

# The Bear Put Spread

- Debit Spread
- Defined Risk
- Defined Reward
- Bearish
- Lower Probability, Higher Reward

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## 1. The Bear Put Spread Explained

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

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

The Bear Put Spread is a Low Probability Strategy. The chances of being successful are circa 30%-50% with the way we trade. But the payoff can be substantial yielding returns of over 200%!

We are going to show you:

- How to create a Bear Put Spread
- How to calculate Risk and Reward
- How to find Probabilities of success
- How to identify your breakeven price
- When to place the Bear Put 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 Put Spread

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

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puts to short must be 1:1. The result is a position consisting of a long put (higher strike) and a short put (lower strike). An investor with this position can be said to be long a bear put spread, or in more casual terms to be long a put spread.

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

### 1.3. Debit Spread

Before you read on remember that the Bear Put Spread is a 'DEBIT 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.

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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 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 put will cost more than the premium received for the short, lower strike put with the same expiration, a bear put spread will always be established at a net debit. In other words, the amount of cash paid out is more than the cash received.

### **Bear Put spread = debit spread**

#### **1.4. Example**

See put options quote for SPY below for the March 17th expiry (4 months to expiry). The share price of SPY is currently \$225.45

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TABBED VIEW		STRIKES ▾			SMART	SPY	100
STRIKE	PUTS				IV: 13.2%		
	DELTA	GAMMA	THETA	BID x ASK			
220	-0.398	0.024	-0.030	◆ 4.82 x 4.85 ◆			
221	-0.422	0.025	-0.030	◆ 5.12 x 5.21 ◆			
222	-0.447	0.026	-0.029	◆ 5.46 x 5.55 ◆			
223	-0.472	0.026	-0.029	◆ 5.82 x 5.92 ◆			
224	-0.499	0.027	-0.028	◆ 6.20 x 6.31 ◆			
225	-0.526	0.027	-0.027	◆ 6.62 x 6.74 ◆			

To establish a bear put spread with SPY options, we might buy 1 SPY March 17th \$225 put for \$6.74, and at the same time sell (write) 1 SPY March 17th \$220 for \$4.82.

The result is the investor holding 1 SPY March 17th \$225/\$220 bear put spread, at a \$1.92 (\$6.74– \$4.82) net debit or \$192 total. This is one of the first benefits of the bear put spread versus buying the put. See matrix below:

	<b>\$225/\$220 Bear Put</b>	<b>Long \$225 Put</b>
<b>Cost /Risk</b>	\$192	\$674

### 1.5. Share Price Outlook

The bear put spread is a bearish position. We expect to profit from a decrease in its price.

However, it's a moderately bearish position since we generally expect SPY to decrease down to or slightly below the \$220 short put's lower strike price by expiration. Below that level, the profit is capped. A more bearish investor might simply buy puts outright or short the stock.

**Bear put spread: moderately bearish**

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### 1.6. Motivation for Spreading

Since we are only moderately bearish on SPY, the cost of buying the \$225 put at \$694 might represent more upside risk than we are willing to take. By selling the lower \$220 strike put also and taking in premium, the cost of the \$225 long put is reduced. This premium will at least partially offset a loss on the \$225 long put if we are incorrect and SPY goes up instead. The trade-off for protecting some of the \$225 long put's value in this manner is of course the limited downside profit potential.

#### **Bear put spread: reduce risk of long put**

### 1.7. Maximum Profit

The maximum downside profit for a bear put spread is limited to the difference between the puts' strike prices, less the debit initially paid for the spread. In our example, this profit will be seen if the SPY closes at or below the lower \$220 strike price of the short put at expiration, no matter how low SPY declines.

#### **Maximum profit = difference in strike prices – net debit paid**

In our SPY \$225/\$220 bear put spread example, the maximum profit is:  
 $\$5.00$  strike difference ( $\$225 - \$220$ ) –  $\$1.92$  (debit paid) =  $\$3.08$ , or  $\$308$  total

If at expiration SPY closes at or below the lower (short put) strike price of \$220, then the maximum profit would be realized. This is probably the only downside of the bear put versus the long-put. The long-put has unlimited profit potential whereas the bear put spread has limited profit potential. See matrix below:

	<b>\$225/\$220 Bear Put</b>	<b>Long \$225 Put</b>
<b>Cost /Risk</b>	\$192	\$674
<b>Max Profit</b>	\$308	Unlimited

### 1.8. Maximum Loss

The maximum upside loss for a bear put spread is limited entirely to the net debit initially paid for it. This loss will be seen if SPY closes at or above the \$225 higher strike price of the long put at expiration, no matter how high the SPY increases.

