
THE ULTIMATE GUIDE TO THE **WORLD OF** OPTIONS TRADING

Learn To Harness The Power Of Options Trading

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Introduction: What You'll Learn in this Guide

Options are growing more popular every day, and why shouldn't they be?

After all, with options, you can profit in a *bull market*, a *bear market*, or even a *sideways market*. You can use options to provide “**insurance**” for your portfolio, thus diminishing your risk—or you can **leverage** a little money into controlling a huge amount of stock.

Simply put, options offer something for everybody.

In this guide you'll learn about **calls** and **puts**, which can either be **short** or **long**. That's right—you can have a **long call** or a **short put**, a **short call** or a **long put**, and by the time you're finished reading this book, it will all make sense to you!

Once you've got the basics down, we'll move on to multi-options strategies such as **collars**, **spreads**, **straddles**, and **combinations**. Each of these can be used to your advantage in helping you meet your stated investment objectives—don't ignore them just because they seem “complex.” Every trader should be aware of these strategies, because if you don't, you risk being on the losing side of a game you aren't even aware you're playing.

Finally, we'll look at how to open an **options account** with an **online broker**. We'll even review some of the top online options-brokers to help you see which one sounds best for you.

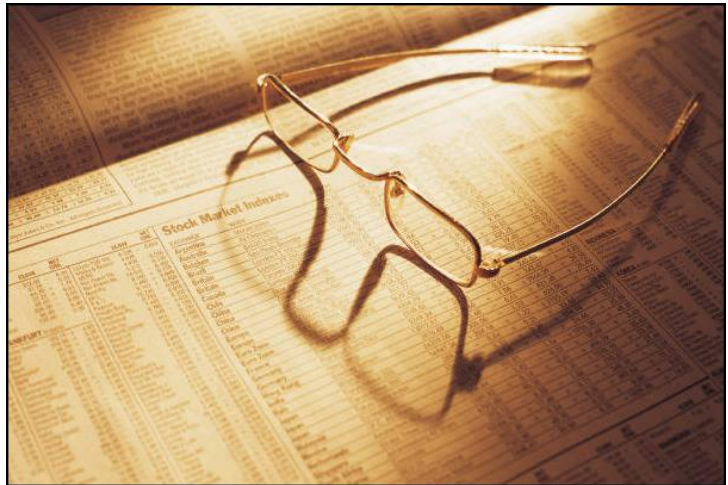
Learning about options may seem like a daunting task at first.

But in many ways, it's like learning a new language.

Once you “get it,” it will begin to intuitively make sense. And then it becomes fun... as well as profitable! So read on and learn how you too can profit and hedge just like the big boys on Wall Street. It's easier than you might think!

Chapter 1: Beginning with Call Options

Today, the investment world presents people with a great number of choices. Instead of building mundane portfolios with common stocks, individual investors can get instant diversification with mutual funds and ETFs (exchange-traded funds), invest conservatively with bonds and other “debt instruments,” or even play the commodities or foreign-exchange (Forex) currency markets.



Options are yet another...well, option.

But individual investors are often steered away from buying (or selling) options by brokers who say they're “too risky.” Indeed, investors need special clearance from most brokerages in order to trade options. What's more, many individual investors think options are too “complicated,” and thus they ignore them—but they do so at their own financial peril.

That's because while options may not be right for literally *every* investor's portfolio, they are flexible financial instruments that can (and in most cases, *should*) be used by investors of all risk tolerances, experience levels, and portfolio sizes.

Some Clarifications

First, let's cut through the confusion: The “options” you hear about in the news most of the time are **employee stock options**, and not the same as the options we're talking about. Employee stock options are contracts between a corporation and its employees -- often upper-level management, at least in the stories that make the news. **Exchange-traded options**, the subject of this guide, are contracts between two individuals: a buyer and a seller. In other words, the options-backdating

scandals so frequently on the front page of the Business section have *nothing* to do with the kinds of options you can buy and sell through a broker.

Secondly, there are options for most every kind of security. There are options on foreign currencies, commodities, and even more sophisticated financial instruments, but this guide will deal exclusively with **equity options**, which are options that give their owner the *right* to buy or sell shares of a given stock at a given price, on or before a given date.

Finally, there are two types of option contracts: **Call options**, which give the holder the *right*, but not the obligation, to *buy* the underlying stock; and **put options**, which give the holder the *right*, but not the obligation, to *sell* the underlying stock. Most beginners are confused by puts so we'll begin with calls. Actually, when most people generically speak of "options" they're referring to call options on common stock.

A 'Real' World Example

To begin, let's back out of the stock market for a moment and look at how options work in real estate. Let's say your rich uncle left you \$300,000 and you were convinced that the best thing to do with it was purchase a new home. The day after learning of his bequest, you find a great place on the market for exactly \$300k. The problem is, you don't get the inheritance until your twenty-first birthday, which is three months away.

You tell the home-seller that you'll gladly pay \$300,000 in one lump sum if he's willing to wait three months to cash the check. Not surprisingly, he laughs in your face, and tells you to come back in three months when you have the money.

The real-estate market is in bad shape, so there's a decent chance it will still be on the market in three months' time. But this house is a bargain—it would have sold for at least \$450,000 a year or two ago—and you're afraid that someone might come along and snatch it up before you get your hands on the \$300k. So you make an offer to the home-seller: "What if I give you \$3,000 as a down-payment right now?" you ask.

After thinking about it for a while, the home-seller makes a counter offer: You give him the money and he promises not to sell the home for three months. But the \$3,000 will be treated as a fee—or *premium*—and not as a down payment. You'll still owe the full \$300k at the end of three months, and if you don't come through, he gets to keep the \$3,000.

The above is almost precisely how equity options trade in the open market.

Options Standardization

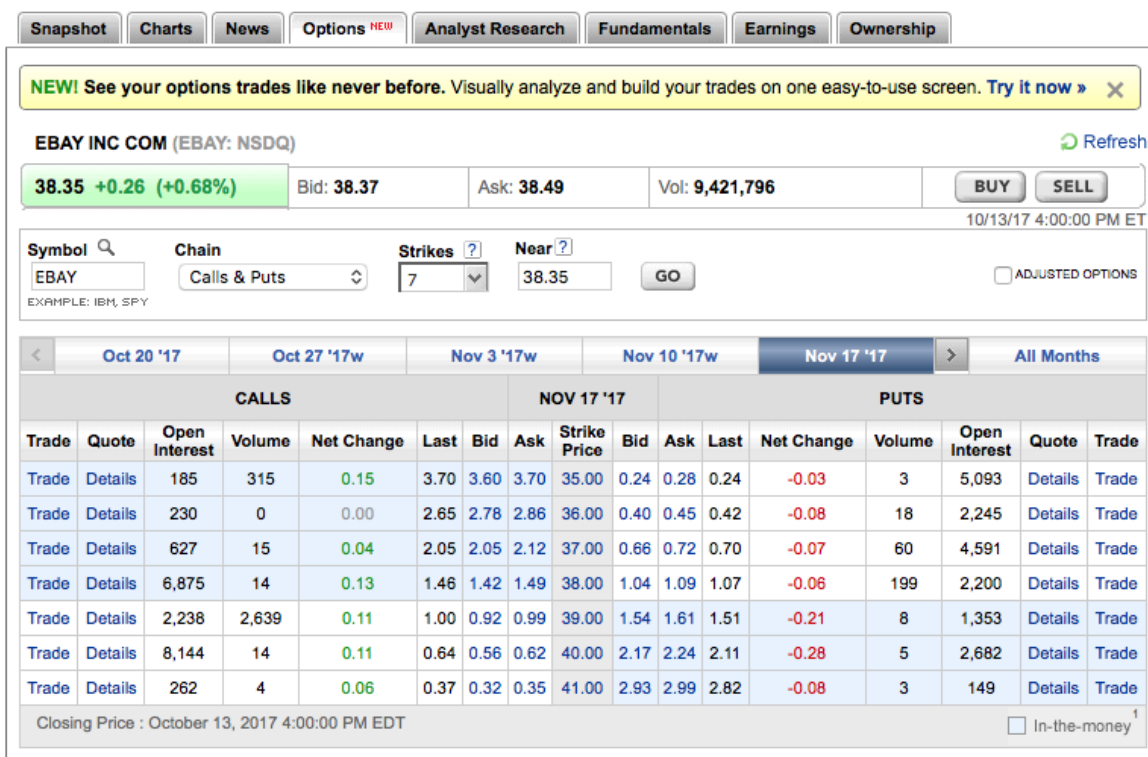
Almost precisely... First, let me clarify that options *do* exist in the real-estate market and they *do* work exactly as described above. The difference with options on stock is that you don't have to reach a detailed agreement with an individual seller in order to buy an option. Stock-market options are *standardized*.



