RJOFutures
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OPTIONS STRATEGIES GUIDE

Common strategies for trading options on futures for any market outlook.

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Important Information About Trading Futures and Options on Futures

This communication is intended as a solicitation. Futures trading involves the substantial risk of loss and is not suitable for all investors. Trading advice is based on information taken from trades and statistical services and other sources which RJ O'Brien believes are reliable. We do not guarantee that such information is accurate or complete and it should be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades. All trading decisions will be made by the account holder. Past performance is not necessarily indicative of future trading results.

When analyzing option strategies, it is important to take into account the commission and fees associated with making a trade. Similar to trading futures, each contract executed in an option strategy is charged commission and fees. Commissions and fees from brokerage firms can be up to $99 per round turn with the vast majority of people paying significantly less. Your actual charges may vary based on the service level you choose. The two primary factors investors tend to overlook when trading options include:

- Each contract traded is charged a commission. This is often misinterpreted as each spread or strategy that is charged a commission. If you trade one bull call spread, your account would be charged for 2 contracts rather than 1 spread.
- Customers often try to sell or collect premium on options that are far out of the money with the belief that they are collecting "easy money." The further away an option strike price is from the current market price, the lower the value of the option. Make sure that you are not paying more in commission and fees than what you are collecting. Keep in mind that until an option expires, you do hold risk in the positions. Is the net premium collected after paying commission and fees worth the risk?

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Getting Started

This guide focuses on some of the most popular strategies used to trade options on futures. It provides an overview of what positions to take to execute your market outlook strategy as well as the potential risks and rewards.

Many traders turn to options for their leveraging power, limited risk, and potential for higher returns. And, if you already have experience with options on stocks, then getting started with options on futures might not be very difficult at all. The principles of options trading—limited risk when purchasing options, unlimited risk when selling and the ability to trade in a neutral market—apply to both. You just have to understand the unique characteristics of having a futures contract as the underlying asset rather than a stock that never expires.

Reading the Risk/Reward Profile Charts

In the risk/reward profile charts accompanying each strategy, the red line depicts the strategy's value when it is initiated. The green line illustrates the value of the option strategy at expiration, net of commissions and fees. As time value decays, the red line and green line gradually converge—assuming volatility and interest rates stay the same until expiration. The X-axis is the underlying price of the contract. The Y-axis is the potential reward/risk for each strategy in price units.

Please note that the strategies are not current market recommendations. In any option strategy, the underlying price, market volatility, interest rates, and time value (days until expiration) all contribute to its value in your account.

IF YOU ALREADY HAVE EXPERIENCE WITH OPTIONS ON STOCKS—GETTING STARTED WITH OPTIONS ON FUTURES MIGHT NOT BE DIFFICULT AT ALL.

Risks of Trading Options

The risks of trading option strategies are often underestimated due to the instrument's inherent "limited risk" profile when buying. However, just because your risk might be limited to the premium you paid for an option doesn't mean you won't lose money.

Traders often refuse to "cash in" prior to expiration, and wind up losing their entire investment as the option expires worthless. And, of course, your risk is entirely unlimited if you sell options outright.

Option Strategies Ideal for the Time-Challenged

If you have limited time to watch the markets during the trading day, limited-risk option strategies may be just what you are looking for because they let you participate without the exposure inherent in holding open futures positions.

However, no matter whether you're trading options or futures, you should always be aware of the underlying market, and analyze possible trend changes to help time entry and exit levels for your strategy. Working with an RJO Futures broker can also help you monitor the market.

Margins on Unlimited-Risk Option Strategies

Some option strategies have unlimited risk, just like futures. And, just like futures, those strategies will require putting up margin money to carry the position. These margin requirements can change as market conditions change and the underlying price fluctuates.

Therefore, if you are trading an unlimited-risk option strategy, you should always maintain plenty of excess margin in your account to avoid the risk of becoming overleveraged. Your RJO Futures broker can provide current hypothetical margin requirements.

ADDITIONAL RESOURCES

Click for your RJO Futures guide, ***Introduction to Options Trading*** for more detailed examination of options trading.

Or, call 800-441-1616 to request your free copy.

Strategies at a Glance

The beauty of trading options is that you can custom-design a strategy to fit your market outlook.

1. Use this guide to pick a strategy that fits with your market outlook. With options, there's a strategy for whether you are bullish, bearish, or neutral the market—volatility, too!
2. Be sure you understand the Risk and Reward parameters that accompany each strategy. Note that in some options strategies, there is just as much risk as if you held an outright futures position.
3. Select the appropriate contract months and strike prices for your strategy. If you need advice, an RJO Futures broker would be happy to assist you.

Market Outlook	Option Strategy	Risk	Maximum Reward
Bullish	Buy a Bull Call Spread	Premium paid	Difference between call option strike prices minus premium paid
	Ratio Call Spread	Unlimited if market rises above the sum of the profit and the higher strike price	Upside maximum profit is limited by the difference in strikes minus premium paid
Bearish	Buy a Bear Put Spread	Premium paid	Difference between put option strike prices minus premium paid
	Ratio Put Spread	Unlimited if market falls below the difference between the lower strike price and the profit	Upside maximum profit is limited by the difference in strikes minus premium paid
Neutral	Sell a Bear Put Spread for neutral/bullish	Difference between put strikes prices minus premium received	Premium received
	Calendar Call Spread for neutral/bullish	Premium paid for long call minus premium received for short call	Premium received for short call
	Sell a Bull Call Spread for neutral/bearish	Difference between call strike prices minus premium received	Premium received
	Short Straddle	Unlimited outside of strikes plus premium received	Premium received (exiting the trade prior to expiration may reduce both risk and reward)
	Short Strangle	Unlimited outside of strikes plus premium received	Premium received
Increased Volatility	Long Straddle	Premium paid	Unlimited beyond strikes minus premiums paid
	Long Strangle	Premium paid	Unlimited beyond strikes minus premiums paid

Bullish Market Outlook

If you expect the market to rally, take a look at two option strategies to see which one might work for you. Buying a bull call spread limits your risk to the premium paid upfront plus commission and fees. A ratio call spread might be the ticket if you believe the market won't climb higher than your upper strike price.

