) strategy, 106–115, 179–192
 - synthetic stock, 88–96
 - time (calendar) spreads, 233–253
 - vertical spreads, 209–231
- Qlogic (QLGC), 187–188
- Rambus (RMBS), 158–159
- Random walk theory, 21–22
- Raymond James Financial (RJF), 251–252
- Raytheon (RTN), 252–253
- Real vs. synthetic stock, 88–96
- Red Hat Inc. (RHAT), 275–276
- Research in Motion (RIMM), 271–272
- Risk. *See also* Potential profit/loss
 - with call options, 16
 - leverage and, 128–130
 - with protective put strategy, 170
 - with put options, 17–18, 128–130
 - with straddles, 266–267
 - with strangles, 285
 - with synthetic calls, 103–106
 - with time (calendar) spreads, 244–246
- Rolling positions, 139–141
 - in covered put (sell-write) strategy, 157
 - in diagonal spreads, 259
 - in time spreads, 246–249
 - in vertical spreads, 218–220
- Scholes, Myron, 26
- Sell-write strategy. *See* Covered put (sell-write) strategy
- Short position, defined, 5

- Short selling, defined, 147–148
- Skewness, 30, 35–39
- Spread trades:
- in butterflies, 303–305
 - credit spread, 209, 220, 225
 - debit spread, 209, 220, 225
 - diagonal spreads, 255–259 (*See also* Diagonal spreads)
 - imaginary scenario, 222–224
 - overview, 207–208
 - and rolling positions, 140–141
 - rolling put spread, 248
 - time (calendar) spreads, 233–253 (*See also* Time spreads)
 - and use of vega, 64–68
 - vertical spreads, 209–229 (*See also* Vertical spreads)
- Sprint (FON), 145–146
- Standard deviation, 23
- Stock:
- borrowed, 105
 - and delta, 93–94
 - real vs. synthetic, 88–96
- Stock price, 8–13, 33, 52, 120–129
- Straddles, 261–277
- break-even point, 267–271
 - construction of, 261–262, 276, 277
 - examples, 271–276
 - implied volatility and, 264–265
 - key concepts of, 276, 277
 - long, 272–274, 276
 - overview, 271
 - potential profit/loss, 276, 277
 - price factors, 263–266
 - process of, 262–263
 - risks/rewards, 266–271
 - short, 274–276, 277
 - synopses, 276–277
 - time decay and, 265–266
 - when to use, 276, 277
- Strangles, 279–295
- break-even point, 285–288
 - construction of, 280–281, 294
 - delta and, 283
 - examples, 289–294
 - implied volatility and, 283–284
 - in iron condor, 326–331
 - key concepts of, 294, 295
 - long, 289–291, 294
 - overview, 289
 - potential profit/loss, 294, 295
 - price factors, 282–285
 - process of, 281–282
 - risks/rewards, 285–288
 - short, 292–295
 - synopses, 294–295
 - time decay and, 284–285, 287–289
 - vega and, 284
 - when to use, 294, 295
- Strategies:
- butterfly, 299–314
 - collar strategy, 193–205
 - condor, 315–333
 - covered call (buy-write) strategy, 131–146
 - covered put (sell-write) strategy, 147–163
 - diagonal spreads, 255–259
 - protective put strategy, 165–178
 - rolling put spread, 248
 - straddles, 261–277
 - strangles, 279–295
 - synthetic calls, 96–106
 - synthetic put (protective call) strategy, 106–115, 179–192
 - synthetic stock, 88–96
 - time (calendar) spreads, 233–253
 - vertical spreads, 209–231
- Strike price:
- defined, 5
 - delta and, 42–46, 49
 - gamma and, 53
 - as input, 34
 - symbols, 6–7
 - theta and, 100
- Symantec (SMYC), 229–230
- Symbols, 5–7
- Synopses:
- butterfly, 313–314
 - collar strategy, 204–205
 - condor, 331–333