This wasn't always the case. There was a time before "exchange-traded" options, and it wasn't that long ago. Options, in their current form, have only been around since 1973, and they've only gained their current level of popularity recently. For example, in 1999, the volume of options contracted traded in the U.S. stood at around 500 million a year. By 2006, that number had leaped to more than two billion.

Standardization is the key to making options widely accessible to individual investors. Whereas real-estate option deals with a particular house, of which there is only one in the world, a stock-option contract deals with 100 shares of a given stock, for which there are *millions* exactly alike.

To understand what is meant by standardization, let's take a look at an example option quote:



Above is the options chain for November 17, 2017 options on eBay (Ticker: EBAY). At the time these quotes were retrieved (October 13, 2017), eBay was trading at \$38.35 per share.

The **bid price** of an option is the price at which you can sell the option; the **ask price** is the price at which you can buy the option. We're dealing with buying call options to start, so let's focus on the ask prices.

Options are purchased in **contracts**, which, thanks to standardization, are always in terms of 100 shares. Therefore, one contract of an EBAY November 17, 2017 37-call option, with a \$2.12 ask price would cost you \$212 (plus brokerage commission).

As the holder of that contract, you would have the right—but *not the obligation*—to buy 100 shares of EBAY at the **strike price**, in this case \$37, any time between now and **expiration**, in this case the Saturday following the third Friday of November 2017.

Note: Options always expire on the Saturday following the third Friday of the month.

Three Examples of Call Options

If, for example, eBay went from \$38.35 to \$40, you—as the holder of one November 2017 37-call option contract—would have the right to purchase 100 shares at just \$37 (the strike price). You could then turn around and sell them for \$40 each.

Now what if the stock had instead fallen to \$20 a share? Well, remember: Options give you the right, *but not the obligation*, to buy a stock at a given price. There would be no point in buying shares at \$37 when you could buy them for \$20 on the open market, so you would simply let your option *expire worthless*. You'd be out \$212 but just as with shares of common stock, you can't possibly lose more than your initial investment when buying options.

Finally, let's look at what would happen if the stock stayed exactly where it was. EBay was at \$38.35 when you purchased your option contract on October 13, 2017 and, in this example, after bouncing around for three weeks, it closed the third Friday of the month right back at \$38.35. Well, your option contract gives you the right to purchase shares at \$37, so you can still make \$1.35 a share by exercising your option. You would thus make \$135 ($\$1.35 \times 100$).

'In-the-Money' and Intrinsic Value

In the example above, you purchased an option that was *in the money*. In the case of a call option that means the strike price is lower than the price of the underlying stock at the time it is purchased. An option that's "in-the-money" is said to have *intrinsic value*...

For example, an option with a strike price of \$37 and a current stock price of \$38.35 could be exercised immediately for \$1.35 in per-share profit. It thus has \$1.35 of *intrinsic value*. But notice that the ask price for the contract is \$2.12 per share. If \$1.35 of the \$2.12 is intrinsic value, what is the remaining \$0.77?

Time Value

The difference between an option's ask price and its intrinsic value is commonly referred to as **time value**—although this is not a universally accepted term. Some traders prefer “speculative” value as an alternative, but for now, let's stick with the term “time value.”

How time plays a factor is obvious when one looks at options with the same strike prices but different expirations. For example, here are some more eBay option quotes:

- An October 20, 2017 37-call has a bid ask price of \$1.77 x \$1.82
- A November 17, 2017 37-call has a bid ask price of \$2.05 x \$2.12
- A December 15, 2017 37-call has a bid ask price of \$2.31 X \$2.36
- An April 20, 2018 37-call has a bid ask price of \$3.50 x \$3.60

The only difference between the November 2017 expiration and December 2017 expiration is their expiration dates, and yet the ask price for December 2017 is \$0.24 higher. The ask prices for the later-expiring options are higher still.

Why? Well, it should be obvious: The longer you have to exercise an option, the greater the chances that the stock will go up and thus give the option intrinsic value.

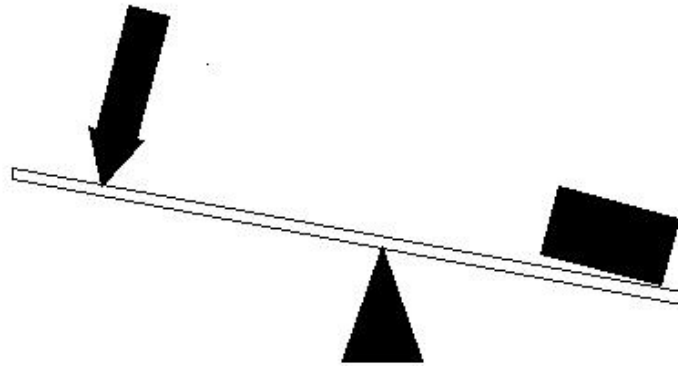
‘Out-of-the-Money’

So far, the options we've been dealing with have been “in-the-money.” Again, this means that the *strike price* of the call option—the price at which the holder of the option has the right to buy the underlying stock—is lower than the current price of the stock itself. Thus, the option has “intrinsic value.”

If you bought an EBAY November 17, 2017 call-contract, with a strike price of \$39, you wouldn't want to immediately exercise the option. After all, you could buy shares for \$38.35—the current stock price, in this example—on the open market, so why would you want to pay \$39 instead? This option has *no* intrinsic value, and thus the ask price of \$0.99 is all time value.

Options Advantage #1: Leverage

By now one advantage of buying call options instead of actual shares of stock should be apparent: *Leverage*.



In the case of the EBAY November 17, 2017 call, which had a \$37 strike price and a \$2.12 ask price, you could control 100 shares of eBay for \$212. If, instead, you had to purchase 100 shares of the actual stock, it would cost you \$3,835. If you actually had \$3,835 to play with, you could instead buy nine options contracts and control 900 shares—and still have some change.

In short, options allow you to control more shares of stock for less money.

The Big Picture

Now the advantages of using options for leverage should really come into focus.

Let's stick with the EBAY November 17, 2017 calls options with the \$37 strike price. Imagine you think eBay is going to do really well between now (October 13, 2017) and December 15, 2017, the options' expiration day for December 2017. You could either spent \$3,835 to buy 100 shares of eBay or spend \$212 to purchase one contract worth 100 shares.

Now, let's say EBAY ran to \$45 by December 15, 2017. You could now sell your 100 shares of EBAY and take a \$665 profit. Or, let's say you bought the options contract, you could exit it for a \$665 profit, which would be a \$453 profit (\$665 – the \$212 price of the contract).

So, if you bought shares you would have made \$665 on an investment of \$3.835.

If you bought the call option, you would have made \$453 on an investment of \$212.

Now for the Downside

But what if instead of going to \$45, eBay's share price fell to \$30?

Options with a \$37 strike price would be worthless—there would be no intrinsic value in them, and as they drew nearer to expiration, their time value would rapidly depreciate. If you purchased one contract for \$212, you would lose all \$212—and if you purchased nine contracts for \$1,908, then you'd be \$1,908 poorer.

Conversely, if you bought 100 shares at \$38.35 each, you'd have a paper loss of \$835 if the stock closed at \$30 on December 15, 2017—but you wouldn't be obligated to sell for a loss.

You could still hold on to the stock and hope that it climbed higher. But even if it didn't and you eventually sold at \$30 per share, your stock loss on an investment would still be smaller than the 100% loss on the call option you held.

This is the double-edged sword of leverage: It works for you when a stock goes up, and against you when a stock goes down. But there are ways you can mitigate the risks you take.

Upping the Ante

Maybe you've already noticed that your leverage is increased by two factors: (1) The further out-of-the-money the option's strike price is, and (2) the more imminent its expiration date.

Conversely, leverage and risk are lessened by buying options that are in the money (the "deeper" in-the-money they are, the less leverage and risk) and have a lot of time value.

Don't Try This At Home

Of course, using options in such an aggressive manner amounts to little more than gambling. The example above is not a recommended investment strategy but is simply intended to illustrate how options can be used to leverage relatively limited funds for comparatively larger profits.



Of course, if you do have a hunch that a stock will experience a rapid gain, it's okay to make a play similar to the one outlined above—so long as you do it with money you can afford to lose. Options don't have to be risky, but out-of-the-money calls with a little time before expiration *are* risky, and there's a very good chance you'll lose your entire investment.

