Rolling the Position, the Call Spread and the Put spreads

Rolling the Position

Time spreads are unlike all the other strategies we have discussed before when we talk about rolling or continuing the position. In other strategies, the option component is limited to a single month. At expiration, the position disappears. It either transforms into stock or expires worthless leaving you with no option position. It is different in the case of a time spread because you are dealing with two different expiration months. After the front month expires, in addition to a potential stock position, you will still have an option position – the out-month option will still have time until expiration. To properly roll that position, you must first understand the new position you have inherited.

Rolling the Call Spread

Let's look at the call time spread first. For the purposes of our example, let us pretend we are long the September / October 25 call spread. If the stock were to close below $25.00 on expiration Friday of September, the September 25 calls would expire worthless and you would be left with a long October 25 call position. From this position, you would have several things that you could do.

First, you could just sell out the October 25 call. Hopefully, the combination of the expiration of the September 25 calls and their subsequent worthlessness along with the proceeds gained from the sale of the October 25 calls after September expiration might make a profitable trade.

You could keep the position open and continuing in several ways. You could stay long the October 25 call naked. You could sell the October 30 call and become long the October 25 / 30 vertical call spread if you are bullish. You could sell the October 20 call and become short the October 20 / 25 vertical call spread if bearish.

You could buy the October 25 puts and become long the October 25 straddle if you felt the stock would become volatile. You could even sell the stock and create a synthetic put if you were very bearish. There are ways to create a new position that reflects any possible future outlook an investor can have.

If the stock were to close above $25.00, then the September 25 call would close in-the-money. At that time, you would be assigned your short September 25 call and that would translate into a short stock position. That short stock position that you received from the assignment of your short September 25 call along with the

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remaining October 25 long call position is the equivalent of a synthetic put. At this time, you could close out the position or keep it.

The position is a bearish one so if you felt the stock would be heading down, you could keep the position on. You could sell another option of a different strike to set up either a bull or bear put spread. You could buy the October 25 call to create a long straddle. As you see, there are many different combinations that could be created.

If you were short the September / October 25 call time spread and the stock expired under $25.00 on expiration Friday of September , then you would have a remaining position of a short October 25 call naked. Again, there are many potential ways of continuing the position. Of course, you could always buy back the naked call and close the position if you no longer wanted to maintain a position in the stock.

If you did, you could buy a call in the same month and create a vertical spread, sell the corresponding put and create a short straddle, buy the stock one to 1 and create a buy-write or other combination based upon what you felt the stock would do.

If the stock closed above $25.00 and you were short the call time spread, then you would be left with a long stock position from your long September 25 call and short the October 25 call against the long stock position. The position you would be left with is a buy-write. Depending on your outlook for the stock, you could keep the buy-write on, take it off, or use other options to change the position to what you want it to be.

Rolling Put Spreads

As far as put spreads, let's take an example and see where we are when the front month option expires. We will use the September / October 25 put spread for our example.

When long the spread, and the stock closes above $25.00, the September 25 puts, which you are short, will expire worthless leaving you with a long naked put position. From that position, you can close it or combine it with other option or stock to create a different position. Again, there are many different possibilities.

If you were short the put time spread, and the stock closed above $25.00 then the September 25 put, which you are long, will expire worthless leaving you with a short naked put position in the October 25 puts. This position can be closed out or combined with other options or stock to create a strategy that will take advantage of the outlook you have on the stock.

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When the stock closes below $25.00, the scenario is different. When long the spread with the stock closing lower than the strike price, the front month put which you are short will be assigned to you thus making you long stock in addition to your long October 25 put. This position is known as a synthetic call.

As before, there are many ways to combine other options and/or stock to change the position so that it is in line with want it to be going forward.

If you were short the spread, and the stock closed below $25.00, then you would exercise your long September 25 put making you short stock and short the October 25 put. That position, which is called a "sell-write" (the sister strategy to the buy-write), can be kept as is, closed out, or changed in different ways by combining it with stock or other options based upon your expectations of the stock's future movements.

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