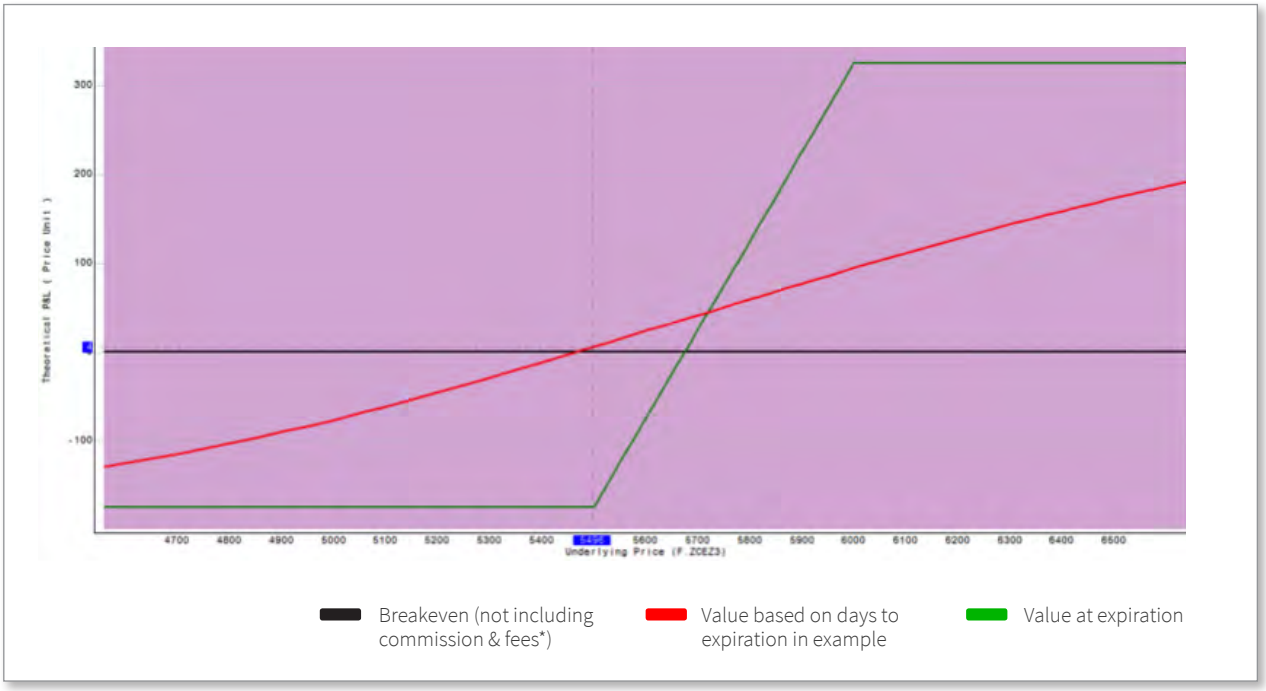
Long Bull Call Spread
(Limited risk)

Buying and selling calls allows investors to capture potential profit in a bullish market, with your risk limited to the net premium paid.

In a bull call spread, you simultaneously buy (pay premium) a lower-strike call and sell (collect premium) a higher-strike call in the same contract month. The lower-strike call will always be pricier than the higher-strike call because it has higher odds of being in-the-money at expiration.

Example:

Buy 1 December Corn 550 call at 40 1/2
Sell 1 December Corn 600 call at 22 1/2
Days to expiration: 166
Net premium paid = 40 1/2 – 22 1/2 = 18 cents
1 cent = $50
Net premium paid (Maximum Risk) = 18 cents x $50 = $900 + commission and fees*
Maximum Profit Potential = 600 – 550 = 50 cents x $50/cent = $2500 - Net Premium Paid



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Ratio Bull Call Spread
(Unlimited risk)

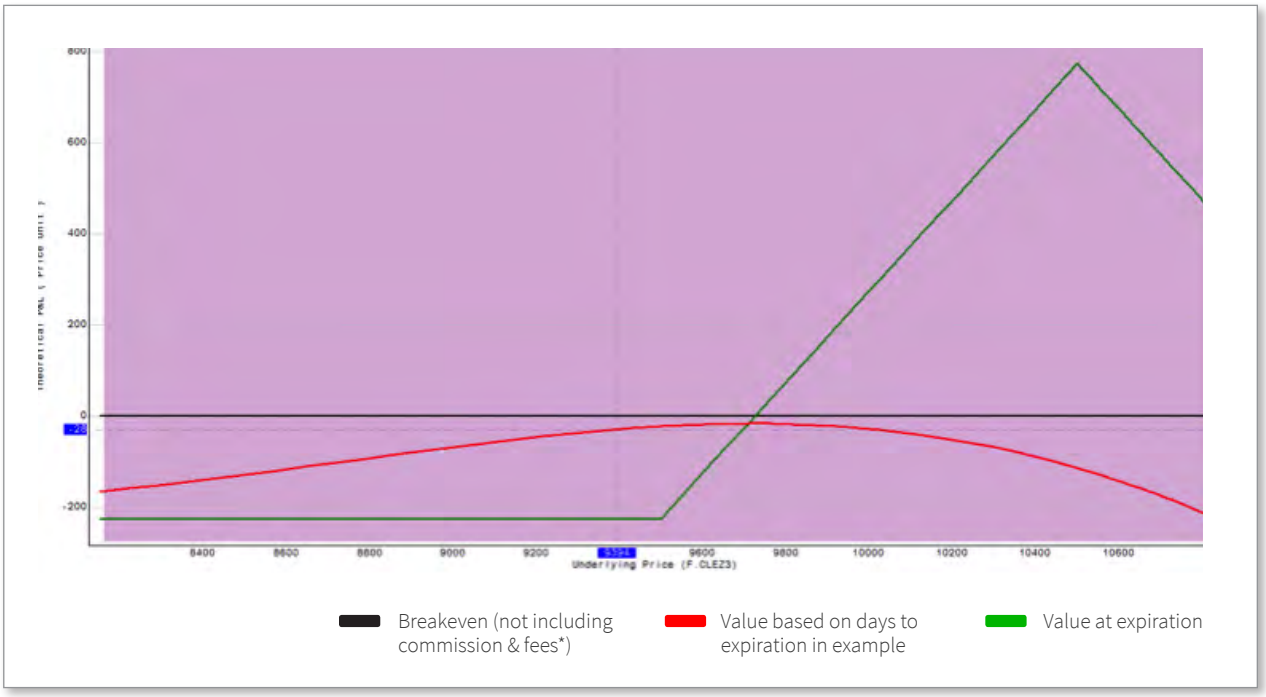
In a ratio call spread, you buy a nearby call and sell multiple higher-strike calls in the same contract month. This strategy is ideal if you believe that the market is likely to rally, but will not rise beyond the higher strike price.