American-Style vs. European Style Options

American-style options can be exercised or sold at *any time* (while the market's open) prior to expiration. When an options contract still has time value, you'll make even more than in the examples listed above. What's more, you can sell a contract that doesn't appear to be going your way and has no intrinsic value—but still some time value—to mitigate your losses.

European-style options are the alternative. These cannot be exercised at any time prior to expiration, but only *at the time of* expiration. This style, which has nothing to do with the underlying company's nation of origin, is used mostly for options that trade “over the counter” rather than on an options exchange. For the most part, European-style options can be safely ignored.

Important Concepts to Remember

- **Call options** give the holder the right—but *not the obligation*—to buy a given stock at a specified price before their expiration date.

- When people generically talk about “options,” they are almost always talking about call options.
- **Equity options**—the subject of this guide—have nothing to do with the employee stock options that have been the cause of many corporate scandals as of late.
- Options are traded in **contracts** of 100 shares.
- The quote of an options contract is priced per-share, and must be multiplied by 100 to get the real contract price.
- The **strike price** of a call option is the price at which shares of the underlying stock can be purchased.
- Options contracts expire the Saturday after the third Friday of the given month.
- A call option with a strike price lower than the current share price of the underlying stock is considered **in the money**.
- A call option with a strike price higher than the current share price of the underlying stock is considered **out-of-the-money**.
- The **intrinsic value** of an in-the-money call option is the difference between the share price of the underlying stock and the strike price of the option.
- Out-of-the-money options have no intrinsic value, and *not* negative intrinsic value.
- The difference between the per-share contract price of an option and its intrinsic value is its **time value** or **speculative value**.
- You don’t have to exercise your options to make a profit—you can sell the contract on the open market. Only about 10% of options contracts are actually exercised.
- Options afford investors financial **leverage**—they can control more shares with less money.
- Leverage is a double-edged sword: It compounds the gains you make if the underlying stock goes up, but also compounds the losses you endure if the stock goes down.
- The “deeper” in the money and more time value an option has, the less risky it is.
- It is fairly easy to lose your entire investment with options—especially out-of-the-money options with little time value.

Chapter 2: Writing Calls, Covered and Naked

Thus far, we've looked at options from the perspective of the buyer. Yes, we've talked about selling options contracts *after they've been purchased*, but you can also sell options *short*—just as with stocks.

Remember our real-estate example? In that case, there was an option buyer and an option seller. In order for the buyer to purchase the contract, the seller had to *write* it first. The options market for stocks works the same way.

Mr. Market Maker

There is one minor difference: Since options contracts are standardized, **market makers**—middlemen—stand ready to buy and sell options contracts.

Although there doesn't have to be one buyer for every seller, the spread between the bid and ask prices will shift to encourage balance. For example, if there are more sellers than buyers, the market maker will lower the bid and ask prices to encourage more buyers and discourage sellers until he's achieved relative parity. So while the balance between buyers and sellers may not be perfect, it is usually very close to 50-50.

An Example of Options Writing

The best way to understand “going short” on an options contract is to think of it this way: In order for you to buy an options contract, someone has to create it first. This process is called **writing**—just as the homeowner physically *wrote* a contract in our real-estate example.

Imagine you own 10,000 shares of Intel (Ticker: INTC), which, at the time of this writing, was worth \$40 per share. You don't think the stock is going to do much in the near future, but you expect it to perform really well by the end of the year.

You could sell the stock for \$400,000 and buy a short-term CD and earn interest for a few months and then buy it back—but the proceeds from the stock sale would be subject to capital gains taxes, which would greatly cut into your rate of return. Luckily, there's a way you can earn money on your \$400,000 without selling your stock and subjecting yourself to the Tax Man.

In our real-estate example, the homeowner earned a \$3,000 *premium* for writing the option contract for the buyer. But thanks to standardization, stockholders don't need to hunt down buyers—they can write contracts and sell them to the market maker.

In the case of Intel, which was trading at \$40 on October 13, 2017, you could write a call option with a strike price of \$39 and an expiration of November 17, 2017, and receive a premium of \$1.37 per share. If you wrote 100 contracts, covering all 10,000 of your shares, you would receive \$13,700.

To be clear: You own 10,000 shares of Intel and you want to generate some income on your investment without selling the shares. So you simply place a *sell order* for 100 contracts of the Intel November 17, 2017 calls with a \$39 strike price—and you receive \$13,700 in your brokerage account... It's that simple!

Covered vs. Naked

In the example above, we were examining what are known ***covered calls***.

This term refers to writing calls for which you own the underlying stock.

Writing covered calls is one of the most conservative investment strategies an individual can employ—so much for options being universally “risky.” Even Warren Buffett (pictured, right) recommends generating investment income with covered calls!



But the opposite of covered calls—**naked calls**—are very risky indeed. For these are call-option contracts written by investors who *do not own* the underlying stock.

Sticking with our earlier example, let's assume that you think Intel is going nowhere between now and October. Now, you don't own any shares of Intel—why would you want to own a stock you think is going to be flat for the next two months? — But you still want to profit from this hunch you have.

So, just as in the example above, you write 100 November 17, 2017 39-call contracts with a \$40 strike price. Just as in the example above, you're immediately paid \$13,700 (\$1.37 per-share premium * 10,000 shares). And just as in the example above, if Intel closes November 17, 2017 at \$39 or lower, you'll pocket the \$13,700 and live to speculate another day.

But what if Intel goes to \$50, \$60, even \$100 instead?

In any such case, you will be obligated to buy your contracts to sell 10,000 shares at \$39 apiece. Where do you come up with the shares? You have to buy them on the open market—for \$40, \$50, or \$100—whatever the current price is.

Let's imagine your contracts are exercised when Intel is at \$40 per share. You would then be contractually obligated to sell 10,000 shares at \$39 each. If you don't own 10,000 shares, you would have to go into the open market and purchase them for \$39 apiece--\$390,000 in all—and then sell them for \$40.

As you can no doubt see, writing naked calls is a very risky proposition, and because of this, not everyone is to place such trades. In order to write naked calls, you must have permission to have a *margin account* and enough value in your portfolio to cover reasonably expected losses.

Naked Calls: High Leverage and High Risk

Clearly, writing naked calls is an exceptionally high-risk investment activity. So why bother doing it? Well, as with most cases, with great risk comes the potential for great reward.

Looking at the previous example, what is your rate of return if you sell the Intel November 17, 2017 39 calls and Intel closes at or below \$39 on expiration day? Your investment in this case was \$0 and your reward would be \$39 per contract.

Limited Profit, Unlimited Losses



When you *buy* a call option, your losses are limited to the purchase price of your contracts, plus commissions. Your potential profits, however, are unlimited.

But when you *write* a naked call option, your profit is limited to the premium you received. And *your losses are unlimited*.

Your broker will perform a margin call if your paper losses get too great, and you can always close out your position (see below) before things get too far out-of-hand, but if the price of the underlying stock gaps—i.e. the stock makes a sharp move to the upside—you could find yourself in a lot of trouble.

Conversely, when writing covered calls, your losses are limited to *potential* losses. After all, if Intel goes to \$1,000 a share and you're forced to sell at \$40, you would lose the *potential* of \$960 per share, but no *actual* loss would take place unless you paid less than \$40 for the shares when you originally purchased them.

How Volatility Matters

It's important to understand that when you write an options contract, you are betting *against* volatility. The best way to understand this is to look at two stocks with similar share prices but vastly different options prices.

For example, let's say stock ABC closed at \$26.80 per share. Stock XYZ closed at \$26.85 per share. The difference in share price, obviously, was just \$0.05.

But now let's take a look at some of ABC's option series:

<u>Strike</u>	<u>Exp.</u>	<u>Last</u>	<u>Bid</u>	<u>Ask</u>
20.00	Aug	5.50	6.70	6.90
25.00	Aug	1.85	2.20	2.30
30.00	Aug	0.15	0.05	0.15

And now XYZ:

<u>Strike</u>	<u>Exp.</u>	<u>Last</u>	<u>Bid</u>	<u>Ask</u>
20.00	Aug	6.50	6.70	7.30
25.00	Aug	2.00	2.40	2.90
30.00	Aug	0.40	0.25	0.55

The first option on each list has a strike price of \$20. Since ABC closed at \$26.80 and XYZ at \$26.85, this means that the ABC 20 strike and XYZ 20 strike have *intrinsic value* of \$6.80 and \$6.85, respectively.

But look at the difference in the ask prices of the two series: The market maker is willing to sell the ABC 20 strike for \$6.90, while he's demanding \$7.30 for XYZ 20 strike.

Since we know the ABC 20 strike has \$6.80 in intrinsic value, a \$6.90 ask price means it only has \$0.10 in time value. Conversely, XYZ has a little more intrinsic value—\$6.85—but a *lot* more “time value”—\$0.45.

