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OPTIONS STRATEGIES

From covered calls to spreads and iron condors — Part 3, with numbers on every strategy.

Alpha Academy · Team Alpha Trading

Options Part 3: Strategies, From Simple to Spreads

In Parts 1 and 2 of this options series, you learned what calls and puts are, how premiums are priced, and how time and volatility move an option's value. That was learning the tools. This part is about using them: the standard ways traders combine buying, selling, and owning stock into complete plans called **strategies**.

A strategy is a plan made before you trade. It says what you buy or sell, what you expect to happen, the most you can make, and the most you can lose. That last number matters most. Every strategy here states its maximum loss in plain dollars, because a trader who knows the worst case in advance can survive being wrong.

We build in order, simplest first, each strategy adding one small idea to the one before it. By the end, you will be able to take apart any common options strategy piece by piece.

> **NOTE**
> This chapter is education only, not financial advice. Some strategies involve selling options. Selling options can create losses larger than the money you collect, and your broker may require experience approval and a margin account first. Learn the math here; trade live only when you fully understand the worst case.

A Quick Refresher Before We Start

Every example uses the same made-up company, **ABC**, trading at **$100 per share**.

- A **call** gives the buyer the right to buy 100 shares at a set price, the **strike price**, before a set date, the **expiration date**. A **put** gives the right to sell 100 shares at the strike.
- The **premium** is the option's price, quoted per share. One contract covers 100 shares, so a $2.50 premium costs $2.50 × 100 = **$250 per contract**.
- An option is **in the money** when it has real value at expiration (a call whose strike is below the stock price, a put whose strike is above it) and **out of the money** when it does not.
- **Theta** is time decay: the slice of value that melts away each day as expiration approaches. Buyers fight theta. Sellers collect it.

> **RULE**
> Before entering any options trade, write down three numbers: what you pay or collect, the most you can lose, and your breakeven price. If you cannot write all three, you do not understand the trade yet.

Strategy 1: Buying a Call

The simplest bullish trade in options. **Bullish** means you expect the price to rise.

Instead of buying 100 shares of ABC for $10,000, you buy one call with a **$105 strike**, expiring in about a month, for **$2.50** — a cost of **$250**.

- ABC rises to $115. The call is worth $115 − $105 = $10 per share, or $1,000. Profit: $1,000 − $250 = **$750**.

- ABC reaches $107.50. The call is worth exactly what you paid. Breakeven for a call = strike + premium = $105 + $2.50 = **$107.50**.
- ABC stays at $100 or falls. The call expires worthless. You lose the full **$250** — and not one cent more.

Your maximum loss is locked at the premium from the moment you buy. The catch is time: ABC must rise far enough, fast enough — a move to $106 after expiration pays you nothing.

Risk in one line: You can lose the entire $250 premium if ABC does not rise above $107.50 before expiration.

Strategy 2: Buying a Put

The simplest bearish trade. **Bearish** means you expect the price to fall.

You buy one put with a **$95 strike**, expiring in about a month, for **$2.00** — a cost of **$200**.

- ABC falls to $85. The put is worth $95 − $85 = $10 per share, or $1,000. Profit: $1,000 − $200 = **$800**.
- ABC falls to $93. The put is worth exactly what you paid. Breakeven for a put = strike − premium = $95 − $2.00 = **$93**.
- ABC stays at $100 or rises. The put expires worthless. You lose **$200**, and no more.

Buying a put is also how a stock owner buys protection — that idea returns in Strategy 5, where the put becomes insurance instead of a bet.

Risk in one line: You can lose the entire $200 premium if ABC does not fall below $93 before expiration.

Strategy 3: The Covered Call

Now we add stock ownership. A **covered call** means you own 100 shares and sell one call against them. "Covered" means the shares sit in your account, ready to be delivered if needed — which makes this the most conservative selling strategy.