#### **Maximum loss = debit paid**

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At expiration, if SPY closes at or above the higher strike price of \$225, both put options would expire with no value, and the net \$1.92 debit paid for the spread would be lost. Maximum loss = \$1.92 debit paid, or \$192 total

This is a real benefit of the bear put spread versus the long-put strategy. Our risk is lower. See matrix below.

	<b>\$225/\$220 Bear Put</b>	<b>Long \$225 Put</b>
<b>Cost /Risk</b>	\$292	\$674
<b>Max Profit</b>	\$208	Unlimited
<b>Max Loss</b>	\$192	\$674

### 1.9. Return on Investment

The return on investment formula is simply:

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

Looking at our SPY example:

$$\{\$308 (\text{Max Profit}) / \$192\} * 100$$

$$= 160.4\%$$

I think you will agree that this return on investment is substantial. It is difficult to make a direct comparison with the long \$225 put strategy as the long-put strategy has unlimited reward. But if we were to compare strategies based on the share price falling to the lower strike price of \$220 at expiration you would make a loss on the \$225 long put but would make the maximum profit on the bear put spread.



	<b>\$225/\$220 Bear Put</b>	<b>Long \$225 Put</b>
<b>Cost /Risk</b>	\$192	\$674
<b>Max Profit</b>	\$308	Unlimited
<b>Max Loss</b>	\$192	\$674
<b>Profit (If at \$220 at Expiration)</b>	\$308	-\$174
<b>Return on Investment if at \$220</b>	160.4%	-25.81%

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

The break-even price for a bear put spread at expiration is a closing SPY price equal to the \$225 higher strike price of the long put minus the \$1.92 debit paid for the spread.

$$\text{Break-even price} = \text{higher strike price} - \text{net debit paid}$$

For the SPY \$225/\$220 Bear Put  
 = \$225 higher strike – \$1.92 debit paid  
 = \$223.08

This is another major advantage of the bear put spread over the long-put strategy. The share price of SPY doesn't have to fall as much from its current level of \$225.45 to start making a profit at expiration. See matrix below:

	<b>\$225/\$220 Bear Put</b>	<b>Long \$225 Put</b>
<b>Cost /Risk</b>	\$192	\$674
<b>Max Profit</b>	\$308	Unlimited
<b>Max Loss</b>	\$192	\$674
<b>Profit (If at \$220 at Expiration)</b>	\$308	-\$174
<b>Return on Investment if at \$220</b>	160.4%	-25.81%
<b>Break-Even</b>	\$223.08	\$218.26

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### 1.11. Probability of Profit

One of the major drawbacks of the long-put strategy was the probability of profit at expiration. Because the break-even price of the bear put spread is higher, the probability of profit will also be higher. Remember, the share price of SPY was at \$225.45 for this example. With the long put the share price needs to fall to \$218.26 or below to start making a profit at expiration. In the case of the \$225/\$220 bear put spread, the share price must only fall to \$223.08 at expiration to make a profit. That is why the probability of profit is higher for the bear put spread.

In the SPY example, the probability of profit for the long \$225 put is 38%. But the probability of profit for the \$225/\$220 bear put spread increases to 45%. See matrix below:

	<b>\$225/\$220 Bear Put</b>	<b>Long \$225 Put</b>
<b>Cost /Risk</b>	\$192	\$674
<b>Max Profit</b>	\$308	Unlimited
<b>Max Loss</b>	\$192	\$674
<b>Profit (If at \$220 at Expiration)</b>	\$308	-\$174
<b>Return on Investment if at \$220</b>	160.4%	-25.81%
<b>Break-Even</b>	\$223.08	\$218.26
<b>Probability of Profit</b>	45%	38%

**Note:** This probability is still not high (by our standards) but it's better than the long-put strategy. If implied volatility was higher we would prefer to place a bear call spread. But when implied volatility is low and we believe a share price will fall to a certain level, the bear put is the best strategy to apply.

### 1.12. Partial Profit or Loss

At expiration, if SPY closes at a point between the break-even price and either of the two strike prices, 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.