Since both series have the same expiration date, why should the right to buy XYZ at \$20 have a much higher per-share premium than the right to buy ABC at \$20, given that there's only a nickel's difference between their share price?

The answer is *volatility*.

Beta as a Measure of Volatility

Time for a little stock-market review: A stock's **beta coefficient** is a measure of its past volatility. This is an important statistic for options traders to pay attention to since the more volatile a stock, the more expensive its option premiums are likely to be.

In the examples above, ABC has a beta of 0.67. This means that for every 10% the broad market has gone up, ABC has historically gone up just 6.7%. By contrast, for every 10% the market has gone down, ABC has fallen by 6.7%.

A stock with a beta of 1.0 has mirrored the market's performance. Stocks with betas of less than 1 (but greater than 0) have been less volatile than the broad market, and stocks with betas higher than 1 have been more volatile. Stock XYZ, for example, has a beta of 1.2 as of the time of this writing. There are stocks that have negative betas. This means that they have historically gone up when the market has gone down, and vice versa.

The Advantage of Writing Calls

Most laypeople that don't invest think you can only make money when stocks go up. People with a little more experience know you can also profit during a down market by shorting stocks (or buying *put options*—which we'll look into in the next chapter). But writing calls allows you to make money during a flat or sideways market, too!

One way you can do this is by writing naked calls. Of course, as we've discussed, this can be a dangerous strategy.

Another way is by hunting for options that you think is overpriced, and then selling them while simultaneously buying the underlying stock.

For example, stock ABC closed at \$8.49 per share on October 13, 2017. Let's say you don't expect it to break \$12.50 by mid-November, nor do you think it's likely to fall much lower than \$8.49. If you're right, you could profit on your hunch by buying 1,000 shares of ABC for \$8,490 and simultaneously selling ten contracts of ABC (\$12.50 strike price, November expiration, \$0.30 ask price) for \$300.

The above move would reduce the *cost basis* of your ABC shares to \$8.19, since you paid \$8,490 for them but were *paid* \$300 for writing the ABC 12.50-contract—your net expense would be \$8,190 (\$8,490 - \$300) for the 1,000 shares. ABC would thus have to fall lower than \$8.19 per share in order for you to lose money.

Let's look at a few possible ways this position could play out:

1. ***ABC falls to \$8 a share.*** In this case, the ABC 12.50-call contract you sold expires worthless (the outcome you want) but you have a paper loss of \$0.19 per share or \$190. If you sell the shares on the market, you will lose \$190.
2. ***ABC closes on November 17 (the third Friday of the month) at \$10 per share.*** In this case, the call option contract expires worthless and you keep the \$300 premium. What's more, you can sell the 1,000 shares you bought for \$8.49 for \$10, making another \$1,510. Your rate of return is thus 18.4%. This is a far cry from 19,000%, but much less risky than writing naked calls.
3. ***ABC gets a bailout from the federal government and goes to \$20 per share.*** In this case, you are forced to sell your shares at the \$12.50 strike price but you keep your \$300 premium. You "lose" the *potential* of selling the shares at \$20, but in reality, you make money on the deal. After all, you got \$300 for writing the option and you made another \$4.01 per share by selling at \$12.50 when you paid \$8.49.

Options get a bad rap. As you can see from the many examples detailed in this chapter, options are *not* inherently risky investments—it's all about how you use them. In fact, as we'll learn in the next chapter, you can actually use options as a form of *insurance*. What could be less risky than that?

Important Concepts to Remember

- **Writing** an option is the process of selling an options contract that you didn't previously purchase. It can be thought of as "creating" the contract.
- Theoretically, in order for someone to buy an options contract, someone else must first create it. In reality, **market makers** buy and sell options contracts from individual investors and try to keep an even balance between buyers and sellers.
- If you write a call-option contract for a stock you own, it's called writing a **covered call**. If the contract is exercised, you'll be forced to sell your shares at the strike price dictated by the contract.
- If you write a call-option contract for a stock you do *not* own, it's called writing a **naked call**. If the contract is exercised, you'll be forced to buy shares on the open market and then sell them at the strike price dictated by the contract.
- The advantage of writing naked calls—though they are extraordinarily risky—is that you can make money with no investment whatsoever beyond broker commissions.
- The downside of writing naked calls is that your losses are unlimited, and your gains are limited to the premium you receive.
- You can always **close out your position** by buying an offsetting contract on the open market. This way, you don't have to worry that your contract might be exercised.
- The historical and expected volatility of an option's underlying stock greatly affects the option's premiums. The more volatile a stock is expected to be, the greater "time value"—or **speculative value**—the option series is likely to have.
- The biggest advantage of writing calls is that you can profit in a flat or sideways market.

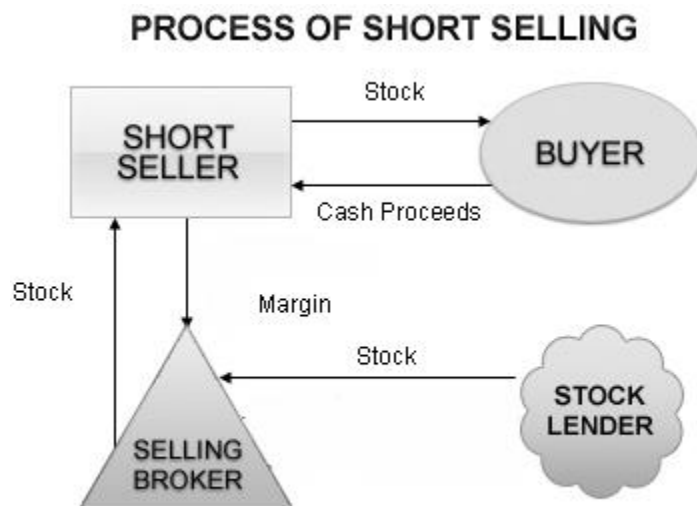
Chapter 3: The Long and Short of Puts

When you buy a call, you're hoping for the price of the underlying stock to go up. When you *write* a call, you're hoping that the price of the underlying stock goes down, stays roughly the same, or in the case of a *covered call*, goes up but not high enough for the contract you sold to be *exercised*.

But even in the case of a naked call, where you can make money if the stock goes down, you don't make *more* the more it goes down. So long as the contract is unexercised, you make your premium and nothing more. But what if you think a stock is going *down*? Is there a way to profit from such a hunch?

A Review of Short Selling

Of course there is! Most novice traders are aware of **short selling**—the process of selling shares of a stock you do not own. How this works is you borrow shares from a broker, sell them on the open market, and then buy them back at a later date—hopefully at a lower price than you paid. In this way, you can profit by selling high and *then* buying low.



For example, let's say Bank of America is trading at \$32 and you think it's overvalued. You put in an order with your broker to sell 100 shares short, and your account would be credited with \$3,200 in restricted funds (i.e. you couldn't take the money and blow it all on hats until you *covered* your position).

A month later, the stock has gone to \$35, and if you **covered** your position at that price, you'd be out \$3 per share or \$300. You'd have to spend \$3500 to buy back the shares at \$35 each.

But assuming you have at least \$300 in your brokerage account, you would not be forced to buy back the Bank of America shares at that time. In fact, you could leave them shorted indefinitely, although you would have to pay interest and dividends on your borrowed shares.

But let's say that eventually, Bank of America drops to \$20. At this point, you decide its time to cover and close out your position, so you buy 100 shares at \$20 each (\$2,000) and return them to the broker. In this case, you borrowed 100 shares and returned 100 shares. The only difference is that when you borrowed them (and sold them) they were worth \$35 each, and when you (bought them and) returned them, they were worth \$20 each. You pocket the \$15 per-share difference.

Short Selling vs. Put Buying

Short selling stocks has nothing to do with options trading, but the review above is necessary since people sometimes confuse *put buying* with *short selling*. In both cases, you profit by a stock's fall. But the mechanism for shorting a stock and buying a put are entirely different.

A put is an options contract that gives the holder the right, but not the obligation, to *sell* a stock at a certain price prior to the contract's expiration. Whereas a call gives the holder the right to *buy*, a put gives the holder the right to *sell*. This can be a bit confusing, so let's take a look at an example.

An Example of Put Buying

Let's say you're certain for some reason that shares of Coca-Cola (Ticker: KO) currently trading at \$46.60 is headed nowhere but down. You could short the stock, but there are many reasons why buying puts might make more sense for you. For example, maybe you haven't been approved for shorting, which requires a margin account.

