

## The Bear Call Spread

- Credit Spread
- Defined Risk
- Defined Reward
- Mildly Bearish
- Higher Probability, Lower Reward

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## 1. The Bear Call Spread Explained

Welcome to the Bear Call Spread Option strategy course. This strategy will suit a trader who is Mildly Bearish on a stock or index.

Explained in its simplest terms the Bear Call Spread strategy is a combination of Call Options which allows you to profit from stocks that you believe will stay below a certain price. This creates an Option Spread trade with defined risk and defined reward.

The Bear Call Spread is a High Probability Strategy. The chances of being successful are over 80% with the way we trade.

We are going to show you:

1. How to create a Bear Call Spread
2. How to calculate Risk and Reward
3. How to find Probabilities of success
4. How to identify your breakeven price
5. When to place the Bear Call Spread and manage the trade

With every strategy there are pros and cons. During this course we will highlight these to you.

The course consists of video, pdf, quizzes, assignments etc..... It is important that you complete the assignments. The only way to learn about options is 'to do'. You will have access to a 'Demo' account and will be able to practice implementing the strategies learnt. This is important. So practice, practice, practice.

### 1.1. Short Explainer Video

[CLICK HERE to view.](#)

### 1.2. How to create a Bear Call Spread

The bear call spread is made up entirely of call options on the same underlying stock (or index). It's constructed by purchasing a call with one strike price and selling (writing) another call with a lower strike price but the same expiration month.

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The ratio of long calls to short must be 1:1. The result is a position consisting of a long call (higher strike) and a short call (lower strike). An investor with this position can be said to hold a bear call spread.

**Bear call spread = buy higher-strike call + sell lower-strike call**

### 1.3. Debit Spread

Before you read on, simply remember that the Bear Call Spread is a 'CREDIT SPREAD'.

In very simple terms, a spread is an option strategy, or position, that is composed of both long option contracts and short option contracts, of the same type (call or put), and on the same underlying stock (or index). The sides of a spread, i.e., the long option(s) and the short option(s), are commonly called the “legs” of the position, and for most spreads, each leg would by itself benefit from an opposite move, bullish or bearish, in the underlying stock (or index). As opposed to the outright purchase or sale of calls or puts, spreads are termed “complex” strategies, a term that reflects their composition (of different pieces) rather than any level of difficulty in understanding their use.

Spreads can be broadly categorized: vertical spreads, horizontal spreads and diagonal spreads (or variations thereof). Each of these may further be categorized by type: call (composed of only call contracts) or put (composed of only put contracts). The profit & loss profiles of each spread category will be somewhat different. Let's take a closer look at these terms:

- Vertical (call or put) – legs have same expiration months but different strike prices
- Horizontal (call or put) – legs have same strike prices but different expiration months (also called time spreads or calendar spreads)
- Diagonal (call or put) – combination of vertical or horizontal characteristics (different strike prices and expiration months)

The spreads most commonly used by investors are vertical spreads and horizontal spreads.

Another category of widely used complex option strategies comprising two legs, but which are not by definition spread, are straddles and strangles. These don't follow our definition of spreads literally, because they are composed of both calls and puts, either all long contracts or all short ones. However, the two legs of each of these strategies

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can be characterized as one bullish and one bearish. For educational purposes, or for sake of convenience, we will include these strategies in the larger family of spreads.

In terms of cash flow upon establishing spread, straddle or strangle positions, there are debit spreads and credit spreads:

- Debit spreads – total cash amount paid out for purchased (long) options is greater than the total cash amount received for sold (short) options
- Credit spreads – total cash amount received for sold (short) options is greater than the total cash amount paid out for purchased (long) options

Generally, a debit spread will be established (or purchased) at a net debit but will be closed (sold or liquidated) at a net credit. The opposite is true for credit spreads; they may initially be established (or sold) for a net credit, but will be closed (bought back or liquidated) at a net debit. Sometimes, however, a spread may be established or closed for “even money,” or with the total cash amount paid out equaling the total cash amount received.

Since the long, higher-strike call will cost less than the premium received for the short, lower strike call with the same expiration, a bear call spread will always be established at a net credit. In other words, the amount of cash received is more than the cash paid out.