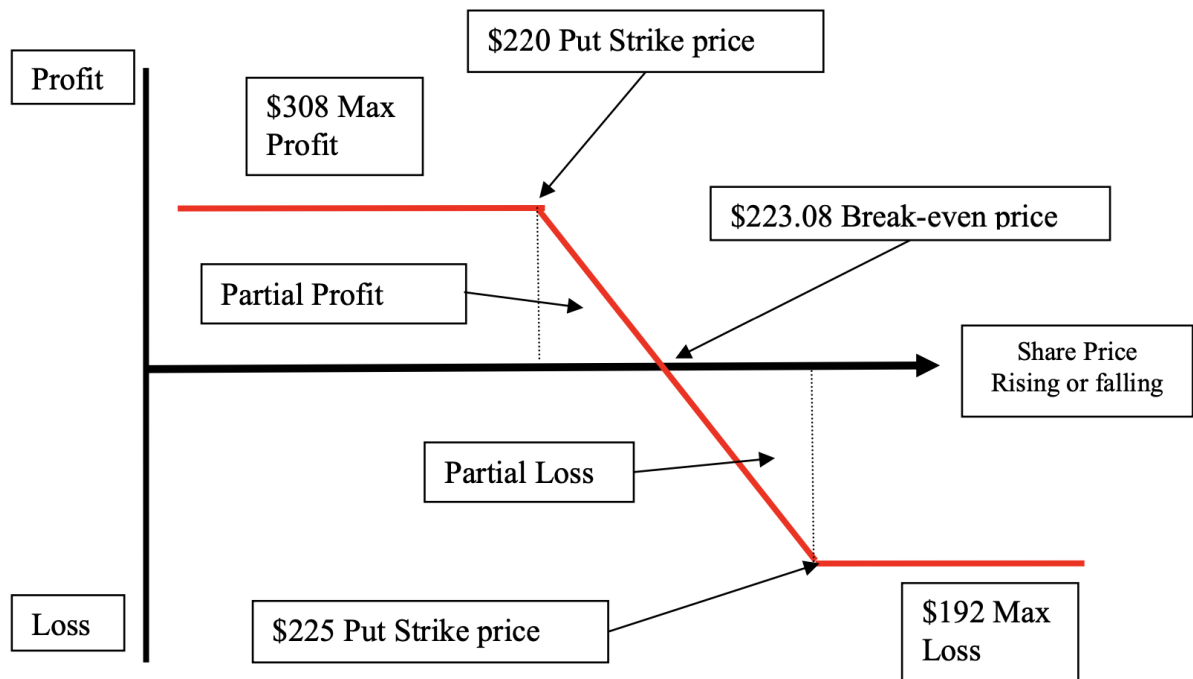


Figure 1: Profit and Loss Dynamics for the bear put spread

### 1.13. Profit & Loss Before Expiration

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

### 1.14. Profit and Loss Table

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

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 March 17th \$225/220 Bear Put Spread. Remember we paid \$1.92 for the spread:

SPY price at Expiration	Short 220 Put Value	Long 225 Put Value	Cost of Spread	Spread Profit/Loss
\$210	- \$1,000	+ \$1,500	- \$192	+ \$308
\$212	- \$800	+ \$1,300	- \$192	+ \$308
\$214	- \$600	+ \$1,100	- \$192	+ \$308
\$216	- \$400	+ \$900	- \$192	+ \$308
\$218	- \$200	+ \$700	- \$192	+ \$308
\$220	0	+ \$500	- \$192	+ \$308
\$222	0	+ \$300	- \$192	+ \$108
\$224	0	+ \$100	- \$192	-\$92
\$226	0	0	- \$192	- \$192
\$228	0	0	- \$192	- \$192
\$230	0	0	- \$192	- \$192

### 1.15. Impact of Volatility

The financial impact of a change in volatility depends on whether one or both puts are in-the-money and the amount of time until expiration.

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

Theta is the rate of decay in the time value of an option. For a bear put spread, if SPY is closer to the \$225 higher strike of the long put, losses should increase at a faster rate as time passes. Conversely, if SPY is closer to the \$220 lower strike of the short put, profits should increase at a faster rate with time. Look at the option quotes again:

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TABBED VIEW		STRIKES ▼		SMART	SPY	100
STRIKE	PUTS			IV: 13.2%		
	DELTA	GAMMA	THETA	BID x ASK		
220	-0.398	0.024	-0.030	◆ 4.82 x 4.85 ◆		
221	-0.422	0.025	-0.030	◆ 5.12 x 5.21 ◆		
222	-0.447	0.026	-0.029	◆ 5.46 x 5.55 ◆		
223	-0.472	0.026	-0.029	◆ 5.82 x 5.92 ◆		
224	-0.499	0.027	-0.028	◆ 6.20 x 6.31 ◆		
225	-0.526	0.027	-0.027	◆ 6.62 x 6.74 ◆		

The SPY March 17th \$225/\$220 bear put spread we have two positions to consider.