So let's say you decide to buy a put. You look at the November 2017 put contracts:

Strike Price	Bid	Ask	Last	Net Change	Volume	Open Interest	Quote	Trade
42.00	0.03	0.05	0.03	0.00	0	4,167	Details	Trade
43.00	0.04	0.06	0.05	-0.01	25	5,402	Details	Trade
44.00	0.08	0.10	0.08	-0.05	6	4,337	Details	Trade
45.00	0.17	0.19	0.18	-0.04	66	14,013	Details	Trade
46.00	0.40	0.41	0.41	-0.02	99	4,743	Details	Trade
47.00	0.80	0.87	0.86	-0.07	164	2,341	Details	Trade
48.00	1.51	1.56	1.50	-0.13	11	208	Details	Trade
49.00	2.40	2.47	2.35	-0.20	10	25	Details	Trade
50.00	3.35	3.50	4.20	0.00	0	0	Details	Trade
55.00	8.35	8.50	0.00	0.00	0	0	Details	Trade
60.00	13.35	13.50	0.00	0.00	0	0	Details	Trade

Now again, we are looking at the ask prices here, since they represent the per-share premium at which the market maker is willing to sell us a contract.

The November 2017 42-strike price gives you the right to sell shares of Coca-Cola for \$42 any time between the present and expiration. This can be a bit confusing so let's take our time here. A call gives you the right to buy, and a put gives you the right to sell. If you had the November \$42 puts in hand and the underlying stock, Coca-Cola, was trading at \$46.60, it would make no sense to exercise the contract. Why you would want to use your put to sell shares of Coca-Cola for \$42, when you could sell them without the use of your put at \$46.60?

So let's say you had the Coca-Cola \$49 put.

By exercising that, you could sell shares of Coca-Cola to a market maker for \$50. Since the current share price is \$46.60, you could go into the market and buy the shares at that price, and then sell them for \$50 – a \$3.40 per share gain. Or, alternatively you could simply exit your put contract, which would increase in value as the price of the stock decreased.

Intrinsic Value and Time/Speculative Value

Let's continue looking at the Coca-Cola November 2017 50 put.

If the stock is currently trading at \$46.60, then the option has \$3.40 of intrinsic value. This put is in the money because the strike price is higher than the market price. This is the opposite of calls, but it makes sense if you think about it. After all, calls give you the right to buy shares at a certain price – you want to buy them for less than they're currently trading for.

Puts, by contrast, give you the right to sell shares at a certain price, and you want to be able to sell them for more than they're currently trading for.

So we've established that the Coca-Cola November 50 put has \$3.40 of intrinsic value (\$50 strike price - \$46.60 market price). The per-share ask-price, however, is \$3.50, so it's all intrinsic value. But let's assume the ask-price was \$4, we would have 60 cents of time or speculative value. So, it would not make sense to buy KOUK.X contracts and immediately exercise or sell them, nor would it ever make sense to buy and immediately exercise or sell any option.

If you were to immediately exercise this option, you would lose 60 cents per share (the time / speculative value).

So how do you make money with a put?

Answer: By waiting for the underlying stock to go down. As this happens, your put will increase in intrinsic value even if its time/speculative value decays a bit.

How to Use Puts as 'Insurance'

In the last chapter, we learned it was a myth, albeit a popular one, options are inherently risky. Writing covered calls, after all, is one of the most conservative investment activities one can un-

dertake. Buying puts, as “insurance” is another way even the most risk-averse of individuals can use options to meet their investment objectives.

Let’s say you’re an extremely cautious investor who owns 500 shares of Proctor & Gamble (Ticker: PG), which has a current value of \$91 in this example. You’re afraid the stock might go down, but you’re too cautious to sell—after all, what if it goes up? Well, you can buy puts to protect your downside. In this way, you are effectively *insuring* yourself against catastrophic losses.

For example, look at these quotes for Proctor & Gamble puts expiring November 17, 2017:

Strike Price	Bid	Ask	Last	Net Change	Volume	Open Interest	Quote	Trade
85.00	0.17	0.20	0.19	0.08	499	223	Details	Trade
87.50	0.30	0.47	0.40	0.15	3,069	15,257	Details	Trade
90.00	0.74	0.99	0.88	0.28	3,363	11,816	Details	Trade
92.50	1.75	2.11	1.99	0.51	374	2,653	Details	Trade
95.00	3.55	3.95	3.25	0.00	0	248	Details	Trade
97.50	5.50	6.40	5.90	0.00	0	41	Details	Trade
100.00	8.15	8.85	9.00	0.00	0	77	Details	Trade

You could buy the right to sell your shares at \$85 for \$0.20.

This way, your losses would be limited to \$10.48 per share. If Proctor & Gamble were to be cut in half from \$91 to \$45, instead of losing half of your investment, you’d be out just \$6 per share—plus the \$0.20 “insurance” premium. That might be worth your peace of mind.

Why a Put Can Be Better Than a Stop-Loss

Of course, there's another more widely known form of "insurance" on stocks—the **stop loss**.

When you place an order to buy shares of a given stock, you can also stipulate a lower price at which you'd like the shares to be automatically sold. This is known as a *stop loss*. For example, say General Electric (Ticker: GE) is trading at \$23.60. You could place a market order to buy 100 shares with an \$18 stop loss. This would mean that if the stock fell to \$18 or below, your broker would automatically sell the shares.

The problem with a stop loss is the possibility of **gapping**. This occurs when there is a major decline in the price of a stock with no stops in between. For example, if GE slowly declined from \$23.60 to \$18 over the course of several weeks, and then, amid a broad market crash, opened the next day at \$16 per share, your broker would sell your 100 shares at \$16, not \$18—there would be no takers at \$18.

If, instead, you purchased a *put* with a \$23 strike price, you would be protected. That's because the put contract would give you the right to sell your shares at \$23 no matter how far below \$23 they dropped.

Of course, this comes with a price.

As of October 2017, GE puts with a \$23 strike price had \$0.30, \$0.56, \$0.80, and \$0.85 premiums for October, November, December, and January expirations, respectively. But \$85 for a put contract with a \$23 strike price and January expiration might be worth it to guarantee a sale price of no less than \$23. It depends on your objectives as an investor and the individual particulars of the stock in question.

Using Puts on Restricted Stock

Another reason to buy puts is if for some reason you are *restricted* from selling stock you own



for a set period of time. This often happens when CEOs of startups sell out to bigger firms, but it can happen to regular folks, too.

Imagine this: Your grandma leaves you 10,000 shares of AT&T (Ticker: T) in her will, but the stock is held up in probate, or perhaps you receive the stock when you hit a certain birthday. For the

purpose of this example, let's say it's July 31, and you're going to officially take ownership of the shares on January 1 of the following year.

Right now, the 10,000 shares would be worth \$362,300 (\$36.23 per share), but what if something happens in the next five months and the share price is cut in half or worse?

What if AT&T goes bankrupt? How bad would it feel to have \$308,100 slip out of your hands and end up with nothing?

But even though you don't own the shares, there's something you can do to protect your inheritance: You can buy puts. Below is a list of put series for AT&T that expire on January 17, about three months from the date used in this example:

CALLS							JAN 19 '18			PUTS						
Trade	Quote	Open Interest	Volume	Net Change	Last	Bid	Ask	Strike Price	Bid	Ask	Last	Net Change	Volume	Open Interest	Quote	Trade
Trade	Details	16	0	0.00	6.60	5.40	5.55	31.00	0.15	0.17	0.16	0.00	69	27,472	Details	Trade
Trade	Details	136	0	0.00	4.25	4.50	4.60	32.00	0.24	0.26	0.28	0.02	1	46,054	Details	Trade
Trade	Details	267	26	0.00	3.50	3.60	3.70	33.00	0.40	0.42	0.41	-0.01	38	17,915	Details	Trade
Trade	Details	599	140	0.06	2.70	2.81	2.97	34.00	0.52	0.67	0.65	-0.04	5,172	21,543	Details	Trade
Trade	Details	1,992	54	0.04	2.14	2.10	2.14	35.00	0.91	1.02	1.01	-0.01	1,934	85,861	Details	Trade
Trade	Details	13,866	228	0.05	1.53	1.50	1.59	36.00	1.36	1.45	1.41	-0.07	552	46,899	Details	Trade
Trade	Details	69,950	1,249	0.04	1.05	1.02	1.10	37.00	1.93	2.07	1.97	-0.04	199	99,590	Details	Trade
Trade	Details	55,455	1,154	0.01	0.68	0.66	0.69	38.00	2.63	2.71	2.71	-0.06	74	29,873	Details	Trade
Trade	Details	47,758	5,200	0.01	0.42	0.43	0.45	39.00	3.40	3.50	3.46	0.01	190	25,420	Details	Trade
Trade	Details	69,146	1,095	0.03	0.28	0.25	0.27	40.00	4.25	4.35	4.30	-0.15	45	58,621	Details	Trade
Trade	Details	102,034	207	0.01	0.16	0.15	0.17	41.00	5.15	5.35	5.29	-0.03	4	8,065	Details	Trade

To cover your position of 10,000 shares, you'd need to purchase 100 contracts.

