GREAT PACIFIC TRADING COMPANY

Introduction to Options

There are two types of Options: Calls and Puts. The purchaser of a Call option has the right to go long the commodity at a predetermined price, on or before a specific date. Buying Call options is a bullish strategy, meaning you are speculating that prices will rise. The buyer of a Put option, has the right to go short the commodity at a predetermined price, on or before a specific date. Buying Put options is a bearish strategy, for those speculating that prices will decline.

The main advantage to buying options is that you have a predetermined amount of risk: the cost of the option. The cost of the option is referred to as the premium. When you buy an option, you pay the premium. When you sell options, you receive the premium. The amount of risk incurred when buying options is the premium, while the amount of risk incurred when selling options is unlimited. The premium is quoted just like the price of the futures, in cents, points, etc.

The Language of Options

Strike Price: The price at which an option can be converted to a futures contract. For calls this is the price at which one has the right to buy the commodity. For puts this is the price at which one has the right to sell the commodity.

Expiration Month: This is the life of the options contract, or how long the purchaser of an option has until the option expires. Be sure to contact your broker to confirm which futures contract is the underlying contract for a particular option, as sometimes options have expiration months which do not correspond to a futures contract.

Premium: This is the cost of the option, plus commissions and fees. Option prices are quoted similarly to futures prices, but in some instances the value of a "tick", or point is different than the underlying futures contract. As stated above, the real advantage to buying options, is that the only risk involved is the price of the option.

The Mechanics of Option Buying

The major factors effecting the worth of an option are the price of the futures contract, the strike price of the option, and the amount of time left until the option expires. Each option has a strike price, which is the price at which the option may be converted to a futures contract. A July *750* Soybean Call gives the buyer the right, not the obligation, to exercise the option at *750* into a July futures contract long position at *750.* A July 750 Soybean Put gives the buyer the right, again not the obligation, to convert their option into a short July futures position at *750,* if the put holder deems it profitable to due so.

Put Example:

Suppose one is bearish Soybeans, and wishes to speculate that prices will fall. It is March and the following prices exist:

July Soybeans are trading at 785 ¾, and the following strike prices are available:

Option	Strike Price	Premium (in cents per bushel)
July Soybean **Put**	725	7 cents
July Soybean Put	*750*	12 cents
July Soybean Put	775	17 ½ cents
July Soybean Put	800	23 cents
July Soybean Put	825	48 cents where 1 cent is equal to $50.00

Because you think that Soybeans will fall below 750, you decide to purchase the July 750 Put Option. The cost of the option is 12 cents, or $600.00 plus commissions. Now, suppose a drought hits the mid west and Soybean prices go to 900 cents a bushel by early June. Our speculator only loses the cost of the option and any commissions. The put will expire worthless, and the option buyer will have lost the premium.

Now suppose, instead of drought we get ideal growing weather and the market expects a "bumper" crop of soybeans. Soybean prices fall dramatically, and by early June the July contract is trading at 705. Using simple mathematics, we can establish that our option should be at least 45 cents, or *$2,250.* We arrived at the 45 cent figure by subtracting the futures contract price from the strike price (Strike-Futures price). The 45 cent figure arrived at for the value of the Put, is referred to as the intrinsic value of the option (Put Intrinsic Value = Strike Price - Futures Price; intrinsic value is either zero or greater than zero. If the futures contract is trading at a price level greater than the strike price, the option is said to only have Time Value, or Extrinsic Value). Now what should our speculator do?

The Mechanics of Buying an Option (Continued)

Our speculator looks in the paper and sees the following price for the July 750 Soybean Put:
July 750 Put Option 52 cents

The Put option is trading 7 cents more than our 45 cent intrinsic value estimate. Options typically trade at values greater than their intrinsic value, so our speculator would elect to sell the Put Option at 52 cents, not to exercise the Put into a short futures position at
750. Our speculator friend would have made 40 cents, *52* cents - 12 cents that he initially paid for the option, or $2,000.00 dollars in profits before commissions.