### **Bear call spread = credit spread**

#### **1.4. Example**

SPY is trading at \$226.51. We want to create a high probability bearish trade. Look at the option quotes below for SPY which expire in 6 weeks.

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CALLS				STRIKE
DELTA	GAMMA	THETA	BID x ASK	
0.432	0.054	-0.040	◆ 2.37 x 2.38 ◆	227
0.377	0.053	-0.037	◆ 1.88 x 1.92 ◆	228
0.324	0.050	-0.034	◆ 1.49 x 1.52 ◆	229
0.273	0.047	-0.031	◆ 1.16 x 1.19 ◆	230
0.226	0.043	-0.028	◆ 0.89 x 0.92 ◆	231
0.185	0.038	-0.024	◆ 0.68 x 0.70 ◆	232

SPY is trading at \$226.51. We want to create a high probability bearish trade. Look at the option quotes below for SPY which expire in 6 weeks.

To establish a bear call spread with SPY options, we would sell 1 SPY Jan 20th \$231 call for \$0.89, and at the same time buy 1 SPY Jan 20th \$232 call for \$0.70. The result is us holding 1 SPY Jan 20th \$231/\$232 bear call spread, at a \$0.19 (\$0.89 – \$0.70) net credit or \$19 total.

### 1.5. Share Price Outlook

The bear call spread is a moderately bearish position. By employing this strategy on SPY we expect to profit from a decrease in its price. However, it's a moderately bearish position since we generally expect SPY to stay below the \$231 short call's lower strike price by expiration. Below that level, the profit is capped. A more bearish investor might instead simply buy puts outright, buy an out-of-the- money bear put spread or simply short the stock.

#### Bear call spread: moderately bearish

### 1.6. Motivation for Spreading

Since we are only moderately bearish on SPY the risk of selling a call might represent more upside risk than we are willing to take. By purchasing the higher- strike \$232 call, the upside risk of the \$231 short call is covered if our bearish forecast is incorrect and SPY goes up instead. The trade-off for buying upside protection in this manner is reduced downside profit potential on the short call contract.

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**Bear call spread: reduce upside risk of short call**

**1.7. Maximum Profit**

The maximum downside profit for a bear call spread is limited to the net credit received when establishing it. This profit will be seen if SPY closes at or below the \$231 lower strike price of the short call at expiration, no matter how much SPY decreases.

**Maximum profit = credit received**

For our example with SPY May 27th \$231/\$232 bear call spread, if at expiration SPY closes at or below the lower strike price of \$231, both call options would expire with no value, and the net \$19 credit initially received for the spread would be the maximum profit.

**Maximum profit = \$0.19 credit received, or \$19 total**

**Note:** Do not under-estimate the \$19 max profit in this example. It might appear very small, but when looked at from a 'return on investment' point of view, it will become apparent how powerful this strategy is.

	<b>SPY \$231/\$232 Bear Call Spread</b>
<b>Max Profit</b>	\$19
<b>Max Loss</b>	\$81

**1.8. Maximum Loss**

The maximum upside loss for a bear call spread is limited to the difference between the calls' strike prices, or the spread's maximum value, less the credit initially received for the spread.

In our SPY example, this loss will be seen if SPY closes at or above the higher \$232 strike price of the long call at expiration, no matter how high the SPY increases.

**Maximum loss = difference in strike prices – net credit received**

For our example with SPY Jan 20th \$231/\$232 bear call spread, if SPY trades above \$232 at expiry the maximum loss will be:

**\$1 (difference between strike prices) - \$0.19 (credit received)  
= \$0.81 or \$81 total**

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	<b>SPY \$231/\$232 Bear Call Spread</b>
<b>Max Profit</b>	\$19
<b>Max Loss</b>	\$81

This is a real benefit of this strategy, we know exactly what we can make and what we can lose before we even place the trade. This is excellent for total beginners or novice option traders.

### 1.9. Return on Investment

The return on investment formula is simply:

$$(\text{Max Profit} / \text{Max Loss}) * 100$$

Looking at our SPY example:

$$\{\$19 (\text{Max Profit}) / \$81 (\text{Max Loss})\} * 100 \\ = 23.46\%$$

The return on investment is very substantial, I think you will agree? Especially for a 6-week investment! Keep reading, the news gets better!