Traders often underestimate the negative effect that time value to expiration and volatility can have on the spread. Therefore, it is wise to maintain plenty of excess capital to withstand market movements when trading a ratio call spread.

Example:

Buy 1 December Crude Oil 9500 call at 535
Sell 2 December Crude Oil 10500 calls at 155
Days to expiration: 159
Net premium paid = 535 – (155 x 2) = 225
1 tick = $10
Net premium paid = 225 x $10 = $2250 + commission and fees*
Maximum Profit Potential = 10500 – 9500 – 225 premium paid = 775 less commission and fees* assuming the market expires at the higher strike price

- For a 1 X 2 ratio spread, unlimited risk exists at expiration if the market moves above the higher strike price by more than the difference in strikes minus the premium paid. Maximum profit potential exists at expiration if the underlying futures contract is trading at the higher strike price.
- 10500 (higher strike) – 9500 (lower strike) – 225 (premium paid) = 775 + 10500 = 11275 less the commission and fees*. Unlimited risk of loss exists at expiration on a close above 11275 less commission and fees*.



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Bearish Market Outlook

If you think the market is going lower, check out these two option strategies—buying a bear put spread and the ratio put spread.

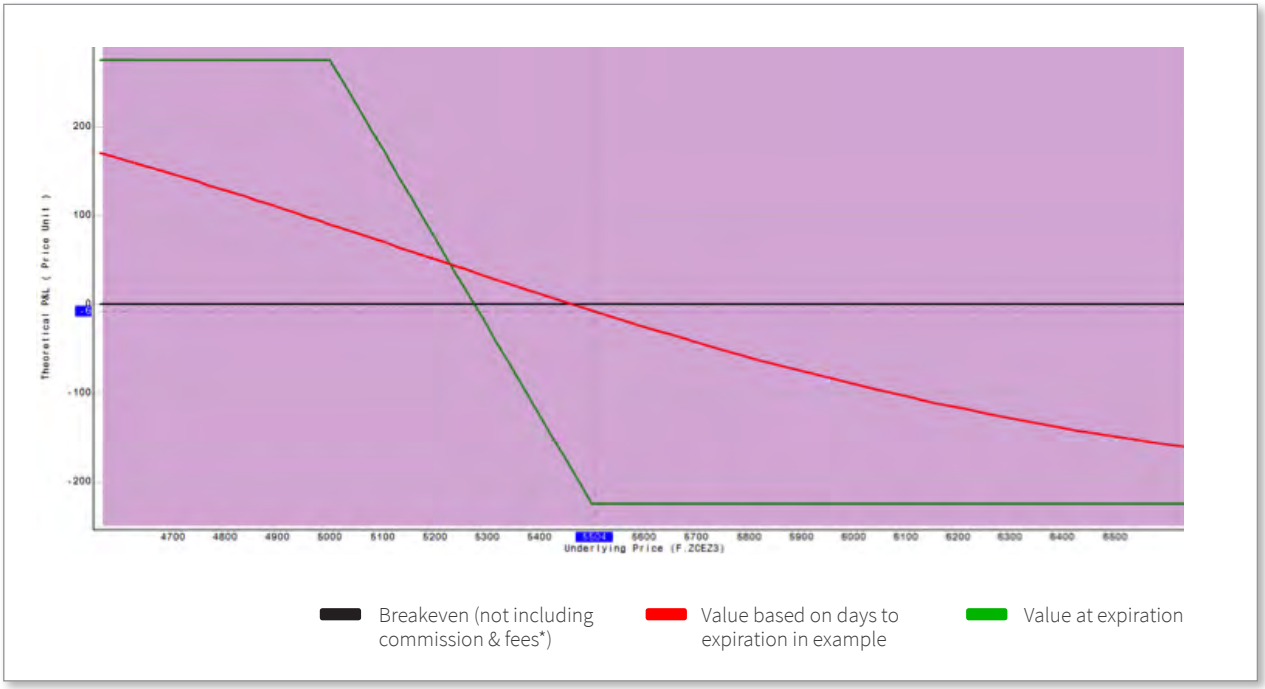
Long Bear Put Spread
(Limited risk)

Buying one put and selling one put lets you capture potential profit from a bearish price move, yet limit your risk to the net premium paid.

In a bear put spread, you simultaneously buy the higher-strike put and sell the lower-strike put. The higher-strike put will always be worth more than a lower-strike put, because its odds of expiring in-the-money are higher.

Example:

Buy 1 December Corn 550 put at 43 3/4
Sell 1 December Corn 500 put at 21 1/4
Days to Expiration: 166
Net premium paid = 43 3/4 - 21 1/4 = 22 ½ cents
1 cent = $50
Net premium paid (Maximum Risk) = 22 ½ cents x $50 = $1125 + commission & fees*
Maximum Profit Potential = 550 – 500 – 22 ¼ premium paid = 27 ¾ cents = $1387.50 less commission and fees*



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Ratio Bear Put Spread
(Unlimited risk)

In a ratio put spread, you buy a nearby put and sell multiple lower-strike puts in the same contract month. This strategy is ideal if you believe that the market is likely to decline, but will not drop beyond the lower strike price.

Traders often underestimate the negative effect that time value to expiration and volatility can have on the spread. Therefore, it is wise to maintain plenty of excess capital to withstand market movements when trading a ratio put spread.