You own 100 shares of ABC bought at $100, a position worth **$10,000**. You sell one call with a **$110 strike**, expiring in about a month, for **$1.50**. **$150 lands in your account immediately.**

- ABC ends at $105. The call expires worthless. You keep the $150 and the shares — a trade many investors repeat monthly for income.
- ABC rockets to $120. The buyer exercises the call and buys your shares at $110. You receive $11,000 plus the $150 premium = $11,150 — but the shares were worth $12,000. You gave up $850 of the rise. Not a loss, but a ceiling you agreed to in advance.
- ABC falls to $85. Your shares lose $1,500 of value. The $150 premium softens the blow slightly — and that is all it does.

A covered call trades away big upside for steady small income. It does **not** protect you from a crash.

> **RISK**
> A covered call is not insurance. If the stock collapses, you own the collapse. The premium is a cushion, not a floor.

Risk in one line: Your shares can still fall almost the full amount; your real trade-off is capping your gains at the strike price.

Strategy 4: The Cash-Secured Put

A **cash-secured put** means you sell a put and keep enough cash in the account to buy the shares if you are assigned. **Assignment** means the put buyer uses their right, and you must buy 100 shares at the strike price.

Think of it as a standing offer: "I will happily buy ABC at $90 — and until someone takes my offer, I keep a fee."

You sell one put with a **$90 strike** for **$1.80**, collecting **$180**, and set aside $9,000 in cash — enough to buy 100 shares at $90.

- ABC stays above $90. The put expires worthless. You keep the $180 and your cash is free again — a 2% return on the cash set aside ($180 ÷ $9,000).
- ABC falls to $80. You are assigned: you buy 100 shares at $90 for stock now trading at $80. Because you collected $180 first, your true cost is $90 − $1.80 = **$88.20 per share**, and you are down $820 on paper.

That second ending is the whole strategy: only sell a cash-secured put on a stock you genuinely want to own at the strike. If owning ABC at $90 would upset you, do not sell the $90 put.

> **RISK**
> If the stock keeps falling after assignment — to $60, to $40 — those losses are yours. The premium does not stop them.

Risk in one line: You can be forced to buy a falling stock at the strike price, and it can keep falling after that.

Strategy 5: The Protective Put

A **protective put** means you own 100 shares and buy one put on the same stock. It is the options version of an insurance policy, and the analogy holds almost perfectly.

You own 100 shares of ABC at $100, and you are worried about an **earnings report** — the company's scheduled quarterly update on its profits, which often moves the stock sharply. You buy one put with a **$95 strike**, expiring just after the report, for **$2.00**. The $200 is your insurance premium.

- ABC crashes to $70 on bad news. Your shares lost $3,000 of value, but the put is worth $95 − $70 = $25 per share, or $2,500. You can exit at an effective $95 per share. Total loss: about ($100 − $95) × 100 + $200 premium = **$700**, instead of an open-ended fall.
- ABC rises to $110. Your shares gain $1,000. The put expires worthless and the $200 is gone. Net result: up $800, and you were protected the whole time.

That is exactly how house insurance feels: most periods nothing burns down, and the premium is simply gone. You are not buying a profit — you are buying a floor.

Risk in one line: Your worst case is known in advance — you can lose down to the strike, plus the premium, and no further.

Strategy 6: Vertical Spreads — The Debit Spread

A **spread** combines two or more options in one trade. A **vertical spread** pairs two options of the same type (both calls or both puts), same expiration, different strikes.

Why spread at all? A lone bought option costs full price and fights theta alone. A spread sells a second option to pay for part of the first, and in exchange your profit gets a ceiling — while both risk and reward become **defined**: known to the dollar on day one.

Bull Call Spread (Debit)

You are bullish but want a cheaper, sturdier trade than a lone call. In one trade you:

- Buy the **$100 call** for **$3.00**
- Sell the **$110 call** for **$1.20**

Your **net debit** — the total you pay — is $3.00 − $1.20 = **$1.80**, or $180.