	<b>SPY \$231/\$232 Bear Call Spread</b>
<b>Max Profit</b>	\$19
<b>Max Loss</b>	\$81
<b>Return on Investment</b>	23.46%

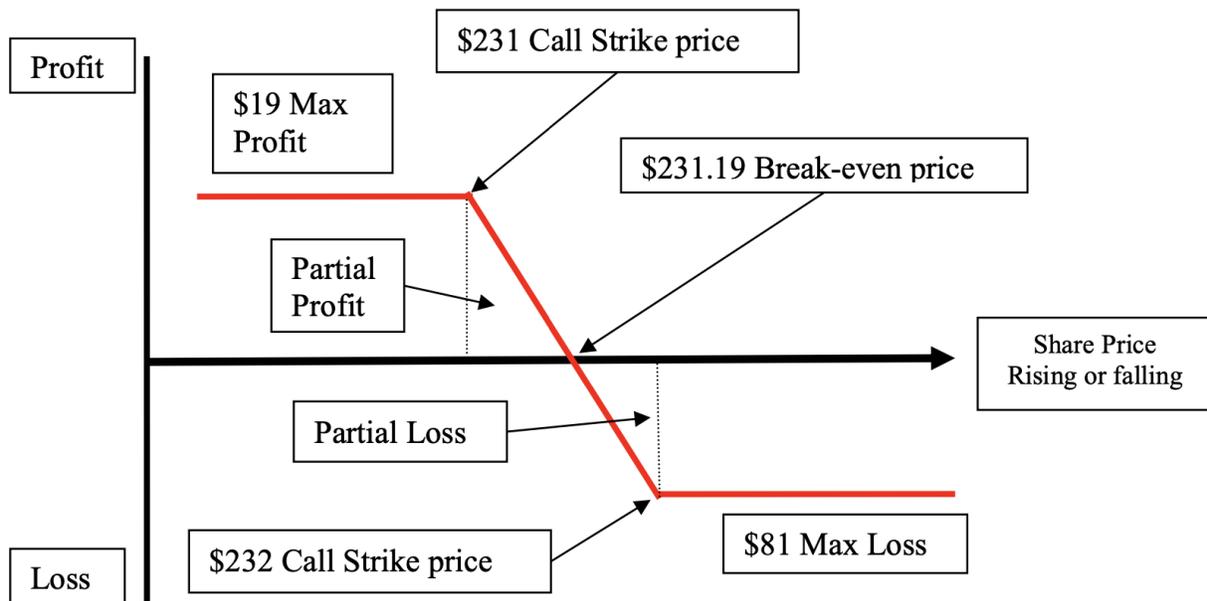
### 1.10. Break-Even Point (Short Term Expiry)

$$\text{Break-even price} = \text{lower strike price} + \text{net credit received}$$

At expiration, the break-even price for the SPY bear call spread example would be a closing SPY share price equal to \$231 (lower strike price) + \$0.19 (net credit received) = \$231.19

	<b>SPY \$231/\$232 Bear Call Spread</b>
<b>Max Profit</b>	\$19
<b>Max Loss</b>	\$81
<b>Return on Investment</b>	23.46%
<b>Break-even price</b>	\$231.19

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### 1.11. Probability of Profit & Leeway

Another major advantage of the bear call spread is the 'upside leeway' it can give you. The share price of SPY could rise by a certain amount and we would still make a profit.

Remember in our SPY example. The share price of SPY was \$226.51 when we placed the \$231/\$232 bear call spread. The breakeven on the trade is \$231.19. This means that the share price of SPY could rise \$4.68 ( $\$231.19 - \$226.51$ ) before we make a loss at expiration. This is the equivalent of a 2.06% rise in the value of the SPY share price. We call this the 'upside leeway'.

Now let's consider our chances of winning. Which is more likely, SPY to close below \$226.51 or SPY to close below \$231.19? Obviously, SPY has a much better chance of closing below \$231.19 as it is currently trading at \$226.51. Most online brokers will tell you the probability of profit on every option trade you place. The probability with the SPY example was 76%.

