



The Straddle Option Explained

Knowing how to use options to “straddle” a stock allows investors to profit on a stock’s general volatility. With a straddle in place, the investor will profit regardless of whether the stock climbs or falls in value.

How The Straddle Works

To straddle a stock, the investor makes simultaneous purchases of both a call and a put option at the same strike price. Consider a stock, say “ABC,” that’s trading at \$30 per share.

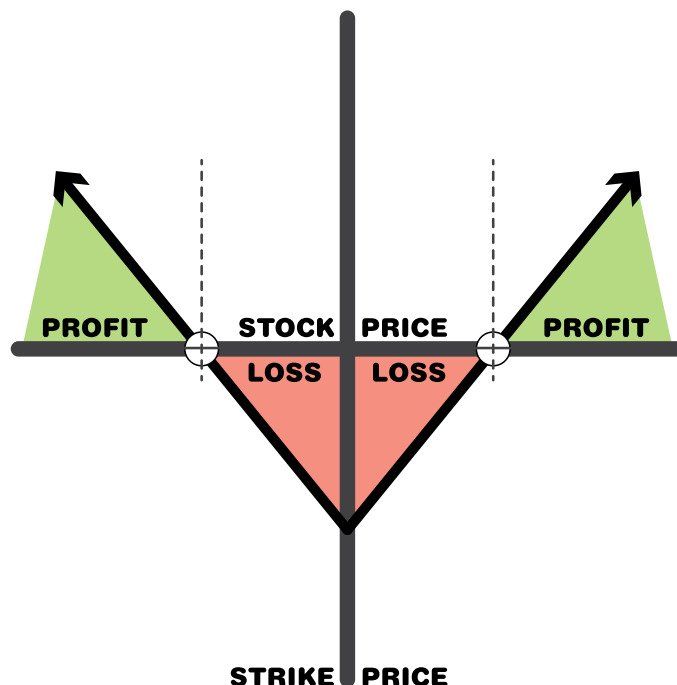
We’re expecting ABC to be highly volatile in the near future, so we decide to straddle the stock using its current market price as our strike price.

To do this, we

1. Buy a call option giving us the right to purchase the stock at \$30 in three months’ time
AND
2. Buy a put option giving us the right to sell the stock for \$30 per share in three months’ time

Each option costs money, of course, so we’ll need the stock to move (in one direction or another) a minimum distance away from its current \$30 value if we’re going to realize a profit.

Straddle



Profitability is reached when the stock price (at the time of the option’s expiration) drops either well below or climbs well above the strike price set when the option was first purchased.

Stocks With Higher Volatility Ratings Have More Expensive Options

As with nearly all aspects of stock trading, you're most likely to profit if you can predict something that others fail to see. If it's widely apparent that a stock is volatile, then the price of that stock's options will go up. This will make the straddle strategy more expensive.

This is an important aspect to keep in mind before committing to a straddle option.

A Good Tactic For Beginner-Level Options Traders

When you use options to straddle a stock, your risk is limited and your potential profits are unlimited. But what if the stock does not change in value enough for a profit to be had? The only loss to the investor is the combined price of the options.

Here, profit is unlimited because there's no limit to how high the stock could climb in value, and if the stock goes belly-up, then the put option becomes highly profitable.

This "cover-your-bases" approach means that no matter the outcome, investors can turn a profit. The limited risk aspect of the straddle makes it a good choice for beginner-level investors, especially those who are interested in learning how to predict and quantify stock volatility.