- **Maximum loss = the debit = $180.** If ABC stays at or below $100, both calls expire worthless.
- **Maximum profit = width − debit = ($110 − $100) − $1.80 = $8.20, or $820** — reached if ABC is at $110 or higher at expiration.
- **Breakeven = lower strike + net debit = $100 + $1.80 = $101.80.**

Compare Strategy 1: the lone call needed ABC above $107.50 to make anything. This spread breaks even at $101.80, costs less, and decays more slowly — but it can never make more than $820.

Bear Put Spread (Debit)

The mirror image, for a bearish view:

- Buy the **$100 put** for **$2.80**
- Sell the **$90 put** for **$1.00**
- Net debit = $2.80 − $1.00 = **$1.80**, or $180
- **Maximum loss = $180** if ABC stays at or above $100.
- **Maximum profit = width − debit = $10 − $1.80 = $8.20, or $820**, if ABC falls to $90 or below.
- **Breakeven = higher strike − net debit = $100 − $1.80 = $98.20.**

> **TIP**
> Debit spreads are the beginner-friendly way to bet on direction: smaller cost, a breakeven that is closer, slower time decay, and a worst case you know before you enter.

Risk in one line: A debit spread can lose only what you paid for it — but it loses all of it if the stock does not move your way.

Strategy 7: Credit Spreads — Paid Up Front, Capped Risk

A **credit spread** flips the flow of money. You collect a premium up front — a **credit** — and profit if the stock stays away from the option you sold. The option you buy, further away, exists purely to cap your loss.

> **RISK**
> Read this section slowly. Credit spreads feel safe because money arrives on day one. That money is not profit yet — it is a deposit against a possible loss. Your maximum loss is always larger than the credit you collect, sometimes much larger.

Bull Put Spread (Credit)

You believe ABC will stay above $95. You are bullish, or at least not bearish.

- Sell the **$95 put** for **$1.60**
- Buy the **$90 put** for **$0.60**
- Net credit = $1.60 − $0.60 = **$1.00**, so **$100 is paid into your account**
- **Maximum profit = the credit = $100.** If ABC stays at or above $95, both puts expire worthless and you keep every cent.
- **Maximum loss = width − credit = ($95 − $90) − $1.00 = $4.00, or $400.** If ABC falls to $90 or below, the spread settles at its full $5 width against you: $500 − $100 credit = $400.
- **Breakeven = $95 − $1.00 = $94.**

Risking $400 to make $100 sounds backwards until you see the point: ABC only has to avoid falling more than 6% before expiration. Credit spreads are high-probability, small-win, defined-loss trades — the danger is sizing by the income and forgetting the $400 side exists.

Bear Call Spread (Credit)

The mirror image, for a bearish or "not bullish" view:

- Sell the **$105 call** for **$1.50**
- Buy the **$110 call** for **$0.50**
- Net credit = **$1.00** ($100 collected)
- **Maximum profit = $100** if ABC stays at or below $105.
- **Maximum loss = $5 width − $1.00 credit = $400** if ABC rises to $110 or above.
- **Breakeven = $105 + $1.00 = $106.**

Risk in one line: You keep a small credit if the stock behaves, and you can lose width − credit — here $400 — if it does not.

Strategy 8: The Iron Condor — Two Credit Spreads, One Range

An **iron condor** is not a new animal. It is the bull put spread and the bear call spread from Strategy 7, placed on the same stock, with the same expiration.

The bet, in plain words: "ABC will stay inside a range. It will not fall far, and it will not rise far, before expiration."

ABC is at $100. You place both spreads:

- Sell the **$95 put**, buy the **$90 put** (the bull put spread below the price)
- Sell the **$105 call**, buy the **$110 call** (the bear call spread above the price)
- Total credit collected = **$1.80**, or $180
- ABC expires anywhere between $95 and $105. All four options expire worthless and you keep the full **$180** — the condor's home turf is a quiet, range-bound stock.
- ABC falls to $90 or below, or rises to $110 or above. One side loses its full width (the stock cannot finish in both places). Maximum loss = $5 width − $1.80 credit = **$3.20, or $320**.

