

VERTICAL SPREADS

Vertical Call Spread and Vertical Put Spread Value

Any spread that has intrinsic value is considered in-the-money. How can you identify the value of a vertical call spread or a vertical put spread? Compare the stock price to the strike prices.

Look at any vertical call spread. If the stock price is above the lower strike of the spread, then the spread is in-the-money. For example, in the Feb. 50 – 55 call spread, if the stock is trading at \$52.00, then the spread would be in-the-money by \$2. This is because if the spread expired today, the Feb. 50 calls would finish \$2.00 in-the-money. The Feb. 55 calls would finish worthless because they are out-of-the-money. The spread, however, would be in-the-money with a value of \$2.00.

The rule is similar for determining whether or not a spread is out-of-the-money. If the stock price is lower than the lower strike of the spread, then the spread is out-of-the-money. Again, looking at the Feb. 50 – 55 call spread, if the spread expired today and the stock price closed at \$48.00, (lower than the lower strike) then the spread would be out-of-the-money, thus the spread will be out-of-the-money. And, of course, if the stock is trading at the same price as the lower strike price, then the spread will be considered at-the-money.

For vertical put spreads, a spread is determined to be in-the-money if the stock price is lower than the higher of the two strikes of the spread. For example, let's look at the Sept. 40 – 45 put spread. If the stock were to close at \$42.00 on expiration day, the Feb. 45 put would end up in-the-money and worth \$3.00. The Feb 40 puts would be out-of-the-money creating a \$3.00 intrinsic value for the spread. Since the spread has an intrinsic value, it is in-the-money.

A vertical put spread is considered to be out-of-the-money if the stock price is higher than the higher strike of the spread. So, going back to our Sept. 40 – 45 put spread example, if the stock was to close at a price of \$46.00 (higher than the higher strike) then both the Sept. 40 and 45 put will expire worthless. Thus the spread will be worthless and out-of-the-money.

A vertical put spread is considered at-the-money when the stock price is equal to the higher strike price.

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