- First, we are short on the \$220 put. The theta value is -0.030. But remember we sold the \$220 put so the theta sign changes to +0.030.
- Second, we bought the SPY \$225 put. The theta value of the \$225 put is - 0.027.
- This gives us a net theta for the bear put spread of +0.003 (0.030-0.027).

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

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## 1.17. Impact of Delta

TABBED VIEW		STRIKES ▾			SMART	SPY	100
STRIKE	PUTS				IV: 13.2%		
	DELTA	GAMMA	THETA	BID	x	ASK	
220	-0.398	0.024	-0.030	◆ 4.82	x	4.85 ◆	
221	-0.422	0.025	-0.030	◆ 5.12	x	5.21 ◆	
222	-0.447	0.026	-0.029	◆ 5.46	x	5.55 ◆	
223	-0.472	0.026	-0.029	◆ 5.82	x	5.92 ◆	
224	-0.499	0.027	-0.028	◆ 6.20	x	6.31 ◆	
225	-0.526	0.027	-0.027	◆ 6.62	x	6.74 ◆	

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 \$225/\$220 bear put spread, we have two positions to think about.

- First, we are short the \$220 put with a delta of -0.398. But remember we sold this put so the delta changes to +0.398.
- Second, we bought the \$225 put with a delta -0.526.
- This gives us a net delta position of -0.128 (0.398-0.526).

This means that the value of the SPY \$225/220 bear put spread will go up by \$0.128 per share or \$12.80 total for a \$1 fall in SPY and vice versa.

We can also consider delta as being short 12.8 shares of SPY. Think about it...if SPY rose by \$1 and we were short 12.8 shares we would lose \$12.80. The exact same as the SPY \$225/220 bear put 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

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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 Put Spread.

### **1.18. Picking the Strikes**

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

- Most bearish: a spread bought when both puts are out-of-the-money. This costs less but the probability of profit is low.
- Moderately bearish: a spread bought when the underlying stock (or index) is between the two strike prices. This will cost more than out-the-money bear put spread but the probability of profit increases.
- Least bearish: a spread bought when both puts are already in-the-money (primarily to take advantage of time decay). This has the greatest probability but will cost more and there is less payoff.

#### **1.18.1. How to reduce risk and hence profitability?**

1. Narrow the width of the strike prices. For example, a \$5 strike price differential carries more risk than a \$1 wide differential.
2. Use in-the-money puts to improve probability

Remember, when you reduce risk, profits will be lower.

#### **1.18.2. How to increase risk and hence profitability?**

1. Widen the width of the strike prices. For example, a \$5 strike price differential carries more risk than a \$1 wide differential.
2. Use out-the-money puts to improve probability

Remember, when you increase risk you have less chances of being profitable. But rewards are also higher. You must make the trade-off between risk and reward.

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### 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 put option, early assignment generally occurs when the short put is deep in-the money, expiration is relatively near, and its premium has little or no time value. If a bear put spread holder is assigned early on the short put, then he may exercise his long put and sell shares purchased per the assignment obligation. In this case, maximum profit on the bear put spread would be realized.

### 1.21. American-Style Index Options

If early assignment is received on the short put of a bear put 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 put is exercised by its owner. After receiving assignment notification, usually the next business day, when the investor exercises his long put the cash settlement amount credited to his account will be determined at the end of that day. There is a full day's market risk if the long option is not sold during the trading day assignment is received.

### 1.22. Powerpoint Video

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### 1.23. Bear Put 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 put strike price: both put options will be in-the-money. There is no need for you to do anything as your broker will assign you the shares and simultaneously sell them with no trading costs. You will make full profit.
- If the share price is above the long put strike price: Both puts are out- the-money and worthless. Nothing to do here except suffer the full loss.
- If the share price is between the long put and the short put: The short put is out-the-money and worthless so nothing to do there. But the long put has value

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in it. You can close the long put before the close of business on expiry Friday. There may be a profit or a loss depending on how deep in-the-money the long put is. If you do nothing and leave the long put expire, you will be assigned the short shares by your broker automatically. You can then buy the stock later to close the position.

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

We much prefer the bear put spread over the long-put strategy as the risk is greatly reduced because the sale of the lower strike put reduces the cost and risk of buying the long put. Also, you have a better chance of making a profit.

We use the bear put spread in the following scenarios:

1. We are bearish on the stock
2. Implied Volatility is lower than normal

If we are bearish and implied volatility is high we will choose credit type strategies such as the bear call spread.

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

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

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

[CLICK HERE.](#)

### 2.3. **Rolling out a Bear Put 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 Put 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**

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