- covered call (buy-write) strategy, 146
- covered put (sell-write) strategy, 163
- protective put strategy, 177–178
- straddles, 276–277
- strangles, 294–295
- synthetic put (protective call) strategy, 191–192
- time spreads, 253
- vertical spreads, 230–232
- Synthetic call:
 - long, 96–100
 - risk involved, 98–101, 103–106
 - short, 100–105
- Synthetic positions, defined, 86–87
- Synthetic put (protective call) strategy, 106–115, 179–192
 - compared to other strategies, 180
 - construction of, 191
 - down scenario, 181
 - examples, 187–191
 - key concepts of, 192
 - leaning, 183–184
 - long, 106–110
 - potential profit/loss, 192
 - risk involved, 108–110, 113–115
 - short, 110–113
 - stagnant scenario, 181
 - summary, 182–183
 - synopsis, 191–192
 - up scenario, 181–182
 - when to use, 184–187, 191
- Synthetic stock, 87, 88–96
- T-delta, 81
- Technical analysis:
 - breakout, 171–172
 - and synthetic put (protective call) strategy, 185
- T-gamma, 82–83
- Theoretical value, 19, 21, 25
 - defined, 39
- Theta, 68–79. *See also* Time decay
 - and butterflies, 308–309
 - and condors, 324–326
 - defined, 11, 41
 - and delta, 71–74
 - and gamma, 74–79
 - key points, 79
 - relationship to strike price, 100
 - and stock, 95–96
 - v-theta, 83–84
- Ticker symbols. *See* Symbols
- Time, effect on delta, 50–51
- Time decay. *See also* Theta
 - and covered calls, 134
 - and covered puts, 150
 - defined, 11
 - and delta, 127
 - and straddles, 265–266
 - and strangles, 284–285, 287–289
 - T-gamma, 82–83
 - and time spreads, 234–235
 - and vertical spreads, 220–222
- Time spreads, 233–253
 - behavior of, 234–236
 - buyer risk and reward, 244–246
 - closing position, 248–249
 - construction of, 233–234
 - effects of volatility on, 237–244
 - examples, 249–253
 - implied volatility and, 222, 244–246
 - key concepts of, 253
 - overview, 249
 - potential profit/loss, 253
 - rolling position, 246–249
 - synopsis, 253
 - when to use, 253
- Trading sheets, 338–342
- Trinomial model, 28–29
- Trumpification, 50–51
- Ulam, Stanislaw, 26
- Value. *See* Extrinsic value; Intrinsic value; Theoretical value
- Value determination, 19
- V-delta, 80–81
- Vega, 41, 57–68. *See also* Greeks; Implied volatility; Volatility
 - and butterflies, 308
 - and condors, 324–326

- Vega (*Continued*)
- and spread trades, 64–68
 - and stock, 95–96
 - and straddles, 265
 - and strangles, 284
 - summary of, 238
 - and time, 60
 - and time spreads, 239–244
 - and vertical spreads, 221
 - volatility smile, 60–62
 - volatility tilt, 62–68
- Vertical spreads. *See also* Butterfly;
- Condor
 - bear spread, 209–210, 227–230, 231–232
 - bull spread, 209–210, 226–227, 230–231
 - construction of, 210–211, 230, 231
 - directional stock play, 209
 - examples, 225–229
 - imaginary scenario, 222–224
 - intrinsic value, 214–216
 - key concepts of, 231
 - overview, 224–225
 - potential profit/loss, 211–214, 231
 - price fluctuations, 217–218
 - rolling position, 218–220
 - synopses, 230–232
 - time decay and, 220–222
 - as volatility play, 221–222
 - volatility skew, 218
 - when to use, 230–231
 - V-gamma, 81–82
 - Volatility, 12–13. *See also* Implied volatility; Vega
 - defined, 12
 - and delta, 51–52
 - implied (*See* Implied volatility) as input, 33
 - key points, 57
 - overview of, 238
 - in straddles, 264–265, 266
 - and time, 50
 - in time spreads, 237–244
 - V-delta, 80–81
 - V-theta, 83–84
 - Volatility sensitivity. *See* Vega
 - Volatility skew, 218
 - Volatility smile, 29, 60–62, 330
 - Volatility tilt, 62–68
 - Volatility trading, in vertical spreads, 221–222
 - VSk model, 37, 38
 - V-theta, 83–84
- Wal-Mart (WMT), 174–175
- Wynn Resorts (WYNN), 190–191
- XILINX Inc. (XLNX), 293–294
- Yahoo (YHOO), 202–203