Module 3.4
Calendar Spreads

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Calendar Spreads Defined

- **Debit Spread**
- **Buy to Open the Trade**
- **Long Call or Long Put is Placed Close to the Money (just in or just out) and Typically 45-90 Days or Farther to Expiration. This is our Primary or Money Making Option.**
- **Short Call or Short Put is Placed in an Earlier Month of Expiration at Any Strike Price (same, higher, lower).**
- **Cost Basis or Net Debit of the Trade is the Debit of the Long Option Minus the Credit of the Short Option**
- **Max Risk = Cost Basis**
- **Max Reward = Is Different in the Case of the Short Option Being Higher, the Same, or Lower than the Long Option.**
- **Good Target ROI is 20-30%**
- **Good Target Time in the Trade is Under 6 weeks.**
Module 3.4
Calendar Spreads
Long Call is placed at the March $170.00 Strike and is the primary option. Short Call is placed at the November $175.00 Strike and is the secondary or hedge option.

\[ \text{Current Price of the Stock} \quad \$173.00 \]

- As the price of the stock moves up both options gain value.
- That’s good for the long calls, but bad for the short calls.
- The long calls have to gain value faster than the short calls, or the short calls need to expire without a loss in value on the long calls for the trade to work.
Calculating Risk to Reward Ratio

1. Max Risk = The net debit of both options (the debit of the long call minus the credit of the short call) if the price of the stock falls and both options expire worthless.

2. Max Risk = The net debit minus the difference in strike prices if the stock moves high enough for us to get called out.

3. Target ROI = The price of the short option divided by the price of the long option.
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**Module 3.4**

**Calendar Spreads**

- **BTO Mar11 $170.00 Strike Call for $23.50 debit.**
- **STO Nov10 $175 Strike Call for $3.55 credit.**
- **Net Debit $19.95 per share. (Cost Basis)**
- **Max Risk = Net Debit if the Stock Price Falls and Both Options Expire Worthless**
- **Max Risk = Net Debit Minus the Difference in Strike Prices if Called Out**
- **Target ROI is Equal to the Short Call Price Divided by the Long Call Price**
  
  \[
  \text{ROI} = \frac{\text{Short Call Price}}{\text{Long Call Price}}
  \]

  \[\frac{3.55}{23.50} = 15\% \text{ ROI}\]
Long Put is placed at the February $35.00 Strike and is the primary option.

Short Put is placed at the December $33.00 Strike and is the secondary or hedge option.

As the price of the stock moves down both options gain value.
That’s good for the long puts, but bad for the short puts.
The long puts have to gain value faster than the short puts, or the short puts need to expire without a loss in value on the long puts for the trade to work.

Current Price of the Stock $35.85

Long Put is placed at the February $35.00 Strike and is the primary option.

Short Put is placed at the December $33.00 Strike and is the secondary or hedge option.
BTO Feb11 $35.00 Strike Puts for $3.35 debit.
STO Dec10 $33.00 Strike Puts for $0.86 credit.
Net Debit $2.49 per share. (Cost Basis)
Max Risk = Net Debit if the Stock Price Rises and Both Options Expire Worthless
Max Risk = Net Debit Minus the Difference in Strike Prices if Stock is Put to Us
Target ROI is Equal to the Short Call Price Divided by the Long Call Price
$0.86 / $3.35 = 26% ROI
Defining our Exit Strategy

1. Primary Exit for Any Calendar Spread is to see the Short Option Lose Value or Expire Worthless with Little or No Change in the Long Option Price.

2. The Target ROI should always be approximately the ROI calculated by dividing the price of the short option by the price of the long option and should ideally be set at 10% or higher.

3. Being in the trade for six weeks or less is ideal, but depends largely on how far out the short option is to expiration.

4. The Adjustment or Secondary Exit will be covered in Module 6.6
When describing calendar trades there are horizontal and diagonal calendars depending on the placement of the short option relative to the long option.
When describing calendar trades there are horizontal and diagonal calendars depending on the placement of the short option relative to the long option.
1. When a stock has an expectation for a slow to stagnant move, either bullish or bearish, a calendar spread of some type can take significant advantage and is a very flexible trade.

2. The trade works best just after an earnings event has occurred and levels of support or resistance seem to be holding.

3. A good target ROI is 10-30% and a good expectation of time spent in the trade is 2-6 weeks.

4. Time decay in the short option can significantly help the success of the trade.