Call Example:

Now suppose that our speculator is bullish the Wheat Market because it just completed a major bottoming formation. Expecting the July Wheat prices to dramatically rise between February and mid June, our speculator wants to buy a call option on July Wheat. Consulting his Great Pacific Broker, our speculator is informed of the following prices:

July Wheat is trading at 420 and the following July Wheat Calls are available:

Option	Strike Price	Premium (in cents per bushel)
July Wheat Call	410	42
July Wheat Call	420	37
July Wheat Call	430	21
July Wheat Call	440	5
July Wheat Call	450	9

1 cent is equal to $50.00

Since our speculator is expecting a major bullish run in wheat prices, he chooses the July 450 Wheat Call, and pays 9 cents for the option. Now suppose by mid May, prices have advanced dramatically, just as anticipated. Seeing signs that the market may be "topping out" around 500, our speculator wants to exit his trade. With July Wheat trading at 500, the intrinsic value of the option should be 50 (Intrinsic value for a Call is the Futures Price - the Strike Price, or zero. If the Futures contract is trading for less than the strike price, then the call option is said to have only time value). Remembering that options usually trade at a value greater than their intrinsic value, our speculator calls to get the current market on the July 450 Wheat Calls. The market is trading these calls at 61, so our trader knows that he should liquidate the options position by selling his long call. Our speculator makes 52 cents on the trade (61-9 cent initial purchase price), or $2,600 before commissions are included.

What would happen if instead of rallying, Wheat prices continued to fall when our speculator purchased his July 450 Wheat Call. By mid May, suppose prices had fallen to 350 cents per bushel. Our speculator was "long and wrong", and wheat prices had fallen 70 cents per bushel between February and mid May. Our speculator sees opportunity in another market, and wants to know how much money he has lost in the Wheat market. Contacting his Great Pacific Broker, he is quoted that the July 450 Wheat Calls are trading for 1 cent. Our speculator figures that since the option is worth only 1 cent, or $50.00, he is better of holding onto the wheat call and letting it expire worthless. Our speculator would have only lost the initial purchase price of his option, or the 9 cents, which equates to $450.00 dollar plus commissions that it cost to put the position on.

Reviewing the Basics

Options provide an excellent way to take advantage of upward and downward movement by purchasing either calls or puts. When a speculator feels that the market is going into a bull market, he or she can take advantage of the higher prices by purchasing a call option, as call option prices increase when the underlying futures contract price increase. When speculators are bearish, the purchase of put option is advisable, as put option prices increase when the price of the underlying futures contract decreases.

In most cases it is not necessary to convert your options position into a futures position, as it is typically more profitable to sell your option than convert it to a futures contract. Options are traded in an open out cry environment, just like futures, so there is always a bid to buy a listed option and an offer to sell a listed option. The mechanics of buying and selling options is just like a futures contract. To liquidate a position you simply sell the same option you purchased, and your account is debited or credited any profits or losses, minus the commissions and fees charged.

If you have any questions regarding options, be sure to contact your Great Pacific Broker today, as all of our brokers are well versed in the mechanics of the options market and will be happy to clear up any points that are not clear.

Feel free to contact us at 1-800-479-7920 if you should have any questions.

Factors to Consider When Choosing Options

The three major factors to consider when setting up an options position are: Option Type (Calls or Puts), Strike Price, and Contract
Month.

Calls or Puts

If one is Bullish the market, and expecting prices to go up, then one should consider buying Calls. If one is bearish the market, and expecting the market to go down, then one should consider buying Puts. Calls increase in value when the price of the underlying futures contract goes up. Puts increase in value when the price of the underlying futures contract decreases in value.

What Strike Price

The next decision is which strike price does one wish to purchase. The strike price is the major determining factor in the cost of the option. For Calls, the lower the strike price, the more expensive the option will be, but the greater the chance the option will make money. If the strike price is less than the price of the futures, then Calls are said to be "in the money". In the money calls are typically expensive, but also have a higher probability of being worth something at expiration. Puts are said to be "in the money" when the futures prices are lower than the strike price. If a Call option has a higher strike price than the current futures price, then the option is considered "out of the money", and will be incrementally less expensive the higher the strike price is. Puts are considered "out of the money" if the strike price is less than the underlying futures price. Puts get cheaper as the strike price gets lower, or further below the price of the underlying futures contract.