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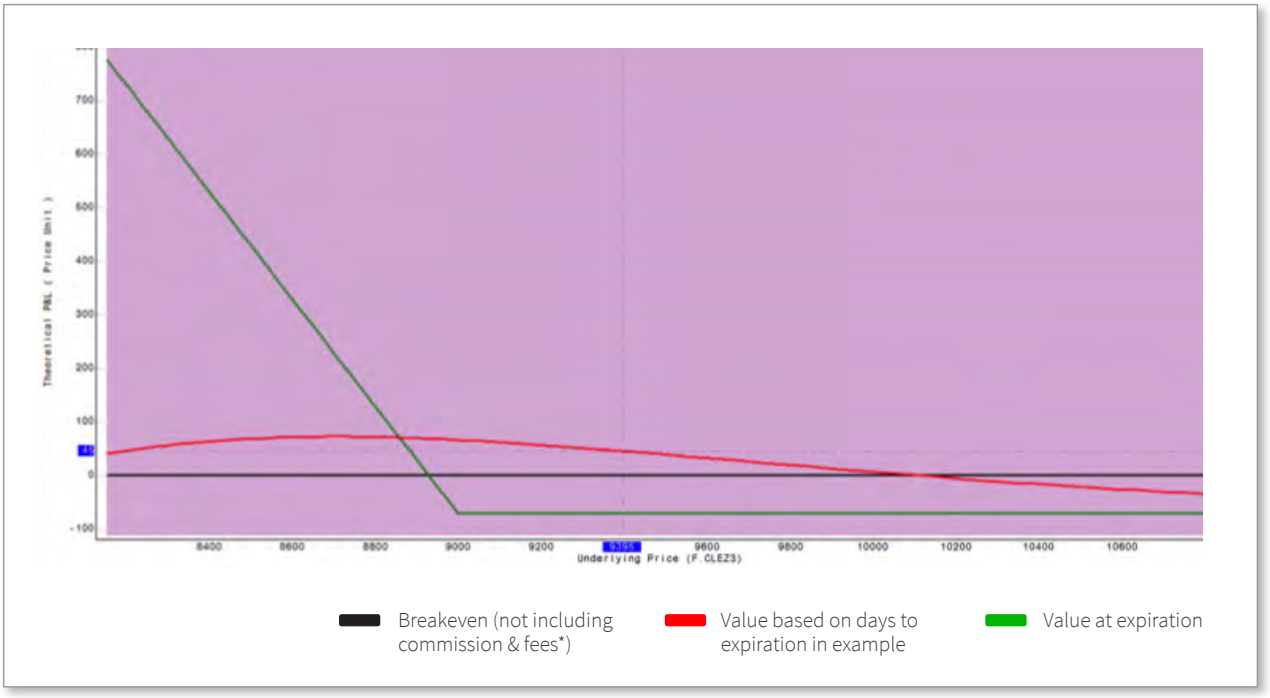
Example:

Buy 1 December Crude Oil 9000 put at 350
Sell 2 December Crude Oil 8000 puts at 139
Days to Expiration: 159
Net premium paid = 350 – (139 x 2) = 72
1 tick = $10
Net premium paid = 72 x $10 = $720 + commission & fees*
Maximum Profit Potential = 9000 – 8000 – 72 premium paid = 928 less commission and fees* assuming the market expires at the lower strike price

- For a 1 X 2 ratio spread, unlimited risk exists at expiration if the market moves below the lower strike price by more than the difference in strikes less the premium paid. Maximum profit potential exists at expiration if the underlying is trading at the lower strike price.
- 9000 (higher strike) – 8000 (lower strike) - 72 (premium paid) = 928. Unlimited risk of loss exists at expiration if the market is trading below 8000-928=7072 plus commission and fees*.



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Neutral Market Outlook

With "neutral" option strategies, you can potentially profit while prices move sideways in a trading range. And, you can create a limited-risk strategy that has just a hint of bullish/bearish bias.

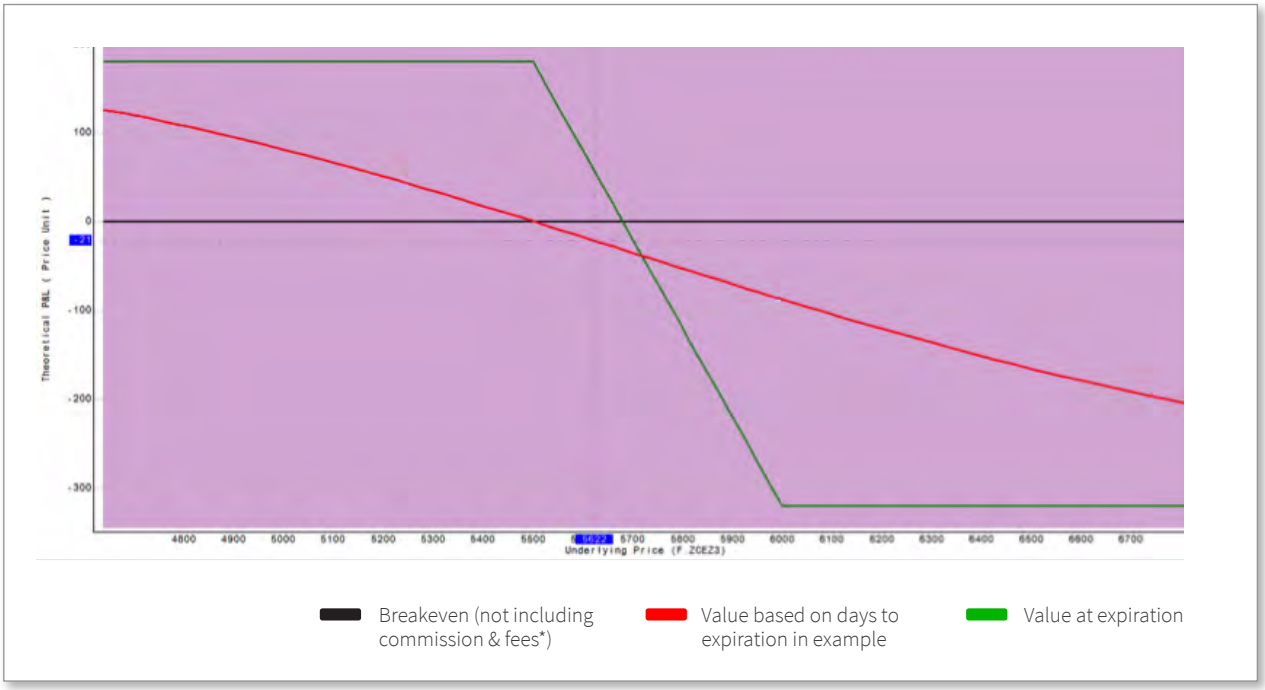
Credit "Short" Bear Put Spread
(Neutral/bullish with limited risk)

Selling and buying a put lets you capture potential profit from a bullish price move, yet limit your risk to the net premium received.