Does this mean we are guaranteed to make profit? No, but it means that you have much better odds.

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	<b>SPY \$231/\$232 Bear Call Spread</b>
<b>Max Profit</b>	\$19
<b>Max Loss</b>	\$81
<b>Return on Investment</b>	23.46%
<b>Break-even price</b>	\$231.19
<b>Upside Lee-way</b>	2.06%
<b>Probability of Profit</b>	76%

Now, you can see the benefit of this strategy. We have a 76% probability of making a return on investment of 23.46% in 6 weeks! This is not a guaranteed return but the odds of winning are high. At Share Navigator, we increase our odds to over 80% and are happy to take in less premium to increase our odds. Our results have been 84% profitable versus 16% loser.

#### **1.12. Partial Profit or Loss**

At expiration, if SPY closes at a price between the \$231.19 break-even price and either of the two strike prices \$231 & \$232, either a partial loss or partial profit would be seen. Below the break-even price there would be a partial profit; above the break-even point there would be a partial loss.

#### **1.13. Profit & Loss Before Expiration**

Before expiration, an investor can take a profit or cut a loss by purchasing the spread in the marketplace. This involves selling the long call and buying the short call, which will be done at a net debit, and these closing trades may be executed simultaneously in one spread transaction. Profit or loss would simply be the net difference between the credit initially received for the spread and the debit paid to close it.

#### **1.14. Profit and Loss Table**

[CLICK HERE](#) to watch a video showing you how to do P&L tables for the Bear Call spread.

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It is important for you to get into the habit of creating profit and loss tables.. Here is an example of a P&L table for the SPY Jan 20th \$231/\$232 bear call spread. Remember we received \$0.19 for the spread:

SPY price at Expiration	Short \$231 Call Value	Long \$232 Call Value	Credit from Spread	Spread Profit/Loss
\$220	0	0	+ \$19	+ \$19
\$222	0	0	+ \$19	+ \$19
\$224	0	0	+ \$19	+ \$19
\$226	0	0	+ \$19	+ \$19
\$228	0	0	+ \$19	+ \$19
\$230	0	0	+ \$19	+ \$19
\$231	0	0	+ \$19	+ \$19
\$232	- \$100	0	+ \$19	-\$81
\$234	- \$300	+ \$200	+ \$19	-\$81
\$236	- \$500	+ \$400	+ \$19	-\$81
\$238	- \$700	+ \$600	+ \$19	-\$81
\$240	-\$900	+\$800	+ \$19	-\$81

### 1.15. Impact of Volatility

The financial impact of a change in volatility depends on whether one or both calls are in-the-money and the amount of time until expiration. The bear call spread is best placed when implied volatility is high as it generally means you can command more premium from the trade.

### 1.16. Impact of Time Decay (Theta)

Theta is the rate of decay in the time value of an option. For a bear call spread, if SPY is closer to the higher \$232 strike of the long call, losses should increase at a faster rate

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as time passes. Conversely, if the SPY is closer to the \$231 lower strike of the short call, profits should increase at a faster rate with time. Look at the quotes again below:

CALLS				STRIKE
DELTA	GAMMA	THETA	BID x ASK	
0.432	0.054	-0.040	◆ 2.37 x 2.38 ◆	227
0.377	0.053	-0.037	◆ 1.88 x 1.92 ◆	228
0.324	0.050	-0.034	◆ 1.49 x 1.52 ◆	229
0.273	0.047	-0.031	◆ 1.16 x 1.19 ◆	230
0.226	0.043	-0.028	◆ 0.89 x 0.92 ◆	231
0.185	0.038	-0.024	◆ 0.68 x 0.70 ◆	232

Positive theta works against you and negative theta works for you. For a bear call spread, we have two positions to consider for theta.

- First, we own the SPY \$232 call with a theta of -0.024.
- Second, we sold the \$231 call for the same expiry with a theta value of -0.028. Because we sold the \$231 call the theta sign changes to positive +0.028.
- The net theta position is +0.004 (0.028-0.024).