What Expiration Month

Choosing the expiration month of the option is also an important decision. Because options have a limited life span, one wants to make sure to buy enough time so that the expected move happens before the option expires. All commodities with listed options contracts, have at least one option month that coincides with the underlying futures contract expiration month. Typically, the longer the life of an option, the more expensive the option is.

General Rule of Thumb in Choosing Options

As **a** general rule of thumb, Great Pacific recommends purchasing options with about 3 months of life left, and about three strikes out of the money. This is a very broad based rule of thumb, and we do recommend other strike and expiration combinations when market conditions warrant. This general rule of thumb typically allows one enough time to profit from an impending move, and the option is close enough "to the money", to appreciate if the market moves in the desired direction.

Be sure to read the option risk disclosure document thoroughly before considering options trading. If you have any questions regarding the risks involved in options feel free to contact your Great Pacific Trading Company broker.

Factors Effecting the Price of an Option

The Price of an option, or the premium, is the direct result of the following factors:

Strike Price: Is the option "in the money" or "out of the money", or in other words where is the futures price in relation to the strike price. For Calls, the lower the strike price, the more expensive the option is. For Puts, the higher the strike price, the more expensive the option will be.

Volatility: Volatility is a measure of how fast and how much the market moves. Option prices are high during periods of high activity and large price swings. Option prices are typically lower when futures prices are quiet, and the market is not moving very much The higher the volatility of a market, the more expensive an option will be.

Time: The longer an option has until expiration, the more expensive it will be. This is because the underlying market has more time to move, and a greater likelihood of moving substantially in one direction or the other. As the time to expiration gets closer, options lose value because the likelihood of a large move occurring before expiration decreases. This makes options a decaying asset, where option premiums will decline as the days to expiration get less and less.

Intrinsic Value: This is the amount an option is "in the money". The Intrinsic Value for Calls is the Futures Price Strike Price; or zero if the futures market is trading below the strike price. The Intrinsic Value for Puts is the Strike Price - Futures Price; or zero if the futures market is trading above the strike price.

Extrinsic Value (Time Value): The extrinsic value of an option is the price difference between the market price of the option and the intrinsic value. "Out of the money" options only have extrinsic value. The extrinsic value is a measure of the markets expectations of where the options market thinks the market has a chance of trading at. The greater the extrinsic value, the higher probability the options market puts on that option expiring "in the money". Extrinsic value is greatest for thc further out options because obviously nobody knows what the future holds, so the uncertainty of future events builds a premium into the price of the option.

?? Commonly Asked Questions Regarding Options??

What Happens if my option is approaching expiration and it has not reached the strike price yet?

Option purchasers have the right, not the obligation, to exercise the option. One would only wish to exercise an option if it is profitaNe to do so, therefore the best approach in this situation is to let the option expire worthless, and the only loss taken to the trader is the cost of the option. If expiration is still a little ways away, one may wish to sell the option in the options market, and recover a portion of the price paid for the option.

Do I have to Exercise an Option to realize the profit?

No In fact most of the time it is wise to sell the option, not to exercise the option. Options typically have a time value component that makes it advantageous to sell the option you have purchased in the options market, rather than exercising it into a futures position (For example, suppose you are Long a 350 July Corn Call Option, and Corn is trading at $4.00 per bushel, basis the July Corn Futures; to liquidate the position you would sell a July 350 Corn Call option). This time value, or extrinsic value often is a substantial amount of money. If you have any doubt about the advisability of exercising versus selling the option in the options market, please contact your Great Pacific Broker for expert advice on the best alternative.

What if I forget about my option, and it expires "In the Money"?

Options that are "in the money" at expiration, are automatically exercised into a futures position, unless the customer states otherwise. Great Pacific is very diligent about contacting clients about the expiration of options that are "in the money", but we can not guarantee you will be notified before expiration. But, if the option is "in the money", then exercising will produce a profit in the futures contract, even though the profit in the futures position may not offset the cost of the option. Remember that "in the money" means for a call option that the futures contract is trading above the strike price, or that the futures are trading lower than the strike price for a put option.

When I sell out a long options position, am I creating a short option position?

