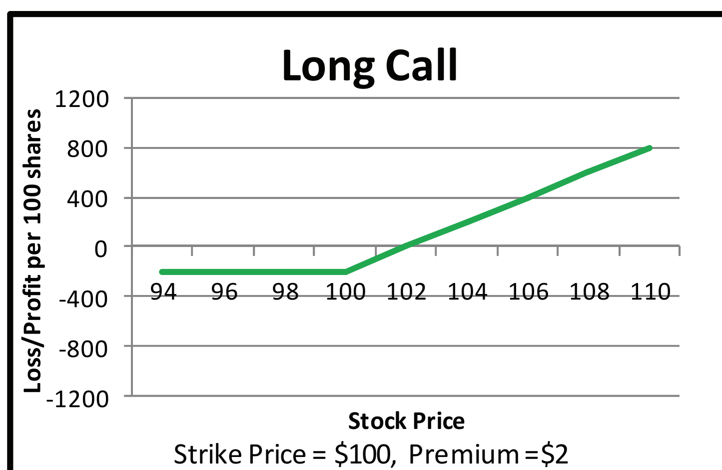
Options Strategy

Bluffing in the Options Market: When a Call is Really a Put



The profit or loss for an option position at expiration is a linear function of the exercise price, the premium paid and the price of the underlying security.

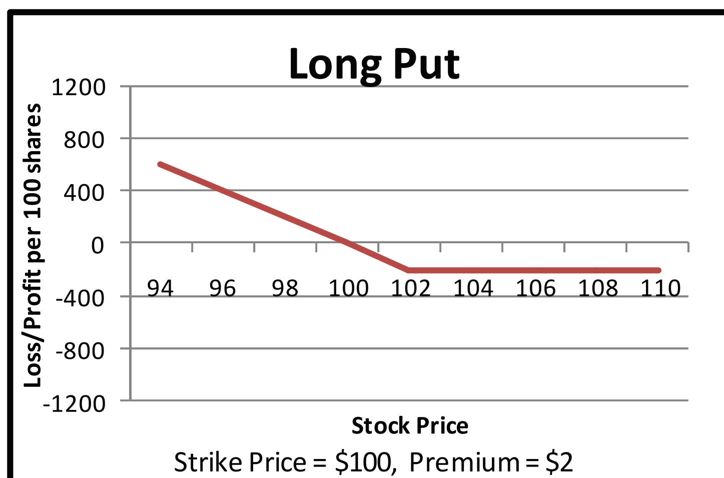
A long call position, granting the owner the right to buy the stock at the exercise price thru expiration, gains value as the security price rises above the exercise price and has a maximum loss of the premium paid.

Consequently, in the absence of any related position, a long call is a bullish strategy.

Conversely, a long put position granting the owner the right to sell the security at the exercise price prior to expiration. gains in value as the underlying security declines in value.

Like the call position, the maximum loss is limited to the premium paid for the puts.

In contrast to a long call however, in the absence of any related position, a long put is a bearish strategy.



So it would seem that the purchase of calls represents a bullish outlook and the purchase of puts indicative of a bearish opinion. To quote Ira Gershwin though "It Ain't Necessarily So."

The catch is "in the absence of any related position", because …...

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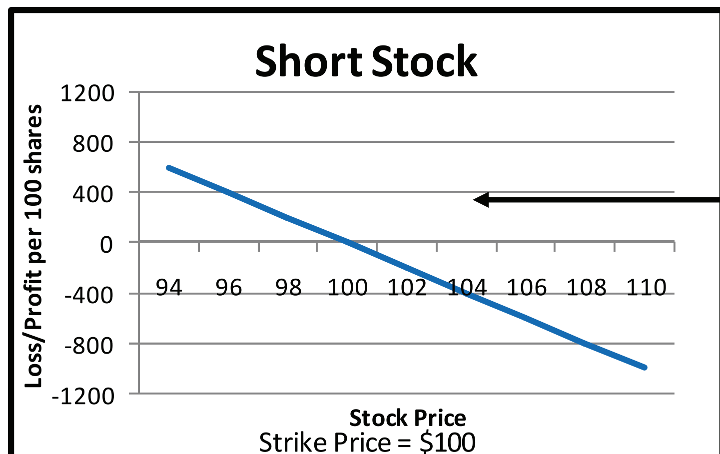

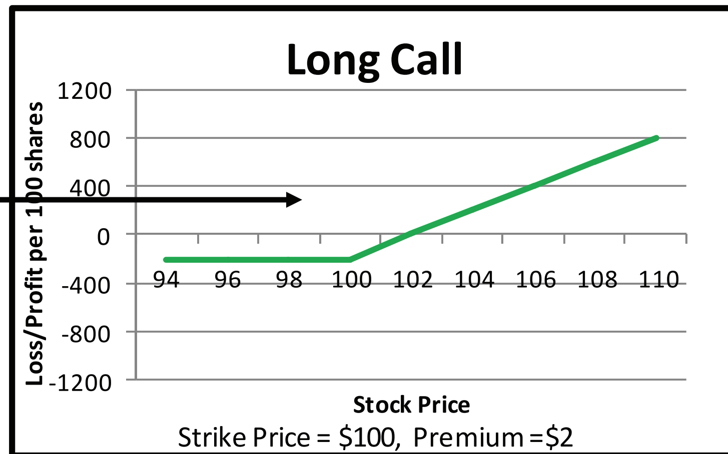

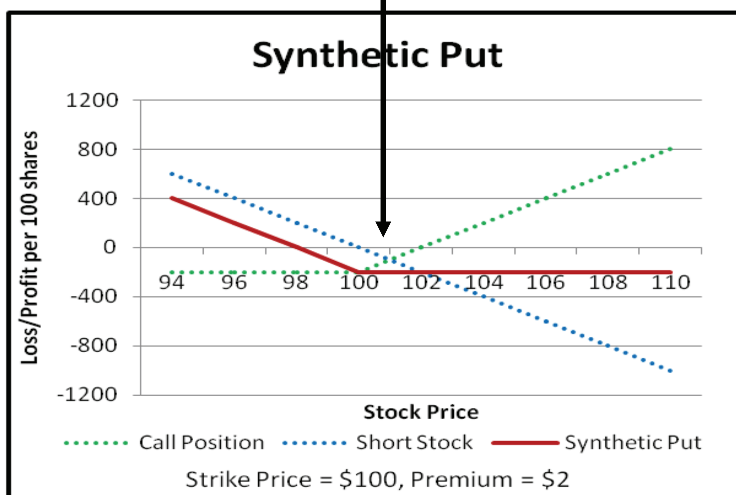

…….when a short stock position, which loses value as the price of the underlying security rises, is added to the long call position it creates a synthetic put.

The synthetic put performs exactly like a long put — it profits from a decline in the stock while the loss is still limited to the premium paid for the call.

In summary, a position that would appear to be bullish is in fact bearish.

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