To minimize your losses, you could buy 100 contracts of the AT&T January 19, 2018 36 put options. At the current ask of \$1.45, this would cost you \$14,500. That's a pretty good chunk of change! However, you might have an easy time getting a loan to cover the expense, so long as you pledge your inheritance as collateral.

If you pursue this strategy, the worst that could happen would be AT&T falling under \$36 per share, and once you received your inheritance, you could sell your 10,000 shares at \$36 (no matter how far they've dropped).

A second strategy would be to protect your self from catastrophic loss. You could buy 100 contracts of the January 19, 2018 32 puts, locking in a \$32 share price, for just \$2,600. Or you could buy 100 January 19, 2018 31 put contracts, guaranteeing your right to sell at \$31 per share, for just \$1,700. I'm sure you'll agree \$1,700 might be a small price to pay to ensure your inheritance is not completely wiped out by a severe stock-market crash



Now what if the share price of AT&T goes up before you receive your shares? Well, that would be good news. Even though your puts would expire worthless, you'd want them to. After all, you don't complain when you go a year without using your fire insurance, and that's what buying puts in this case would be—*insurance*!

Married Puts

One final put-buying strategy before we move on to selling puts: ***Married puts***.

Married puts are a lot like buying puts for insurance on shares you already own. The difference is that with married puts, you don't already own the shares—you buy them at the same time you buy the puts.

Some critics say this strategy is foolish. After all, you buy a stock because you think it's going to go up, and you buy puts because you think the stock is going down to down—the two seem to be mutually exclusive. Well, consider this scenario:

A company is a week away from a big earnings announcement. Wall Street has been watching the company carefully, waiting for it to produce big news this quarter. If the news is good, you know the stock will go through the roof. But if the news is anything less than excellent, there's no telling how far shares might fall. You expect the news to be positive, but you want to protect yourself on the downside. This is what married puts are for!

Situations like this happen all the time.

A few years ago, when Alphabet (Ticker: GOOG) was blowing people away with its earnings each quarter, the speculative value of its calls and puts were very high even a few days before expiration (another good example of why “time value” can be a misleading concept).

When Google had good news, shares went soaring. On the rare cases when the news was bad, shares plummeted. One thing you could be sure of was the stock wouldn't stay still.

If you want to buy a stock right before a huge announcement where there is a lot of volatility expected as a result, it makes sense to “marry” your stock purchase with puts. For example: You could buy 100 shares of Google, expecting it to appreciate by 20% off the announcement, but buy one out-of-the-money put contract that would protect you from a 20% loss.

Using married puts is yet another options strategy that is anything but “risky.” In fact, it mitigates risk, rather than adding to it.

An Introduction to Writing Puts

So far, we’ve been talking about buying puts and, to a lesser extent, selling contracts we’ve already purchased to close out a position. But just as you can “write” a call option, you can “write” puts, too. Writing a put is selling *the right to sell a stock* at a given price prior to expiration.

Confusing, isn’t it?

Many students for the Series 7 Stockbroker’s exam fail based on their inability to grasp selling puts. It is a little difficult to wrap your head around, but it’s important for you to understand all four facets of options—buying calls, writing calls, buying puts, and writing puts—in order to be a successful trader.

When you sell a put, you are selling the right to sell a stock. Another way of looking at it is you’re *agreeing to buy* the stock at the specified price.

It’s helpful to forget about market makers briefly and imagine that options contracts are agreements between two people, buyer and seller. When you buy a put, you buy the right to sell a stock at a given price. But who buys the stock from you if you exercise that right? Answer: The writer of the put contract!

The writer creates the contract out of thin air, and the buyer buys it from him (using the market maker as an intermediary). So if the put buyer chooses to exercise the put, he is allowed to “put” the stock to the put seller.

Remember: There are two sides of every trade. When the call buyer has the right to buy stock, the call writer has the obligation to sell it to him. And when the put buyer has the right to sell stock, the put writer has the obligation to buy it from him. Options buyers have rights; options writers have obligations.

Why Go Short on Puts?

When you buy a financial security—be it a stock, a call, a put, or any other instrument—it’s known as going “long.” When you sell a financial security that you do not own, it’s known as going “short.” Thus, when you sell a put contract, you are said to be “shorting” the put.

This is confusing because of the relationship between buying puts and shorting stock, discussed earlier. But when you short a put, you are essentially agreeing to buy a stock at a given price in exchange for a premium.

The primary reason you’d do this should be clear: *To collect the premium.*

For example, take a look at these August puts for Amazon.com (Ticker: AMZN). The prices were retrieved on October 13, 2017, just about a week before expiration, when the stock was trading at \$1,002.94.

Strike Price	Bid	Ask	Last	Net Change	Volume	Open Interest	Quote	Trade
995.00	5.95	7.05	6.59	-1.89	1,338	580	Details	Trade
997.50	6.95	8.05	7.30	-2.20	307	221	Details	Trade
1000.00	7.95	9.15	8.50	-1.90	896	2,527	Details	Trade
1002.50	8.80	10.35	9.97	-2.33	271	113	Details	Trade
1005.00	10.35	11.50	10.96	-2.58	704	295	Details	Trade
1007.50	11.70	13.35	12.63	-2.27	158	66	Details	Trade
1010.00	12.90	14.70	14.00	-2.90	249	733	Details	Trade

The put series from \$995 to \$1,002.50 are all “out-of-the-money,” meaning they have no intrinsic value because the current share price, \$1,002.94, is higher.

An Example of Put Writing

Let’s look at AMZN October 20, 2017 put, with the \$1,005 strike price. You could write these puts for \$1,150 per contract (\$11.50 per-share bid price is what the market maker is willing to pay you for writing the contract). You would immediately receive \$1,150 per contract you wrote, and you would be obligated to buy 100 Amazon shares at \$1,005 each for every contract.

If the share price stayed above \$1,005 for the next week of trading, then the puts would expire worthless (your desired outcome) and you’d keep the \$1,150 per contract. If Amazon shares fell below \$1,005 and the puts were exercised, then you’d have to buy shares at \$1,005, but you’d still keep your \$1,150 premium.

But just as with writing naked calls, writing puts also comes with unlimited risk. If Amazon fell to \$900 a share, you’d still be obligated to buy them for \$1,005.

Of course, you can mitigate this risk by being smart and cautious, and by employing several advanced techniques that we’ll explore later.

Another Put Writing Strategy

Put writing can be an ideal strategy for entering into a stock at a specific price. For example, let's say you want to buy shares of Best Buy (Ticker: BBY), but you don't want to pay more than \$50 per share.

Perhaps the stock's chart says it's a buy at \$55—maybe this is the bottom end of a predictable trading range the stock's been in.

You could put in a limit buy order for \$50 and wait until the stock reaches \$50 for your order to be executed, but an even better strategy, in most cases, is to write a put.

On October 13, 2017, Best Buy was trading at \$55. If you were willing to buy 100 shares at \$50, you could write a December put contract with a \$50 strike price and receive a \$156 premium. That's a much better deal than simply waiting for the stock to reach your entry price of \$50!

What are some of the possible outcomes of the above scenario?

1. The share price of Best Buy does not fall to \$50 or below, and thus your put option goes unexercised. You keep the \$156 premium.
2. The share price of Best Buy falls below \$50 and your put option is exercised. You are forced to buy the stock at \$50, the price you were willing to pay anyway. You still keep the \$156 premium.

Of course, the stock could fall *well below* \$50—in which case, you might not like being obligated to pay \$50 for it. But if you're confident that \$50 is a good entry-point, why not earn some income on your desire to buy the stock, rather than simply waiting for it to come down?