If you own an option, and you sell it, then you have no position as long as you sell the same month, strike and type of option. For example, if you bought a July 400 Corn Put, and several days later you sell a July 400 Corn Put, then you have offset your position and your account is debited or credited the profit or loss on the trade. You have no position because the sale was to close the trade. Trading in options is very similar to the futures in this respect.

How do I figure out the dollar cost of an option?

The actual cost of an option is the premium amount multiplied by the contract value. For example in the grain markets, the contract size is 5,000 bushels. If the premium is 9 cents, then multiply .09 x 5,000, and you get $450.00 dollars. Be sure to see how the price is quoted, is it in cents, or dollars. Your Great Pacific Broker is always able to assist you in these matters, and Great Pacific has a complete library of contract specifications.

What is the Margin Requirement for Buying an Option?

There is no margin requirement for buying options. That's the beauty of buying options, no margin is required because the loss is limited to amount of premium paid for the option. A long option position (either Calls or Puts) can never lose more than the initial money paid for the option. However, in order to purchase an option you must have the full value of the premium in your account before the transaction can be executed.

The Risk of loss in trading futures and options can be substantial, therefore only genuine **"risk"** funds should be used in such trading. Futures and options may not be suitable investments for all individuals and individuals should carefully consider their financial condition in deciding whether to trade. Option traders should be aware that the exercise of a long option will result in a futures position.

Hypothetical results have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or to adhere to a particular trading program in spite of tradine losses are material points which can also adversely affect actual trading results. There are numerous other factors rclated to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in thc preparation of hypothetical performance results and all of which can adversely affect actual trading results.

Introduction to Option Bull Call Spreads

The Bull Call Spread is one of the most popular forms of option spreading. In this type of spread the speculator buys a call at a particular strike price and sells a call at a higher strike price in the same commodity. Generally, both options have the same expiration month. Bull Call Spreads tend to be profitable if the underlying futures contract settles at or above the higher strike price (the short option) upon expiration - hence this is a bullish position because it relies on the underlying future moving up in price.

The bull call spread has both a limited risk and a limited reward. This spread can never lose more than it's initial costs (plus commissions and fees), and therefore does not require the speculator to post a margin requirement. Bull Call Spreads typically require less "upfront" money than the outright purchase of a call option, and therefore have less risk than the straight purchase of a call option, though the outright purchase of a call option only involves one commission and has unlimited profit potential. The limited risk of the Bull Call Spread does come at a price: Limited Reward. The Bull Call Spread will never yield a profit larger than the difference between the strike prices minus the cost to establish the position. Given this limited reward nature of the Bull Call Spread, it is usually appropriate to use this strategy when trying to "pick bottoms" in a market, when volatility is high and the straight purchase of a Call option is too expensive.

A Hypothetical Example of a Bull Call Spread

Lets assume that during the month of June, a speculator begins looking for a bottom in Orange Juice prices. Assuming that the following prices exist:

November Orange Juice Future Settlement price: 82~00

Strike Price	Option Premium	$ Value of Option
80 Call	900	*$1,350* + commissions & fees
85 Call	700	$1,050 + commissions & fees
9Ocall	*520*	$780 + commissions & fees
95 Call	400	$600 + commissions & fees

*note: 100 points in the Orange Juice market is equal to $150.00

Being bullish on the Orange Juice market, our speculator has an upside target of 100 on the November futures. Our speculator can either Buy a Call option or establish a Bull Call Spread. If our speculator buys an 85 Call option, his maximum risk is $1,050 + commissions, with an expected profit of $1,200 before commissions (Our target price of 100 - the strike price of 85 -the cost of the option of $1,200). This yields an expected reward ratio to risk ratio of 1.14 to 1.

Or our speculator could establish an 85/95 Bull Call Spread, by buying a November 85 Call and selling a November 95 Call. This position would cost $450 + commissions to establish (the price paid for the 85 call ($1,050) minus the premium received for the 95 call ($600). If our speculator were correct and the price of November Orange Juice went to 100 on options expiration, the speculator would realize a profit of $1,050 before commissions (the difference between the higher and lower strike price minus the cost to establish the position, or $1,500 - $450). Since the Bull Call Spread is a fully covered position, the maximum risk involved is the cost of the position, the expected reward to risk ratio is 2.33 to 1. If prices were to exceed our expectation (100) the long 85 call option would be a better speculation, but using our initial expectation, the Bull Call Spread is the better speculation.