This means that for our SPY \$231/\$232 bear call spread, \$0.004 per share or \$0.40 per contract per day is eroding from the value of the position. This is positive for us. It might not sound a lot but when you consider the credit on the trade was only \$19 per contract, the theta erosion is substantial, especially if you traded several contracts.

[CLICK HERE](#) to watch a video on the impact of Theta on the Bear Call Spread.

### 1.17. Impact of Delta

Delta is the rate of change in the value of an option for a \$1 move in the underlying share price. In our example with the SPY Jan 20th \$231/\$232 bear call spread we have two positions to consider. See option quote below.

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CALLS				STRIKE
DELTA	GAMMA	THETA	BID x ASK	
0.432	0.054	-0.040	◆ 2.37 x 2.38 ◆	227
0.377	0.053	-0.037	◆ 1.88 x 1.92 ◆	228
0.324	0.050	-0.034	◆ 1.49 x 1.52 ◆	229
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0.226	0.043	-0.028	◆ 0.89 x 0.92 ◆	231
0.185	0.038	-0.024	◆ 0.68 x 0.70 ◆	232

- First, we own the \$232 call with a delta of +0.185.
- Second, we sold the \$231 call with a delta of +0.226. The sign of the delta changes for the \$231 call because we sold the call option and it becomes -0.226.
- The result for the overall position is a delta of -0.041 (0.185-0.226).

A delta of -0.041 means that for a \$1 rise in the share price of SPY the value of the SPY Jan 20th \$231/\$232 bear call spread will fall by \$0.041 per share or \$4.10 and vice versa.

We can also consider delta as being short 4.1 shares of SPY. Think about it...if SPY rose by \$1 and we were short 4.1 shares we would make a loss of \$4.10. The exact same as the SPY Jan 20th \$231/\$232 bear call spread.

A couple of things to know about delta:

1. Positive delta is a bullish bias
2. Negative delta is a bearish bias
3. You should always consider the overall delta position in your portfolio – we like to be option sellers and keep our overall portfolio delta as neutral as possible. In this way we do not get too upset in moves in the market up or down. As a general rule of thumb we like to keep our deltas below plus or minus 1% of the value of our portfolio.

[CLICK HERE](#) to watch a video showing the impact of Delta on the Bear Call Spread.

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### 1.18. Picking the Strikes

Some bear call spreads can be considered more bearish than others. The degree of bearishness depends primarily on the strike price of the short call, which determines how low the underlying stock (or index) needs to decline for maximum profit to be realized at expiration.

- **Most bearish:** a spread sold when both calls are in-the-money. This yields a higher credit but the probability of profit is lowest.
- **Moderately bearish:** a spread bought when the underlying stock (or index) is between the two strike prices. This will give you a higher probability of profit than in-the-money calls but the credit received is lower.
- **Least bearish:** a spread bought when both calls are already out-of-the-money (primarily to take advantage of time decay). Out-of-the-money calls offer the highest probability of profit but yields the lowest credit.

At Share Navigator, we prefer out-the-money strikes for this strategy.

### 1.19. Assignment Risk

Assignment on any Equity option or American-style index option can, by contract terms, occur at any time before expiration, although this generally occurs when the option is in-the-money.

### 1.20. Equity Options

For an equity call option, early assignment usually occurs under specific circumstances; such as when underlying shareholders are about to be paid a dividend. Assignment at that time might be expected when the dividend amount is greater than the time value in the call's premium, and notice of assignment may be received as late as the ex-dividend date. If a bear call spread holder is assigned early on the short call, then he might exercise his long call, if it is in-the-money, and buy shares to fulfill the assignment obligation. In this case, maximum loss on the bear call spread would be realized.

**Note:** An investor with a bear call spread is short a lower-strike call and long a higher-strike call. It is therefore entirely possible that if the short call is in-the-money and early assignment is received, the long call would be out-of-the-money. In this case, it may not make financial sense to exercise the long call early to buy shares for delivery per the assignment obligation.

Therefore, the investor has choices:

- Purchase shares in the marketplace for delivery, at a realized loss, and retain the long out-of-the-money call

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- Take a short position in underlying shares because of assignment and retain the long call

An investor contemplating the use of a bear call spread should consider the consequences of early assignment, and in advance discuss with his broker a course of action to take if assigned.