In a short bear put spread, you simultaneously sell the higher-strike put and buy the lower-strike put in the same contract month. The higher-strike put will always be worth more than a lower-strike put, because its odds of expiring in-the-money are higher. As a market rallies and time decays, both options deteriorate in value.

Example:

Sell 1 December Corn 550 put at 43 3/4
Buy 1 December Corn 500 put at 21 1/4
Days to Expiration: 166
Net premium received = 43 3/4 - 21 1/4 = 22 ½ cents
1 cent = $50
Net premium received (Maximum Profit) = 22 ½ cents x $50 = $1125 – commission & fees*
Maximum Risk = 550 – 500 – 22 ¼ premium paid = 27 ¾ cents = $1387.50 + commission and fees*



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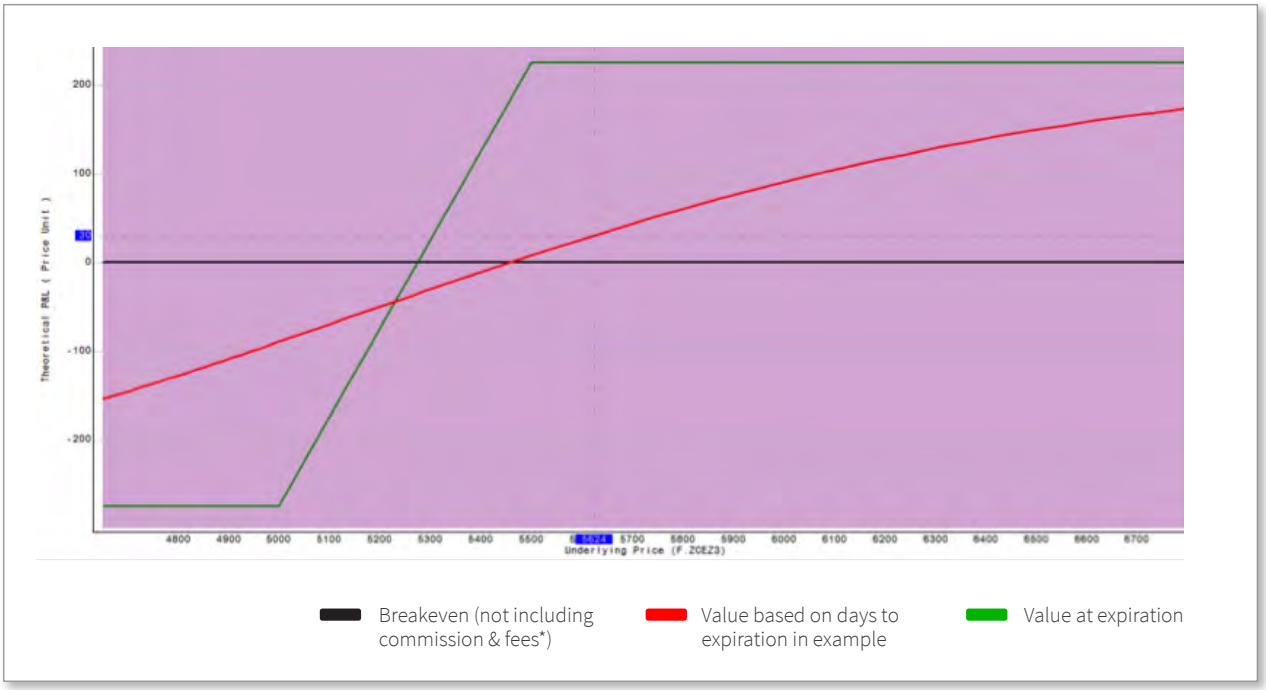
Credit "Short" Bull Call Spread
(Neutral/bearish with limited risk)

Selling and buying a call lets you capture potential profit from a bearish price move, yet limit your risk to the difference in strike prices less the net premium received.

In a short bull call spread, you simultaneously buy the higher-strike call and sell the lower-strike call. The higher-strike call will always be worth less than a lower-strike call, because its odds of expiring in-the-money are lower.

Example:

Sell 1 December Corn 550 call at 40 1/2
Buy 1 December Corn 600 call at 22 1/2
Days to expiration: 166
Net premium received = 40 1/2 – 22 1/2 = 18 cents
1 cent = $50
Net premium received (Maximum Profit) = 18 cents x $50 = $900 – commission and fees*
Maximum Risk = 600 – 550 = 50 cents * $50/cent = $2500 – $900 + commission and fees*



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Calendar Call Spread
(Neutral/bullish with limited risk)