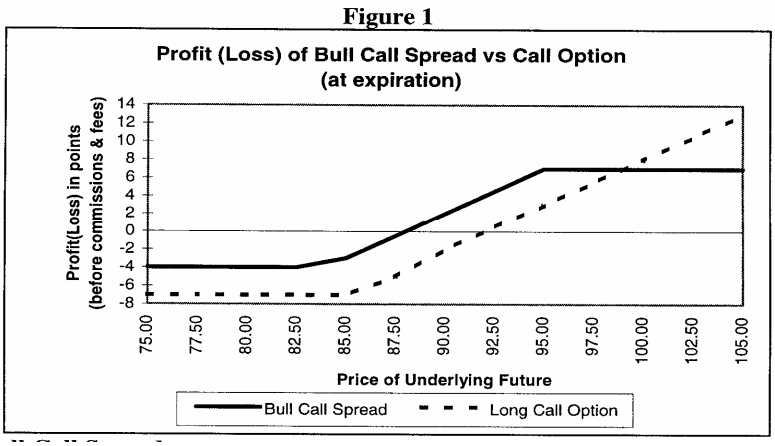
Choosing between Call Purchases and Bull Call Spreads

As always, there is a trade off between risk and reward. Bull Call Spreads typically have lower initial cash outlays than option purchases, $450 vs. $1,050 (plus fees) in the above example. Both positions have limited risk, as the maximum loss occurred with either position is the cost of the position plus commissions and fees. Bull Call Spreads are typically profitable at lower prices, with a break even of 88.00 vs. 92.00 using the above example, but transaction costs (commissions) are doubled since the Bull Call Spread involves both the purchase of an option and the sale of an option. Bull Call Spreads are a limited reward strategy, with maximum reward defined by the difference between the strike prices minus the cost of the position, while thc outright purchase of a call option is only limited in gain to the upside of the underlying futures market. Before deciding between the purchase of Call Option and establishing a Bull Call Spread, examine thc expected reward to risk ratios of both, making sure to account for the additional commissions and transaction fees associated with the Bull Call Spread

Defining Risk and Potential Rewards for Bull Call Spreads

As stated earlier, the Bull CaH Spread is a limited risk and limited reward strategy relying on the proper anticipation of higher future prices to make profits. Using simple mathematics, the exact profit or loss can be calculated of the Bull Call Spread expiration, as well as the exact risk and the break even of the position. In all of the following formulas and examples, we will ignore commissions, for simplicities sake, hut do consider them in your calculations because commissions do have a strong impact on the profitability of any trading. The profit and loss of all Bull Call Spreads will have a similar form to the one presented in Figure 1 (below), which compares the previously mentioned Orange Juice Bull Call Spread to the outright purchase of a Call option.

Figure 1



Formula for Bull Call Spreads:

Definition: All Bull Call Spreads are established by buying a call option and selling a higher strike price call option in the same contract month on the same commodity. This position has limited risk and limited reward

Initial Cost: Purchase Price of Call (lower strike price) - Sale Price of Call (higher strike price); premium paid - premium received plus commissions and fees

Maximum Risk: The maximum risk in a Bull Call Spread is the initial cost of the position plus commissions and fees

Break Even Point: The lower Strike Price (long option) + Initial Cost of Position; the point at which this position will show zero gain or loss before commissions and fees

Maximum Reward: The difference between the Strike Prices (higher - lower) minus the initial cost of the position

Guidelines for Establishing Bull Call Spreads:

1) Try not to risk more than $300.00 plus commissions; liquidate the position if the value of the spread moves below a liquidating value of $300.00 less than the initial cost of the position

2) Bull Call Spreads are best set up with a minimum of 3 months of time value; this position requires a specific amount of movement to reach its full profitability, so a decent amount of time to expiration is critical for this strategy to have a chance to become profitable.

