Chapter 5: Option Trading Strategies MCQs with Answers (NISM Series VIII)

Preparing for the **NISM Series VIII: Equity Derivatives Certification Examination**? Practicing chapter-wise MCQs is one of the best ways to strengthen your concepts and improve your exam score. Below are **20 important multiple-choice questions (MCQs)** from **Chapter 5: Option Trading Strategies**, along with their correct answers and detailed explanations.

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1. Which of the following best describes a Vertical Spread?

A. Options on different underlyings
B. Options with different expiries and different strikes
C. Options with the same expiry but different strike prices
D. Options with the same strike but different expiries

✅ **Correct Answer: C. Options with the same expiry but different strike prices**

Explanation:
A Vertical Spread involves buying and selling options of the **same type (Call or Put)** and **same expiry**, but with **different strike prices**.

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2. How is a Bullish Vertical Spread using Calls created?

A. Shorting a lower strike call and longing a higher strike call
B. Longing a lower strike call and shorting a higher strike call
C. Longing both a lower and higher strike call
D. Shorting both a lower and higher strike call

✅ **Correct Answer: B. Longing a lower strike call and shorting a higher strike call**

Explanation:
A Bull Call Spread profits from a moderate rise in the underlying asset while limiting both risk and reward.

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3. What is the primary purpose of buying a lower strike put in a Bull Put Spread?

A. To create a net premium outflow
B. To increase the potential upside profit
C. To put a floor to the downside risk of unlimited losses from the short put
D. To transition the position into a calendar spread

✅ **Correct Answer: C. To put a floor to the downside risk of unlimited losses from the short put**

Explanation:
The purchased lower strike put limits the downside risk, making the Bull Put Spread a defined-risk strategy.

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4. Which strategy involves shorting a low strike call and longing a high strike call?

A. Bearish Vertical Spread using Calls
B. Bullish Vertical Spread using Calls
C. Short Straddle
D. Long Strangle

✅ **Correct Answer: A. Bearish Vertical Spread using Calls**

Explanation:
This is known as a **Bear Call Spread**, which benefits when the market remains below the lower strike price.

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5. A Horizontal Spread is also known as a:

A. Diagonal Spread
B. Vertical Spread
C. Butterfly Spread
D. Time Spread or Calendar Spread

✅ **Correct Answer: D. Time Spread or Calendar Spread**

Explanation:
A Horizontal Spread uses options with the **same strike price** but **different expiry dates**.

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6. What options combination creates a Horizontal Spread?

A. Same strike, same type, but different expiry options
B. Different strike, same type, same expiry options
C. Same strike, different type, same expiry options
D. Different strike, different type, different expiry options

✅ **Correct Answer: A. Same strike, same type, but different expiry options**

Explanation:
Calendar spreads exploit differences in time decay between near-term and long-term options.

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7. How is a Long Straddle position created?

A. Buying a call and a put option of the same strike and same expiry
B. Buying a call and a put option of different strikes and same expiry
C. Shorting a call and a put option of the same strike and same expiry
D. Shorting a call and a put option of different strikes and same expiry

✅ **Correct Answer: A. Buying a call and a put option of the same strike and same expiry**

Explanation:
A Long Straddle profits from a **large move in either direction**, regardless of whether prices rise or fall.

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8. When would a trader typically undertake a Long Straddle strategy?

A. When they expect the market to remain completely stable
B. When they expect significant market movement but are uncertain about the direction
C. When they want to earn premium income
D. When they want a risk-free arbitrage opportunity

✅ **Correct Answer: B. When they expect significant market movement but are uncertain about the direction**

Explanation:
Long Straddles are ideal before major events such as earnings announcements or important economic releases.

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9. What is the risk profile of a Short Straddle position?

A. Limited loss, limited profit
B. Unlimited loss, unlimited profit
C. Unlimited loss, limited profit
D. Limited loss, unlimited profit

✅ **Correct Answer: C. Unlimited loss, limited profit**

Explanation:
The maximum profit is the premium received, while losses can become very large if the market moves sharply.

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10. How does a Long Strangle differ from a Long Straddle?

A. A Strangle uses different expiries.
B. A Strangle uses different strike prices, typically Out-of-the-Money (OTM).
C. A Strangle involves only calls.
D. A Strangle is bearish.