### 1.21. American-Style Index Options

If early assignment is received on a short in-the-money call of a bear call spread, the cash settlement procedure for index options will create a debit in the investor's brokerage account equal to the cash settlement amount. This cash amount is determined at the end of the day the long call is exercised by its owner.

After receiving assignment notification, usually the next business day, if his long call is also in-the-money the investor may exercise that contract. The cash settlement amount credited to his account will be determined at the end of that day, and there is a full day's market risk if the long option is not sold during the trading day assignment. If the long call is not in-the-money, after the cash settlement amount is debited from his account via assignment the investor would remain long an out-of-the-money index call.

### 1.22. Powerpoint Video

[CLICK HERE](#) to view

### 1.23. Bear Call Spread: Actions to take at expiry

The action you take at expiry will depend on where the share price is trading at:

- **If the share price is below the short call strike price:** Both call options are out-the-money and worthless. The position will disappear on the next trading day. Simply enjoy the profits.
- **If the share price is above the long call strike price:** Both calls will be in-the-money and you will have made the max loss. There is nothing for you to do here as your broker will automatically buy and sell the shares commission free. The next trading day, the position will disappear from your account.

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- **The share price is between both strikes:** The short call option is in-the- money and has value. But the long call option doesn't and will expire worthless. You may be in a partial profit or loss depending on where the share price is trading. You have several choices available to you but which option you pick will depend on your outlook for the stock:
  - Close the entire trade for a partial loss or profit.
  - Roll out the bear call spread for another month with the same strikes. This can usually be done for an extra credit.
  - Take the short assignment of the shares. If you do nothing you will short the shares and they will appear in your account on the next trading day. From there you can buy the shares to close the position.
  - Another option would be to simply rollout the short call part of the trade for another month. This would not be a suitable solution for a novice investor and would also depend on the margin requirement as the call is uncovered or 'naked'.

#### **1.24. Bear Call Spread: Our View**

This is one of our favorite strategies and a favorite of our members too. This strategy is especially for novice investors.

We love the fact that you can place a high probability bearish trade by using out-of-the-money calls, that give you a significant return on investment and most importantly a 'defined' risk trade. Also, you do not need to have a large account to place this trade as the risk is defined. You know exactly what you can make and lose before you enter the trade. We also love the return on investment.

Finally, more advanced investors may prefer the call ratio spread. But the bear call spread is suitable for everybody.

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## 2. **Placing and Managing a Bear Call Spread**

### 2.1. **How to place a Bear Call Spread**

[CLICK HERE](#) to view.

### 2.2. **How to manage a Bear Call Spread**

[CLICK HERE.](#)

### 2.3. **Rolling out a Bear Call Spread**

[CLICK HERE](#)

### 2.4. **Closing down the trade**

[CLICK HERE](#)

### 2.5. **Test Your Knowledge 1**

[CLICK HERE](#) to take the quiz

### 2.6. **Test your knowledge 2**

At this stage it is best if you start practicing for real so this is what we want you to do:

1. Pick any option able stock that you have a mildly bearish outlook
2. Place a Bear Call Spread
3. Do a profit & Loss table
4. Place the trade in a 'Simulated' or 'Demo' account with an online broker
5. Identify your breakeven
6. Identify your Max Loss
7. Identify your Max Profit
8. Share your insights on our daily members web meetings

### 2.7. **Please leave a Review on Google**

[CLICK HERE](#) to leave a review of this course on Google. We would love to get your feedback. Thank you.

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### 3. Mentoring Service

Embark on a streamlined journey to financial proficiency with our Stock and Options Mentoring Service. Elevate your learning curve by enlisting a **personal** mentor who will guide you through the intricacies of stock and options trading. Our comprehensive program offers:

- Weekly one-on-one mentoring sessions, ensuring personalized attention and targeted skill development.
- Gain a competitive edge with daily live market updates
- Exclusive access to curated stock watchlists
- Insights into our meticulously crafted options and futures trades.
- Save valuable time, effort, and money as you fast-track your education with our dedicated support system.

With daily assistance and a wealth of resources at your fingertips, you'll not only navigate the markets more confidently but also accelerate your journey toward financial success.

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