3) Bull Call Spreads typically work best when the purchased option (the "long leg") is close to "at the money", meaning that the purchased option's strike price is very near the underlying futures price.

4) Set-up Bull Call Spreads with a reward to risk ratio of at least 2 to 1 meaning that the total cost of the position is less than or equal to half of the maximum gain, should the underlying futures market move above the higher strike price (the "short leg" of the Bull Call Spread).

For further information on Bull Call Spreads or Bear Put Spreads or a copy of our current recommended BuII Call and Bear Put Spreads please contact your Great Pacific Trading Company broker at 1-800-479-7920. Option traders should be aware that option trading involves risk, and that both Bull Call and Bear Put spreads can leave speculators open to options exercises which will result in additional commissions and fees if the position is not liquidated on or before options expiration.

Introduction to Option Bear Put Spreads

The Bear Put Spread, has many of the same characteristics of the Bull Call Spread. Like Bull Call Spreads, the Bear Put Spread is a limited risk, limited reward speculation on the direction of the underlying futures market. To establish a Bear Put Spread the speculator buys a put and sells a put with a lower strike price in the same commodity, typically in the same contract month. Bear Put Spreads tend to be profitable when the underlying futures contract decreases in value, reaching its maximum profitability when the price of the underlying future declines below the lower strike price of the spread.

The Bear Put spread has both a limited risk and a limited reward. This spread can never lose more than it's initial costs (plus commissions and fees), and therefore does not require the speculator to post a margin requirement. Bear Put Spreads typically require less "up front" money than the outright purchase of a put option, and therefore have less risk than the straight purchase of a put option, though the outright purchase of a put option only involves one commission and has unlimited profit potential. The limited risk of the Bear Put Spread does come at a price: Limited Reward. The Bear Put Spread will never yield a profit larger than the difference between the strike prices minus the cost to establish the position. Given this limited reward nature of the Bear Put Spread, it is usually appropriate to use this strategy when trying to "pick tops" in a market, when volatility is high and the straight purchase of a put option is too expensive.

A Hypothetical Example of a Bear Put Spread

Lets assume that during the month of July, a speculator begins looking for a top in the grain markets. Using the corn market, assume that the following prices exist:

September Corn Future Settlement price: 260

Strlke Price	Option Premium	$ Value of Option
270 Put	19 1/2 cents	$975.00 + commissions & fees
26OPut	121/2	$625.00 + commissions & fees
25OPut	8	$400.00 + commissions & fees
24OPut	4½	$225.00 + commissions & fees

- note: 1 cent move in Corn is equal to $50.00

Being bearish on the Corn market, our speculator has a downside target of 230 on the September futures. Our speculator can either Buy a Put option or establish a Bear Put Spread. If our speculator buys a 260 put option, his maximum risk is $625.00 +commissions and fees, with an expected profit of $875.00 before commissions (The Strike Price - Target Price - Cost of theoption before commissions and fees). This yields an expected reward ratio to risk ratio of 1.29 to 1.

Or our speculator could establish a 260/240 Bear Put Spread, by buying a September 260 Put and selling a September 240 Put. This position would cost $400 + commissions and fees to establish (the price paid for the 260 put ($625) minus the premium received for the 240 put *($225)*. If our speculator was correct and the price of September Corn declines to 230 on options expiration, the speculator would realize a profit of $600 before commissions (the difference between the higher and lower strike price minus the cost to establish the position, or $1,000 - $400). Since the Bear Put Spread is a fully covered position, the maximum risk involved is the cost of the position, the expected reward to risk ratio is 2.50 to 1. If prices were to exceed our expectation (230) the long 260 put option would be a better speculation, but using our initial expectation, the Bear Put Spread is the better speculation.

