



Selling Rich, Buying Cheap: How Overlay Shares Structures Put Spreads



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Why the Skew of Equity Returns Shapes Overlay Shares' Put Spread Strategy

Why volatility, probability, and time all matter

Investors often focus on market direction, rates, or growth. For options strategies, three other forces matter and work together: the price of expected volatility, the probability of different outcomes, and the passage of time. The first sets how much premium an option carries, the second how likely it is to pay off, and the third erodes its value as expiration nears.

Implied volatility is built into option prices through the Greek Vega, which links volatility to premium. When investors pay more for protection, put prices rise; when demand falls, they decline.

But premium is only part of the picture. A second Greek, Delta, measures how much an option moves for a \$1 move in the underlying, and roughly estimates the probability it finishes in-the-money (the odds of the expected return being realized). A third Greek, Theta, measures how fast an option's time value decays each day, which works in a seller's favor. Together, volatility (vega), probability (delta), and time (theta) explain why short put spreads are an interesting structure for generating premium income.

This is especially relevant for the Overlay Shares ETF lineup, which pairs put spread overlays with underlying ETF exposures across equities and fixed income.

The Overlay Shares funds referenced in this article

TICKER	FUND	UNDERLYING EXPOSURE CATEGORY
OVL	Overlay Shares Large Cap Equity ETF	U.S. large-cap equity
OVS	Overlay Shares Small Cap Equity ETF	U.S. small-cap equity
OVF	Overlay Shares Foreign Equity ETF	Foreign equity
OVB	Overlay Shares Core Bond ETF	Core bond
OVT	Overlay Shares Short Term Bond ETF	Short-term bond
OVM	Overlay Shares Municipal Bond ETF	Municipal bond

What is implied volatility?

Implied volatility reflects the market's expectation for the size of future price moves – not their direction. It is derived from option prices and shows how much movement the market is pricing in.

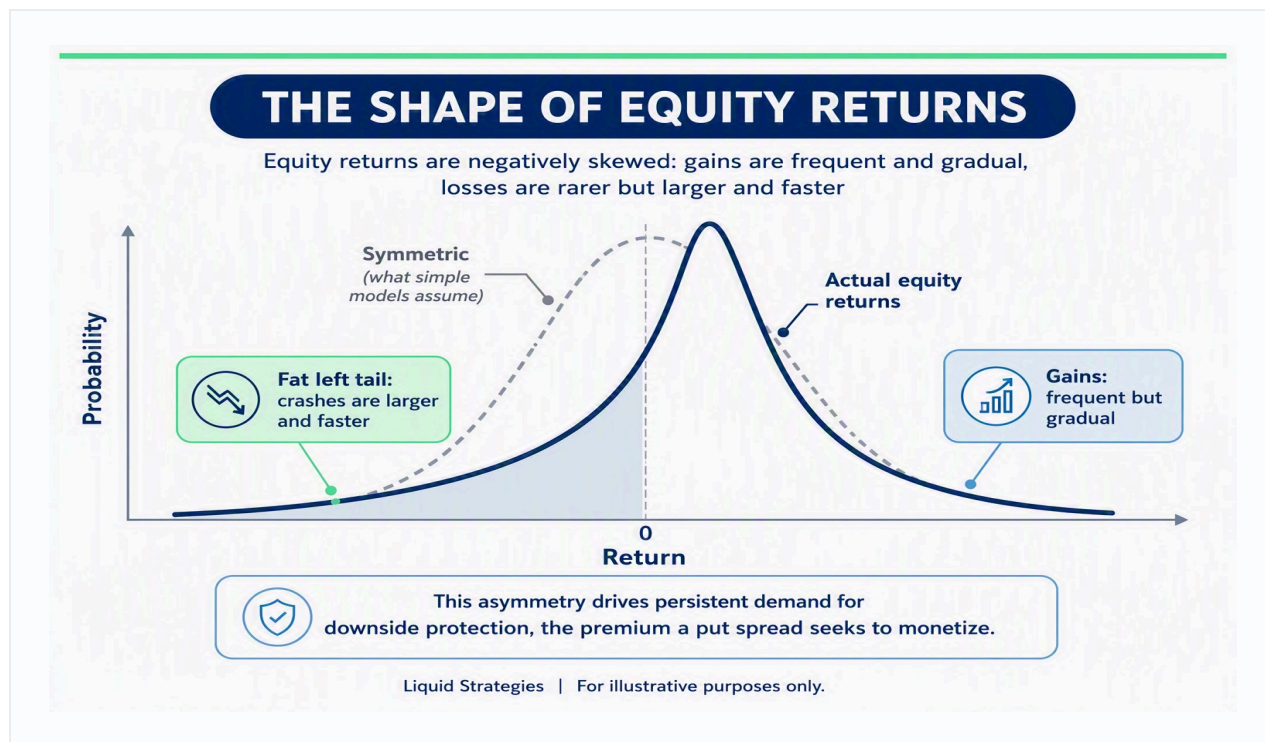
In plain English: higher implied volatility means pricier options; lower means cheaper. For option sellers, that matters because premium is a key input to returns.