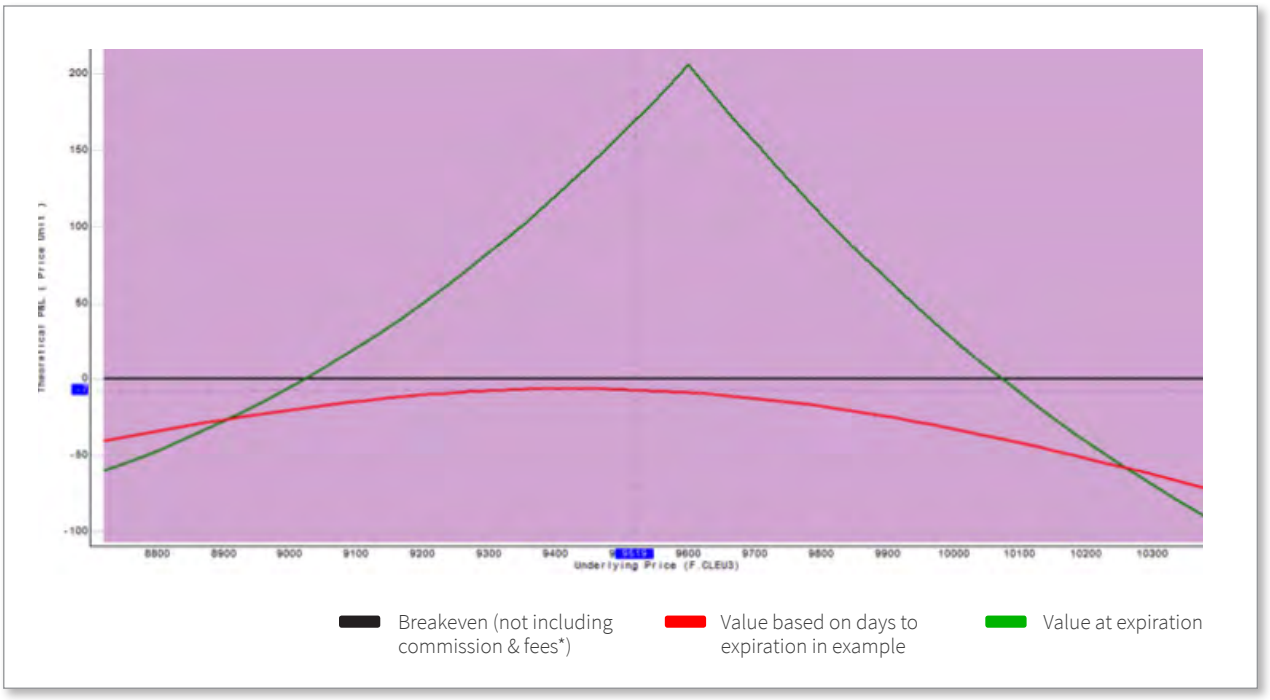
The calendar call spread involves buying and selling two calls in different contract months. When the options have the same strike price it is called a “horizontal” spread.

In this strategy, you sell the nearby option and collect premium, which offsets the cost of buying the more distant option with more time value. This is a limited-risk strategy because the long option should retain some extrinsic and time value. At expiration of the spread, the maximum profit potential would be the value of the long option minus the net premium paid for the spread.

Beware that a “squeeze” on the nearby underlying futures contract could negatively impact the spread relationship as well, which could reduce profitability and create additional risk.

Example:

Sell 1 September Crude Oil 9600 call at 346
Buy 1 December Crude Oil 9600 call at 475
Days to Expiration of the December option leg: 159
Net premium paid = 475 – 346 = 129
1 tick = $10
Net premium paid = 129 x $10 = $1290 + commission and fees*
Maximum Profit is Unlimited Maximum Risk is Unlimited



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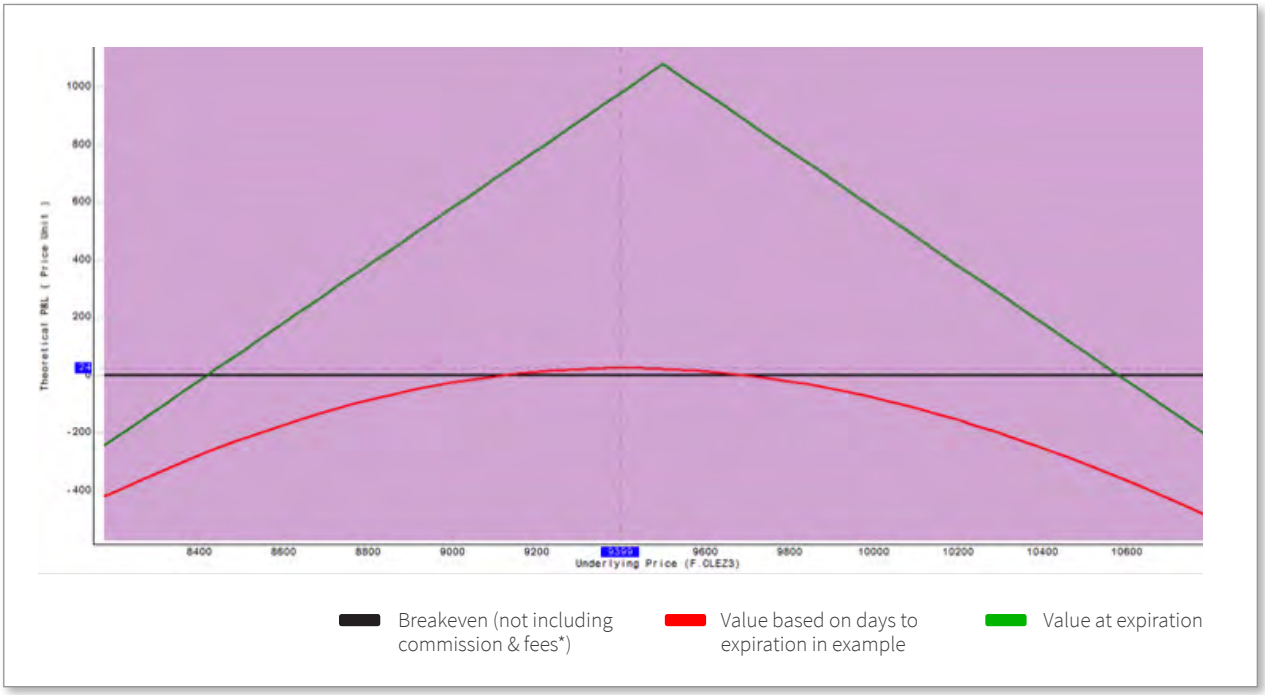
Short Straddle
(Unlimited risk)

A short straddle consists of selling a call and put with the same strike simultaneously in the same contract month. A short straddle is ideal for markets with high volatility that are likely to trade in a longer-term range and decrease in volatility.

Your risk is unlimited on either the call or the put at the point the market exceeds your strike price (to the upside for the call; to the downside for your put) plus the premium collected. Your maximum reward is all of the premium collected if the underlying market expires at your strike price.