- Breakevens: **$93.20** below ($95 − $1.80) and **$106.80** above ($105 + $1.80). Between them, you make at least something.

Time decay works for the condor every day the stock sits still. Its trap: a calm-looking stock can gap violently on news, and many small wins can be handed back in one bad week if you sized too big.

Risk in one line: You profit if the stock stays in the range; your loss is capped at width − credit ($320 here) if it breaks out either way.

Strategy 9: Straddles and Strangles — Betting on a Big Move

Sometimes you are sure a stock will move a lot, but you honestly do not know which way — the night before an earnings report is the classic case. So you buy both sides at once.

A **straddle** is a call and a put bought at the **same strike**, usually the strike closest to the current price (called **at the money**). On ABC at $100:

- Buy the **$100 call** for **$2.80**
- Buy the **$100 put** for **$2.70**
- Total cost = **$5.50**, or $550

To break even, ABC must move more than $5.50 by expiration — above **$105.50** or below **$94.50**. If it lands near $100, both options expire worthless and you lose the whole $550, even though you were "right" that something could happen.

A **strangle** is the cheaper cousin: an out-of-the-money call plus an out-of-the-money put. Buy the **$105 call** for $1.40 and the **$95 put** for $1.30 — total **$2.70** ($270). It costs less, but ABC must travel further to pay you: above **$107.70** or below **$92.30** just to break even.

The IV Crush Warning

IV is **implied volatility**: how much movement the options market is pricing in. Before a big announcement, IV is high and options are expensive — you pay for a move the whole market already expects. The moment the news prints, the uncertainty is gone and IV collapses: **IV crush**. ABC can jump 4% in your favor and your straddle can still lose money, because the options deflated faster than the move paid you.

> **RISK**
> Buying a straddle or strangle into a major announcement means paying the highest prices of the year for options that deflate the instant the news is out — win, lose, or draw. Being right about direction is not enough. The move must be bigger than the large move already priced in.

Risk in one line: Your maximum loss is the premium paid ($550 or $270 here), and you can lose all of it even when the stock moves — if it does not move far enough, or IV collapses.

Defined Risk vs. Undefined Risk

Every strategy above belongs to one of two families, and knowing the family is a survival skill.

Defined risk means the maximum loss is known to the dollar before you enter, and no market move can make it worse. **Undefined risk** — sometimes called naked risk — means no built-in limit: losses keep growing as the stock moves against you.

Strategy	Family	Maximum loss
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Buying a call or a put	Defined	The premium you paid
Vertical debit spread	Defined	The debit you paid
Vertical credit spread	Defined	Width of the spread − credit received
Iron condor	Defined	Width of one side − total credit received
Straddle / strangle (bought)	Defined	Total premium paid
Covered call	Defined, but large	The stock can fall toward zero, minus the premium
Cash-secured put	Defined, but large	Strike × 100 shares, minus premium, if the stock goes to zero
Selling a naked call	Undefined	No limit — a stock's price has no ceiling
Selling a naked put	Undefined	Strike × 100 shares if the stock goes to zero

RISK

A **naked** option is one you sold with no stock and no protective option behind it. A naked call has theoretically unlimited risk, because a price has no maximum. This chapter does not teach naked selling, and most brokers will not approve beginners for it. If a trade's worst case cannot be stated in one sentence with a dollar figure, that trade is not for you yet.

Which Strategy Fits Which View

The whole chapter on one card. Find what you believe, then read across.