But higher premium does not automatically mean a better opportunity. Elevated implied volatility often appears during uncertainty, when the risk of larger moves is also higher. In theory, investors should demand more optionality near spot, since strikes closer to the money are more likely to be realized – a fair generalization for index equity volatility, if not an absolute rule.

The shape of equity returns is not symmetric

Simple models assume that equity returns are symmetric – a large gain and a large loss equally likely. In practice, equity index returns are negatively skewed: markets rise most of the time, but declines tend to be larger and faster than comparable rallies. This “fat left tail” is one of the most consistent features of equity markets, and it means the typical outcome is a modest gain even as the average is dragged down by the occasional sharp drop.

That asymmetry matters for a seller. Because investors dislike losses, they persistently pay up for downside protection — demand that a put spread strategy seeks to monetize. It is also why each short put is paired with a lower-strike long put: the tail is real and cannot be assumed away, and that long put is often relatively “cheap” on a delta basis.



How put spread overlays differ from uncovered put selling

Overlay Shares uses put spread overlays of SPX index options, not uncovered short puts. A put spread sells one put and buys another at a lower strike with the same expiration.

The short put generates premium; the lower-strike long put defines the maximum loss on the options sleeve each cycle, a key difference from uncovered put selling, where the potential loss extends all the way down to a zero price in the underlying.

The defined-risk feature applies only to the options sleeve; the fund continues to maintain exposure to its underlying asset class.

Theta: why the overlay sells short-dated options

Theta explains the overlay's preference for short-dated options. It measures how much time value an option loses each day. For a seller, that daily erosion is a source of return: all else equal, time works in the seller's favor.

But time decay is not steady. It follows the square root of time – slow when many weeks remain, then accelerating sharply near expiration. An option with two weeks left decays far faster per day than one with two months left, as the chart below shows.