✅ **Correct Answer: B. A Strangle uses different strike prices, typically Out-of-the-Money (OTM).**

Explanation:
A Long Strangle generally costs less than a Long Straddle but requires a larger price movement to become profitable.

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11. What is the maximum loss in a Long Strangle position?

A. Unlimited
B. The difference between the two strike prices
C. The sum of the premiums paid for both options
D. The higher of the two premiums paid

✅ **Correct Answer: C. The sum of the premiums paid for both options**

Explanation:
If both options expire worthless, the trader loses only the total premium paid.

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12. Which strategy is used to generate extra income from existing holdings in the cash market?

A. Long Strangle
B. Covered Call
C. Butterfly Spread
D. Protective Put

✅ **Correct Answer: B. Covered Call**

Explanation:
Investors holding shares can sell call options to earn additional premium income.

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13. The payoff of a Covered Call strategy is similar to which position?

A. Synthetic Short Put Position
B. Synthetic Long Call Position
C. Synthetic Long Put Position
D. Synthetic Short Call Position

✅ **Correct Answer: A. Synthetic Short Put Position**

Explanation:
A Covered Call (Long Stock + Short Call) has the same payoff profile as a Short Put due to put-call parity.

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14. What is the primary purpose of a Protective Put strategy?

A. To maximize speculative returns
B. To reduce losses from falling prices while retaining upside potential
C. To generate premium income
D. To benefit from a stable market

✅ **Correct Answer: B. To reduce losses from falling prices while retaining upside potential**

Explanation:
A Protective Put acts like insurance for an investor holding the underlying asset.

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15. A Protective Put payoff resembles which position?

A. Synthetic Long Call
B. Synthetic Short Put
C. Short Straddle
D. Bear Put Spread

✅ **Correct Answer: A. Synthetic Long Call**

Explanation:
A Long Stock plus Long Put creates the same payoff as a Long Call.

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16. A Collar strategy is considered an extension of which strategy?

A. Long Straddle
B. Butterfly Spread
C. Covered Call
D. Short Strangle

✅ **Correct Answer: C. Covered Call**

Explanation:
A Collar adds a Protective Put to a Covered Call, limiting both downside risk and upside potential.

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17. What positions make up a Collar strategy?

A. Long underlying, Long Call, Short Put
B. Long underlying, Short Call, Short Put
C. Short underlying, Long Call, Long Put
D. Long underlying, Short Call, Long Put

✅ **Correct Answer: D. Long underlying, Short Call, Long Put**

Explanation:
A Collar provides downside protection while financing the put purchase through the premium received from selling a call.

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18. A Butterfly Spread is essentially an extension of which strategy?

A. Covered Call
B. Short Straddle
C. Long Strangle
D. Protective Put

✅ **Correct Answer: B. Short Straddle**

Explanation:
A Butterfly Spread limits the unlimited risk associated with a Short Straddle while reducing potential profits.

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19. How can a Butterfly Spread be created using only Call Options?

A. Buy 1 lower strike call, Sell 2 middle strike calls, Buy 1 higher strike call
B. Sell 1 lower strike call, Buy 2 middle strike calls, Sell 1 higher strike call
C. Buy 1 lower strike call, Sell 1 middle strike call, Buy 1 higher strike call
D. Buy 2 lower strike calls, Sell 1 middle strike call, Buy 2 higher strike calls

✅ **Correct Answer: A. Buy 1 lower strike call, Sell 2 middle strike calls, Buy 1 higher strike call**

Explanation:
This is the standard Long Butterfly Spread using Calls and is designed for markets expected to remain near the middle strike.

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20. What is the risk/return profile of a Butterfly Spread?

A. Unlimited profit and limited loss
B. Limited profit and unlimited loss
C. Limited profit and limited loss
D. Unlimited profit and unlimited loss

✅ **Correct Answer: C. Limited profit and limited loss**

Explanation:
A Butterfly Spread is a defined-risk strategy with both maximum profit and maximum loss known at the time of entering the trade.

Conclusion

These **20 important MCQs from Chapter 5: Option Trading Strategies** cover the most frequently tested concepts in the **NISM Series VIII Equity Derivatives Certification Examination**. By practicing these questions, you'll strengthen your understanding of **vertical spreads, calendar spreads, straddles, strangles, covered calls, protective puts, collars, and butterfly spreads**, improving both your conceptual clarity and exam readiness.