Important Concepts to Remember

- Buying **puts** allows you to profit as the underlying stock declines in value.
- In this way, buying puts is similar to short-selling shares of a stock, but the two are not the same.
- When you buy a put, your losses are limited to the amount of premium you pay, and your potential profit is limitless. When you sell a stock short, your losses are unlimited and your maximum profit is the amount you receive for making the sale.
- Buying puts is much less risky than **short-selling** stocks, and thus, it is easier to get broker clearance to buy puts.
- As the owner of a put contract, you have the right (but not the obligation) to sell a stock at a given price, before expiration. Your hope is that the stock goes down, so that you can (theoretically) buy shares at the lower market price, and sell them for the higher strike price of your put contract. In reality, you are more likely to simply sell your put contract, which will increase in value as the price of the underlying stock falls.
- Puts can be used as **insurance** on shares of stock you already own. By having the right to sell the stock at a certain price, you are protected from bigger losses.
- A put can be better than a **stop-loss** since there is no possibility of **gapping** with a put.
- Puts are a great way of getting around restrictions placed on selling stock.
- A **married put** is when you simultaneously buy a stock and puts on the stock. Thus, you own the stock and you own the right to sell the stock at a certain price. This is a good strategy for entering highly volatile stocks shortly before an earnings announcement or some other event.
- By **writing a put**, you sell the right to sell a stock at a given price. Essentially, you agree to buy the stock at a given price in exchange for a premium.
- Writing puts can be a great idea if you want to enter a stock at a price lower than the current share price. Instead of placing a **limit order**, you can write a put, the main difference being you'll receive a premium for writing a put.

Chapter 4: Putting It All Together

You've now been equipped with the basic knowledge you need to understand more advanced options strategies. But before we go on, let's reiterate and underscore the basic concepts of the four types of options positions.

The Four Types of Options Positions

There are four types of options positions you can take. They are:

1. Buying calls (long calls)
2. Writing calls (short calls)
3. Buying puts (long puts)
4. Writing puts (short puts)

Each type of position has its own goal, maximum loss, and maximum gain, as exemplified by the chart below:

	Goal	Maximum Gain	Maximum Loss
Buying calls	Stock price to go up, thereby increasing the value of the call contract	Unlimited	Premium paid
Writing calls	Contract to expire worthless -- doesn't matter if stock price goes up, down, or stays the same, so long as the expiration price is lower than the strike price	Premium received	Unlimited
Buying puts	Stock price to go down, thereby increasing the value of the put contract	Unlimited	Premium paid
Writing puts	Contract to expire worthless -- doesn't matter if stock price goes up, down, or stays the same, so long as the expiration price is higher than the strike price	Premium received	Unlimited

Call buyers want the stock price to go up; put buyers want the stock price to go down. A mnemonic trick from remembering this is *call up* and *put down*.

The writers of calls and puts do not care so much if the price goes up or down—they just want the contracts to expire worthless. Worthless expiration allows the writers of calls and puts to collect their premiums without having to buy or sell the underlying stocks: It's money for nothing.

Motives

People buy call options because they think the price of the underlying stock is due to go up. Calls are the “simplest” options and the easiest to understand. Maybe this is because the motive behind buying them is so basic.

The reasons people write call options, by contrast, are more varied. They could write covered calls because they want to generate income on shares they own but don't think the stock will appreciate greatly before expiration. Or they could write naked calls because they think the bid-price premium is “too high” given their assessment of the stock's likelihood to reach the strike price before expiration.

People buy put options sometimes because they think the price of the underlying stock is headed down. But other times, they do so for insurance on a position they already hold, or as part of a married puts strategy to enter a volatile stock prior to an earnings announcement. Thirdly, people can buy puts as a substitute for a stop loss.

And finally, the put seller is the person who *sells the right to sell a stock* at a certain price before expiration. What's his motivation? Well, he could be riskily trying to collect premiums that he thinks are “too high,” or at least “high enough” to justify his risk. Or he might be willing to enter the stock at the strike price and actually hope the contract gets exercised, thereby giving him an entry point and the premium. In this way, the put writer is using put writing as a substitute for placing a limit order on the stock.

Closing Out Your Positions

It rarely makes sense to actually exercise an option. Instead, most options traders “close out their positions” by buying an offsetting contract. If you buy an option, you can close out your position by selling that same option. If you write an option, you can close out your position by buying that same option—this prevents the option you wrote from being exercised.

Consult the chart below:

Opening Action	Closing Action
Buying a call	Selling the same call
Writing a call	Buying the same call
Buying a put	Selling the same put
Writing a put	Buying the same put

Don’t be confused: Buying a put does not offset a call, or vice versa. Calls and puts are entirely different animals, and the opposite of a *long* call is a *short* call, not a long (or short) put.

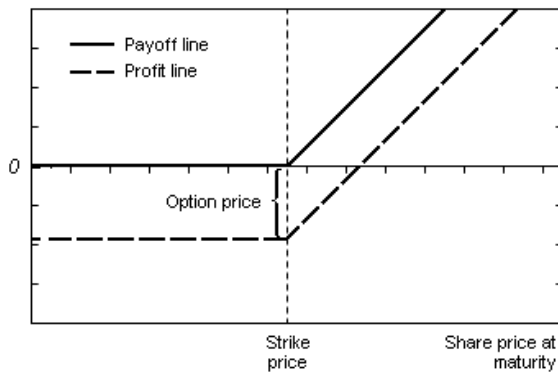
In Conclusion...

Once you understand the four types of options positions a trader can take, and the motivations behind each, options begin to really make sense—and become a lot of fun.

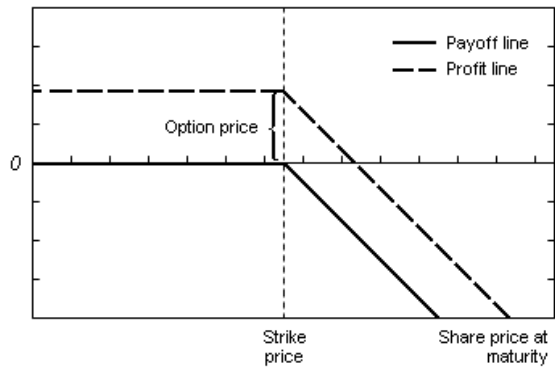
Before going on, make sure you fully understand everything up until this point, with an emphasis on this final chapter. You’ll need this basic understanding before you’re ready to buy (or sell) your first options in real life. If you *do* understand everything so far, then get ready—you’re almost there!

Charts from Wikipedia

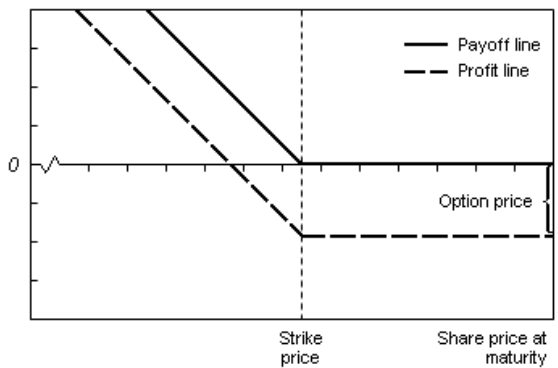
Long Call



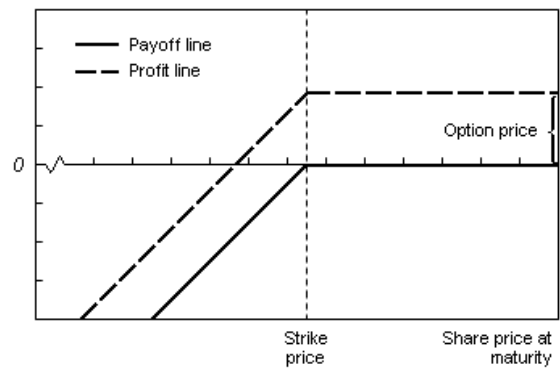
Short Call (Naked)



Long Put



Short Put (Naked)



Chapter 5: Using Collars for Insurance

Now that you have the basics of single-options strategies down, we'll begin looking at the advanced, multi-options strategies that are often the most prudent to employ. But before we dive in, a word on formatting:

Thus far, we've used *real* options quotes with *real* options ticker symbols. This was to demonstrate that options are unique securities, just like their underlying stocks, and that you can retrieve quotes for them using their unique tickers. But now that that's been established, we will begin using "descriptive quotes" for illustrative purposes.

Descriptive Quotes

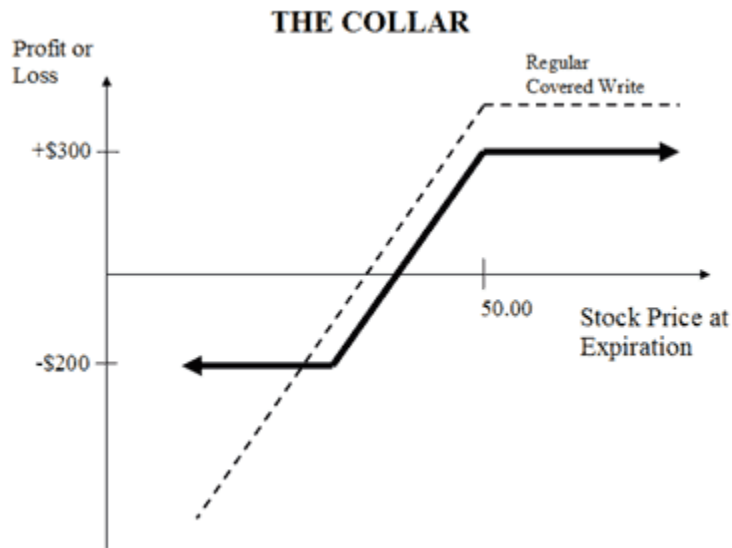
Long EBAY Nov 37 Call at 2.12, the descriptive-quote format, tells you everything you need to know about your call-option choice.