Example:

Sell 1 December Crude Oil 9500 call at 540
Sell 1 December Crude Oil 9500 put at 540
Days to Expiration: 159
Net premium received = 540 + 540 = 1080
1 tick = $10
Net premium received = 1080 x $10 = $10,800 - commission and fees*
Unlimited risk in bull market above = 9500 + 1080 = 10580 + commission & fees*
Unlimited risk in bear market below = 9500 – 1080 = 8420 - commission & fees*



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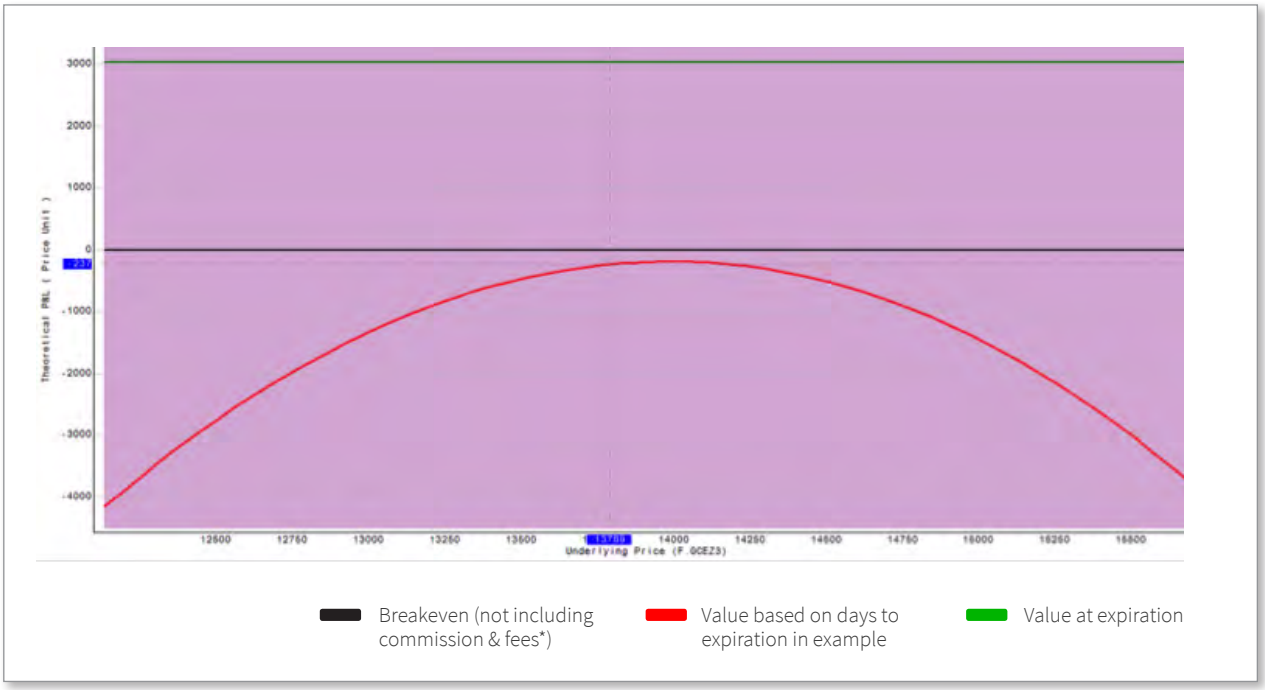
Short Strangle
(Unlimited risk)

A short strangle—simultaneously selling a call and a put with different strike prices—is ideal for markets with high volatility that are likely to trade in a longer-term range with a decrease in volatility.

However, your risk is unlimited if the market moves above or below your strike prices, plus the total premium collected. Maximum profit potential exists if the market closes between the strikes at expiration.

Example:

Sell 1 December Gold 1600 call at 11.10
Sell 1 December Gold 1200 put at 19.20
Days to Expiration: 169
Net premium received = 11.10 + 19.20 = 30.3
1 tick ($0.10) = $10 x 10 ticks/point = $100
Net premium received = 30.3 x $100 = $3030 - commission and fees*
Unlimited risk in bull market above = 1600 + 30.3 = 1630.3 + commission & fees*
Unlimited risk in bear market below = 1200 – 30.3 = 1169.7 - commission & fees*



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Increased Volatility Outlook

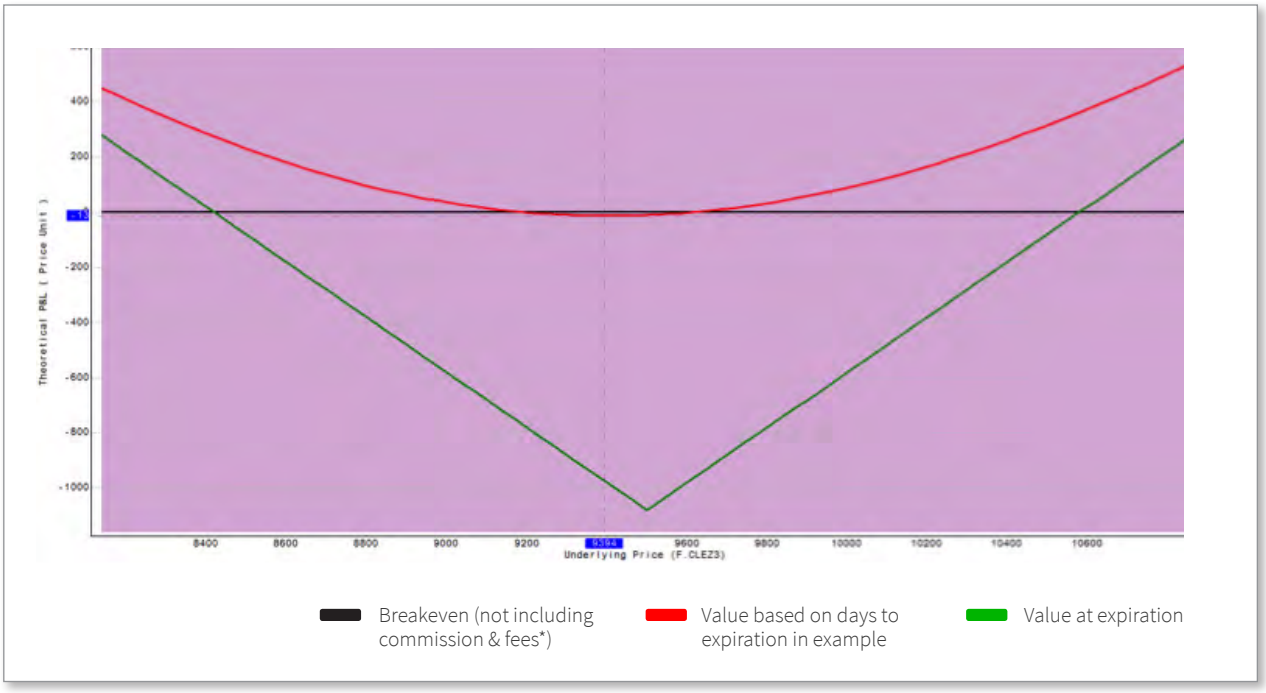
Embrace the potential for increased volatility in the markets with these two limited-risk option strategies—the long straddle and long strangle.