Your view	Simpler approach	Spread approach
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Bullish — "it goes up"	Buy a call — or sell a cash-secured put at a price where you'd happily own the stock	Bull call spread (debit), or bull put spread (credit)
Bearish — "it goes down"	Buy a put	Bear put spread (debit), or bear call spread (credit)
Neutral — "it stays in a range"	Sell a covered call, if you already own the shares	Iron condor, or a credit spread on the side you think is safe

Your view	Simpler approach	Spread approach
Big move coming, direction unknown	Buy a straddle (costly) or a strangle (cheaper)	—
You own it and want protection	Buy a protective put	—

Notice the pattern: the simple column bets on direction with premium you pay. The spread column pays less, risks less, and accepts a ceiling. Neither is "better" — they are different tools for different forecasts.

Common Beginner Mistakes

- **Treating a credit as free money.** The credit is compensation for risk — size every credit trade by its loss column, not its income column.
- **Buying far out-of-the-money options because they are cheap.** A $0.30 option is usually cheap because it will almost certainly expire worthless. Cheap is not good value.
- **Ignoring the breakeven.** You can have the direction right and still lose, because the stock did not move far enough past your breakeven in time.
- **Letting a spread ride into expiration day with no plan.** Prices near the strike get wild in the final hours, and assignment can surprise you. Many traders close spreads early instead of gambling on the final print.
- **Removing the protective leg to "make it cheaper."** The long option in a spread is what makes your risk defined. Remove it, and the trade quietly becomes undefined-risk.
- **Trading a strategy you cannot explain out loud.** If you cannot state what you own, what you sold, and your worst case in one breath, **paper trade** it first — practice with simulated money until the mechanics are boring.

Chapter Summary

- A strategy is a complete plan: entry, forecast, maximum profit, maximum loss, and breakeven — known before you trade.
- Buying a call is a simple bullish bet; buying a put is a simple bearish bet. Both can lose only the premium paid, and both need the stock to move far enough, fast enough.
- A covered call sells away your upside above the strike for income, and does not protect against a falling stock.
- A cash-secured put is a paid standing offer to buy at the strike — use it only on stocks you want to own.
- A protective put is insurance for shares you own: a floor under your loss, bought for a premium.
- Debit spreads (bull call, bear put) cost less than lone options and break even sooner, but cap profit at width − debit. Maximum loss is the debit.
- Credit spreads (bull put, bear call) collect premium and profit when the stock stays away from the sold strike. Maximum loss is width − credit — always larger than the amount collected.
- An iron condor is a bull put spread plus a bear call spread: a bet the stock stays inside a range.
- Straddles and strangles bet on a big move in either direction, and IV crush after news can sink them even when the stock moves.
- Defined-risk trades state their worst case in dollars up front. Undefined-risk trades like naked calls have no ceiling on losses and are not beginner trades.

Check Yourself

1. You buy the ABC $105 call for $2.50. What is your breakeven at expiration, and what is the most you can lose?
2. In a bull call spread, you buy the $100 call for $3.00 and sell the $110 call for $1.20. What are your maximum loss and maximum profit per spread?

3. You sell a bull put spread, collect a $1.00 credit, and the strikes are $5 apart. What is your maximum loss per spread?
4. What is an iron condor made of, and what market behavior are you betting on?
5. Why can a straddle lose money even when the stock moves sharply right after an earnings report?

Answers: 1) Breakeven is $107.50 (strike + premium); the most you can lose is the $250 premium. 2) Maximum loss is the $1.80 net debit ($180); maximum profit is the $10 width minus the $1.80 debit — $8.20 ($820). 3) Width minus credit: $5.00 − $1.00 = $4.00, or $400. 4) A bull put spread plus a bear call spread with the same expiration; you are betting the stock stays inside the range between the two sold strikes. 5) IV crush: volatility is inflated before the announcement and collapses when the news lands, deflating both options — the move must exceed the large move already priced in.

> **RULE**
> Never enter a strategy whose worst case you cannot say out loud, in dollars, in one sentence. Defined risk, known before the trade — that is the line between a plan and a gamble.