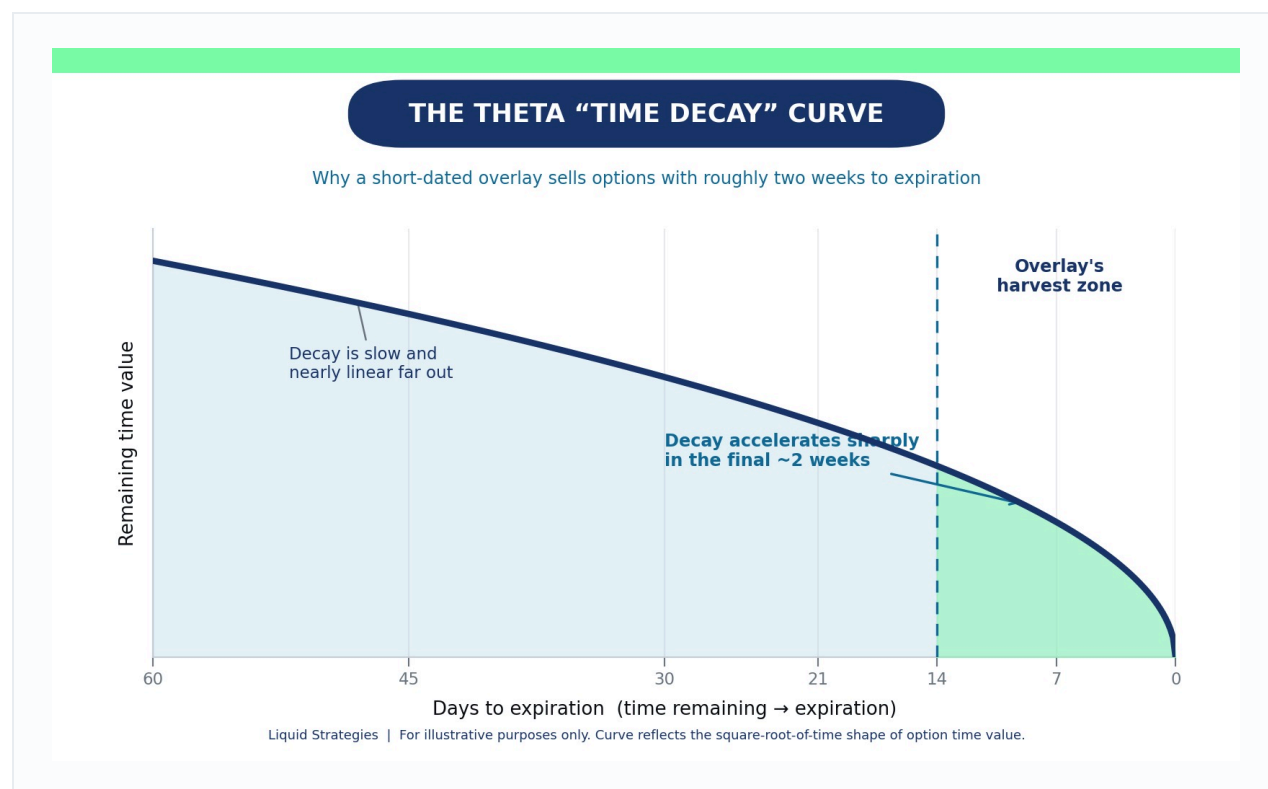


Illustration of how option time value decays as expiration approaches. Does not reflect the performance of any Overlay Shares fund, index, or actual option position.

This is why the overlay concentrates its selling around two weeks to expiration – the steep part of the curve, where time-value erosion is fastest relative to premium at risk. Selling and replacing on a short, repeating cycle seeks to capture that accelerated decay again and again, rather than holding longer-dated options that bleed value slowly.

Short expirations also keep exposure close to current conditions, letting the overlay reset strikes as prices and volatility move. Faster decay does not remove market risk, though: a sharp adverse move can outweigh the time value collected, and short-dated options carry sensitivities that must be actively managed.

Vega and Delta: the sensitivities behind strike selection

Two measures, often called “Greeks” (standard option risk metrics), explain how put spreads can be used to access equity volatility premium. Each gauges how an option’s price responds to one input.

Vega measures how much an option’s price moves per one-point change in implied volatility – the direct link between volatility and premium. It is largest near the current price and smaller further away. So the near-the-money put the overlay sells is where premium and volatility

sensitivity are greatest – where the overlay is positioned to collect option premium associated with volatility risk.

Delta measures how much an option moves per \$1 move in the underlying and roughly estimates the probability it finishes in-the-money. A near-the-money put has a delta near 0.50; a deeper out-of-the-money put closer to zero. Low delta means the option is cheap in dollar terms, because the market gives it a low chance of paying off.

Here is where the two combine – the key to the trade. Because of skew, the lower-strike put the overlay buys carries higher implied volatility than the put it sells, which would make it look “expensive.” But its delta is low, so in dollars it is cheap to own. The strategy is not simply buying low IV and selling high IV across strikes. It does two things at once:

- It sells the near-the-money put, where vega and premium are relatively high and the volatility risk premium has historically been more observable, and
- It buys a lower-strike put whose delta – and therefore dollar cost – is low, even though its implied volatility is high.

The result is net short volatility overall: the long put is itself long volatility, but the near-the-money short put carries greater sensitivity, so the spread nets short. The structure is intended to access the historical tendency for implied volatility to exceed realized volatility, while spending fewer dollars on a defined-risk tail floor. The intent is not any single strike or Greek, but to combine higher near-the-money premium (vega) with lower-cost tail protection (delta) in one defined-risk structure. These relationships are historical, can shift, and are not guaranteed.