Long Straddle
(Limited risk)

A long straddle—simultaneously buying a call and put with the same strike price—is ideal for tightly consolidated markets with low volatility and the likelihood of making a breakout on increased volatility. Your risk is limited to the premium paid for both the call and the put. Your maximum risk would be if the market expired at your strike price.

Example:

Buy 1 December Crude Oil 9500 call at 540
Buy 1 December Crude Oil 9500 put at 540
Days to Expiration: 159
Net premium paid = 540 + 540 = 1080
1 tick = $10
Net premium paid = 1080 x $10 = $10,800 + commission and fees*
Unlimited reward in bull market above = 9500 + 1080 = 10580 - commission and fees*
Unlimited reward in bear market below = 9500 – 1080 = 8420 + commission and fees*



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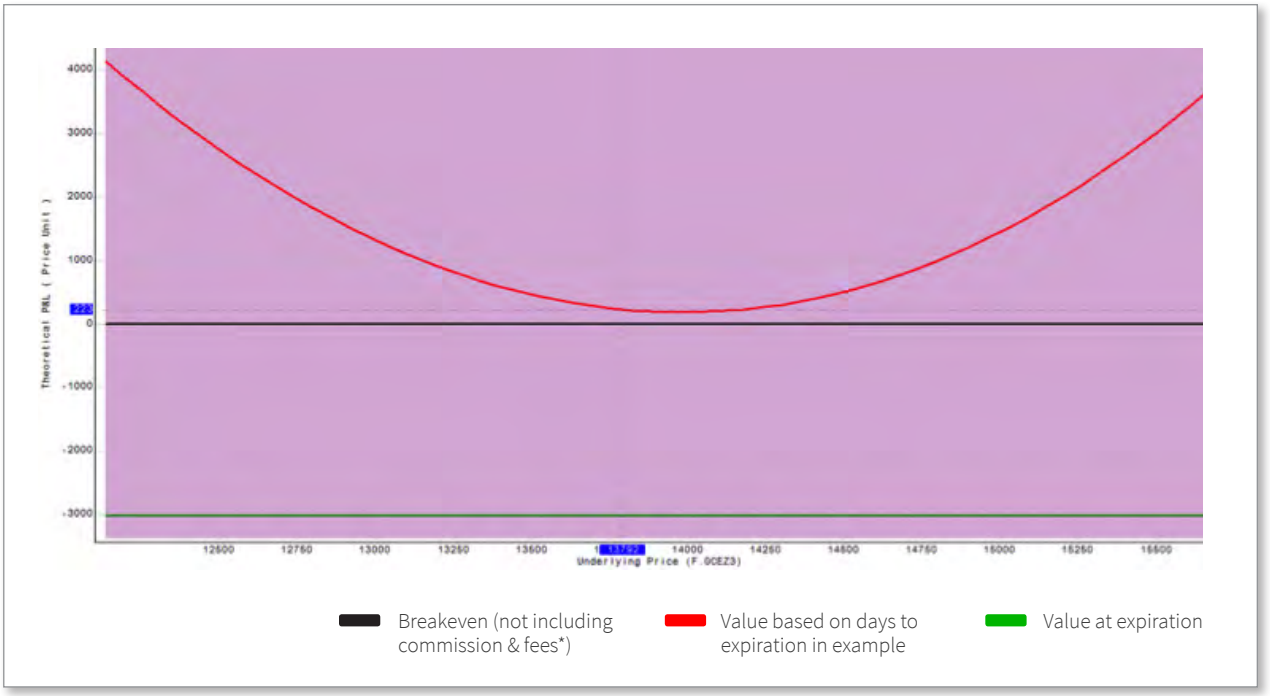
Long Strangle
(Limited risk)

Simultaneously buying a call and put with different strike prices—a long strangle—is ideal for range-bound markets trading at low volatility that are expected to break out of the range and increase in volatility. Your risk is limited to the premium paid for both the call and the put. Your maximum risk occurs when the market closes at or between your two strike prices at expiration. Rewards begin when the market trades either above or below your strike prices by the amount of premium paid.

Example:

Buy 1 December Gold 1600 call at 11.10
Buy 1 December Gold 1200 put at 19.20
Days to Expiration: 169
Net premium paid = 11.10 + 19.20 = 30.3
1 tick ($0.10) = $10 x 10 ticks/point = $100
Net premium paid = 30.3 x $100 = $3030 + commission and fees*
Unlimited reward in bull market above = 1600 + 30.3 = 1630.3 + commission and fees*
Unlimited reward in bear market below = 1200 – 30.3 = 1169.7 - commission and fees*



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Additional Resources

Thank you for the opportunity to provide you with this educational material. Anyone can offer online trading in online markets, but RJO Futures is not just anyone. We are specialists devoted to delivering the best possible trading experience for our clients. Whether you want to trade on your own, tap into the experience of our brokers or let a professional money manager make the calls, you can do it all at RJO Futures, the premier provider of futures brokerage services.

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The RJO Futures brokers provide the experience and background to help you with your trading needs and assist you with reaching your investment goals. We invite you to review each broker's profile, experience and techniques to help you select a partner that best fits your trading needs and style.

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