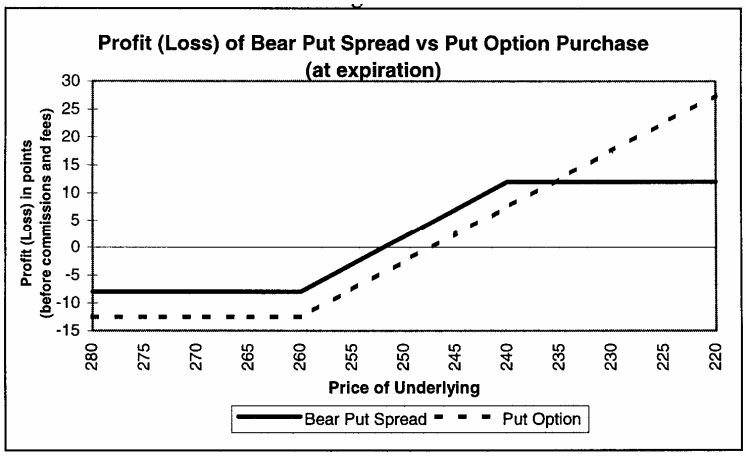
Choosing between Put Purchases and Bear Put Spreads

As always, there is a trade off between risk and reward. Bear Put Spreads typically have lower initial cash outlays than option purchases, $400 vs. *$625* (plus fees) in the above example. Both positions have limited risk, as the maximum loss occurred with either position is the cost of the position plus commissions and fees. Bear Put Spreads are typically profitable at higher prices, with a break even of 252 vs. 247 ½, using the above example, but transaction costs (commissions) are doubled since the Bear Put Spread involves both the purchase of an option and the sale of an option. Bear Put Spreads are a limited reward strategy, with maximum reward defined by the difference between the strike prices minus the cost of the position, while the outright purchase of a put option is only limited by the decrease in price of the underlying futures market. Before deciding between the purchase of a Put Option and establishing a Bear Put Spread, examine the expected reward to risk ratios of both, making sure to account for the additional commissions and transaction fees associated with the Bear Put Spread.

Defining Risk and Potential Rewards for Bear Put Spreads

As stated earlier, the Bear Put Spread is a limited risk and limited reward strategy relying on the proper anticipation of lower futures prices to make profits. Using simple mathematics, the exact profit or loss can be calculated of the Bear Put Spread at expiration, as well as the exact risk and the break even of the position. In all of the following formulas and examples, we will ignore commissions, for simplicities sake, but do consider them in your calculations because commissions will effect the profitability of any trading. The profit and loss of all Bear Put Spreads will have a similar form to the one presented in Figure 2 (below), which compares the previously mentioned Corn Bear Put Spread to the outright purchase of a Put option.

Figure 2



Formula for Bear Put Spreads:

Definition: All Bear Put Spreads are established by buying a put option and selling a lower strike price put option in the same contract month on the same commodity. This position has limited risk and limited reward

Initial Cost: Purchase Price of Put (higher strike price) - Sale Price of Put (lower strike price); premium paid - premium received plus commissions and fees

Maximum Risk: The maximum risk in a Bear Put Spread is the initial cost of the position plus commissions and fees

Break Even Point: The higher Strike Price (long option) - Initial Cost of Position; the point at which this position will show zero gain or loss before commissions and fees

Maximum Reward: The Difference between the Strike Prices (higher - lower) minus the initial cost of the position

Guidelines for Establishing Bear Put Spreads:

1) Try not to risk more than $300.00 plus commissions; liquidate the position if the value of the spread moves below a liquidating value of $300.00 less than the initial cost of the position

2) Bear Put Spreads are best set up with a minimum of 3 months of time value; this position requires a specific amount of movement to reach its full profitability, so a decent amount of time to expiration is critical for this strategy to have a chance to become profitable.

3) Bear Put Spreads typically work best when the purchased option (the "long leg") is close to "at the money", meaning that the purchased option's strike price is very near the underlying futures price.

4) Set-up Bear Put Spreads with a reward to risk ratio of at least 2 to 1 meaning that the total cost of the position is less than or equal to half of the maximum gain should the underlying futures market move below the lower strike price (the "short leg" of the Bear Put Spread).

*For further information on Bull Call Spreads or Bear Put Spreads or a copy of our currently recommended Bull Call and Bear Put Spreads please contact your Great Pacific Trading Company broker at **1-800-479-7920**. Option traders should be aware that option trading involves risk, and that both Bull Call and Bear Put spreads can leave speculators open to options exercises which will result in additional commissions and fees if the position is not liquidated on or before options expiration.*