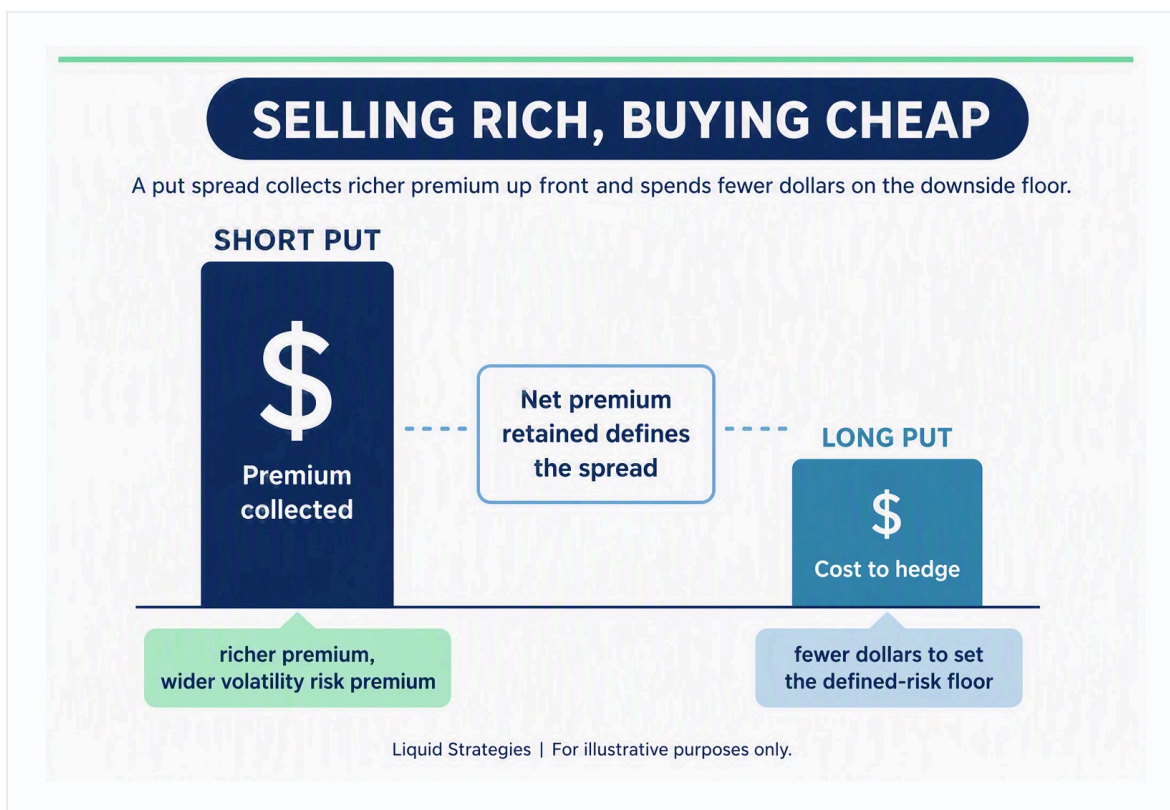
Not all volatility is priced the same: selling the rich part, buying the cheap part

Implied volatility is not a single number. Across strikes and expirations, the market assigns different levels to different options – the volatility surface – and its shape drives how a put spread is built.

For equity index options, that surface has a persistent shape. Deeper out-of-the-money puts carry higher implied volatility than options near the market, a pattern known as skew. More important for a seller, implied volatility has historically tended to exceed realized volatility – the volatility risk premium – which has often been observed near where the market trades.

A put spread is structured around this relationship, and it pays to be precise about “rich” and “cheap.” The strategy sells a put near the market, where dollar premium is larger and the volatility risk premium has historically been more observable, and buys a lower-strike put that costs fewer dollars to set the floor. “Rich” and “cheap” mean premium collected versus dollar cost of protection – not the level of implied volatility at each strike.

The core idea: rather than treating all premium as equal, the strategy is designed to collect higher dollar premium where the volatility risk premium has historically been more observable and to spend fewer dollars on the lower-strike floor. These relationships are historical, can vary, and may not persist.



Application across OVL, OVS, OVF, OVB, OVT, and OVM

The same SPX put spread overlay described above can be paired with portfolios that have different levels of equity market exposure, or beta. Some portfolios may have higher sensitivity to market movements, while others may be designed to be more defensive. Although the option overlay remains consistent, the underlying portfolio characteristics can lead to different risk and return outcomes.

The underlying portfolio matters. Differences in beta (ie. asset class), diversification, volatility, and investment objectives all influence how a combined strategy may perform in various market environments. The SPX put spread overlay is only one component of the overall investment approach.

Investors should evaluate each fund on its full objective, risks, expenses, exposure, tax considerations, and fit within a broader portfolio.

The volatility risk premium, in plain English

Investors study implied volatility partly because it has historically tended to exceed the volatility markets ultimately realize – the volatility risk premium.

In simple terms, investors pay for downside protection potential because losses hurt and uncertainty is hard to tolerate, and sellers may earn premium for taking some of that risk. Sellers can also hedge part of it by buying deeper out-of-the-money puts below the short strike.

This relationship is not guaranteed. It can vary, reverse in stressed markets, and may not persist. Option-selling strategies can lose money, especially in sharp or sustained declines.

What investors should take away

The central idea is simple: not all premium is equal, and a put spread is designed to collect higher dollar premium near the market while spending fewer dollars on the lower-strike floor.

For [Overlay Shares ETFs](#) – OVL, OVS, OVF, OVB, OVT, and OVM – implied volatility is one variable that can affect option premium within the put spread overlay.

The key point: volatility can drive income potential but also reflects risk. A disciplined put spread seeks premium income while defining the risk of the options sleeve, but it cannot remove market risk or assure positive outcomes.

[Glossary of Terms](#)

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The Fund will invest in short term put options which are financial derivatives that give buyers the right, but not the obligation, to sell (put) an underlying asset at an agreed-upon price and date. The Fund's use of options may reduce the Fund's ability to profit from increases in the value of the underlying asset. The Fund could experience a loss or increased volatility if its derivatives do not perform as anticipated or are not correlated with the performance of their underlying asset or if the Fund is unable to purchase or liquidate a position.

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