Let's take a look at the elements of a descriptive quote:

1. **Long**: This means you're "long" the option—you're a buyer, not a writer. The alternative would be "Short."
2. **EBAY**: This is the ticker symbol of the underlying stock.
3. **Nov**: This is the expiration month. If the year isn't given, then the current year is assumed. Remember, all options contracts expire the Saturday following the third Friday of the month.
4. **38**: This is the strike price (\$38).
5. **Call**: This means the option is a call option—the right to buy. The alternative would be "Put."
6. **At 2.12**: This is the per-share premium at which the option has been purchased / can be purchased (depending on the context).

An Example of a Collar Trade

A **collar** is perhaps the most basic of multi-options strategies. It is when you buy a put and sell a call on a stock that you own. The purpose of this strategy is to protect downside risk at little or no expense.



For instance, imagine you own 100 shares of Nike (Ticker: NKE), which is trading at \$50 in this example. You are worried about the stock declining, but for whatever reason, you do not want to sell the stock (there are myriad good reasons why this might be the case). So you want to buy a put on your 100 shares to lock in a share price of no less

than \$50.

Consulting an options quote chart, you find that puts with a \$50 strike price and an expiration four months away are selling at \$1.80 (\$180 per contract of 100).

To buy **Long NKE Jan 50 Put at 1.80** would be four months off you'd have to part with \$180.

A collar seeks to mitigate or even eliminate that cost.

Here's how: By consulting the call side of an options quote chart, you see Nike calls with a \$55 strike price and January expiration are selling for \$0.60. You could sell one of these contracts and receive \$90, thus reducing the cost of your "insurance" to just \$5 (\$180 spent - \$90 received).

Your positions would thus be:

1. **Long NKE Jan 50 Put at 1.5**
2. **Short NKE Jan 75 Call at 1.1**

What Happens Next?

What are the possible outcomes of the above scenario?

1. Nike falls to \$45, and thus, you could exercise your **Long NKE Jan 50 Put** and sell your shares for \$50. You would have protected yourself against \$5 per share (\$500) worth of losses for a cost of just \$40. The call contract you sold would expire worthless, and you'd keep the premium you received.
2. Nike goes to \$80, and thus, your **Short NKE Jan 75 Call** would be exercised, forcing you to sell your 100 shares at \$75. You'd "lose" the potential of selling them at \$80, but assuming you purchased the shares at less than \$75, you'd still have made money. Based on the earlier share price of \$60, you would have made \$15 per share. This \$1,500 gain would be lessened by the \$40 you spent on the collar, though, and your put would expire worthless.
3. Nike closes somewhere between \$50 and \$75. Thus, both your long put and short call contracts expire worthless. You're out \$40, plus or minus the depreciation/appreciation of the stock price, but your downside has been protected for a small sum.

The Purpose of Collars

As seen above, a collar protects you from major losses at the expense of the potential of larger profits. However, the point of a collar is to minimize or eliminate the out-of-pocket expense associated with using puts for "insurance."

In the above example, you sold a call that reduced your outlay from \$150 to \$40. But it's also possible to reduce the cost to \$0. This is called a **cashless collar** or a **costless collar**. It is even possible to make a small amount on a collar play, perhaps enough to offset commissions.

Potential Tax Savings

Used effectively, collars can also save you money when it comes time for you—or your heirs—to pay the Tax Man. For example, if you bought a stock for \$10 fifteen years ago, and it has since gone to \$50, you'd be liable for long-term capital gains taxes if you sold it.

What if you thought the stock was going to go lower in the short term and then bounce back up? If you sold it and then re-bought it, you'd lose a lot of your savings in taxes. Instead, you could use a col-



lar strategy to hedge your position without triggering a taxable event.

Even better, at least for your heirs: By never selling the stock, your posthumous beneficiaries will be able to take a “step up in basis.” This means that, for tax purposes, the stock will be given a base value of its market price at the time of the inheritance, not the price at which you bought it. This way, if they sell the stock for \$55, they'll pay capital gains taxes on just \$5 worth of profit, rather than \$45 worth of gains. The Tax Man doesn't like this rule, but your kids and grandchildren will.

Collars as Collateral

You can use stock as collateral for a loan, but depending on the past performance, reliability, and liquidity of the stock in question, a banker may loan you much less than the current market price of your holding. However, if you use a collar to lock in a minimum price point, your lender may be willing to give the stock full credit as collateral. This way, you can hold your stock and gain access to cash at the same time.

Important Concepts to Remember

- A **collar** is a two-option strategy designed to protect you against losses on a stock you hold with minimum out-of-pocket expense. By using a collar, however, you do risk loss of upside potential.
- You use a collar by buying a put and selling a call with the same expiration date. This allows you to sell the stock at a higher price if it falls, and you pay for most or all the put premium with the premium you receive for selling the call. The downside here is that if the stock appreciates above the call's strike price, you'll be forced to sell and lose potential gains.

Chapter 6: All About Spreads

Spreads are another two-option strategy. They differ from collars in that they make sense for traders who don't own the underlying stock. What's more, a spread user buys a call and sells a call (or buys a put and sells a put), rather than buying a put and selling a call, as with a collar.

There are many types of spreads. The three major types are **price spreads**, **time spreads**, and **diagonal spreads**. Among price spreads, there are **debit spreads** and **credit spreads**. And there are **call spreads** and **put spreads** of all varieties.

The thing to keep in mind is that there are "two legs" to each spread. The dominant leg is the position with the higher total premium (i.e. contract premium * contracts). This is the position you are really banking on, while the recessive leg is a position that hedges your bets, or, "subsidizes" the dominant leg.

For example, if you buy a call contract for \$550, and sell another one for \$250, the \$250 contract is the recessive leg, and its principal purpose is to offset the cost of the dominant leg. Thus, instead of spending a total of \$550, your cost is reduced to \$300, since you receive \$250 in premium income for selling the call.

T-Charts

This can be a little confusing to read in straight text, so here we'll introduce the visual aid known as the t-chart.

DR	CR

The left column, “DR,” signifies a “debit” or expenditure. The right column, “CR,” is for “credit” or income. If, for example, you purchased one option contract with a \$2.50 per-share premium, and sold another with a \$1.20 per-share premium, a t-chart would record the spread like this.

DR	CR
250	120

In this case, you would have spent \$250 and received \$120—making your net outlay \$130 ($\$120 - \$250 = -\$130$).

Now that we have the t-chart to help us make sense of things, we can begin looking at the various subspecies of spreads. First: debit price spreads.

Debit Price Spreads

A **price spread** is a two-option strategy in which both options have the same expiration date but different strikes prices. For example, **Long an AAPL Nov 155 Call at 5.5** and **Short a Nov 160 Call at 3.5** would be an example of a price spread.

DR	CR
550	350

By taking this position, you would have purchased the right to sell 100 shares of Apple (Ticker: AAPL) at \$155 per share, and sold the right to purchase them at \$160 per share. You would have paid \$550 for your long position and received \$350 for your short position. Your net outlay would be \$200.

The above is a **debit spread**, because you paid more for your long position than you received for your short. The goal of a debit spread is for the difference between the two premiums to widen, and for one or both of the contracts to be in the money upon expiration.

Credit Price Spreads

A **credit price spread** occurs when the cost of your long position is less than the premium you receive for your short position. For example, if you went long the AAPL Nov 160 call and short the AAPL Nov 155 call – the opposite of the above position – you would spend \$350 and receive \$550 for a net gain of \$200. In this case, your goal would be for the premiums of the spreads to narrow and expire worthless.

DR	CR
550	350

Time Spreads

Whether debit or credit, price spreads both involve buying one option and selling another, where both options have the same underlying stock and expiration date. A **time spread** is different, in that the two options have the *same* strike prices but *different* expirations.

An example of a time spread for the fictional stock ABC would be **Long ABC Sep 60 Call at 3, Short ABC Nov 60 Call at 5.**

DR	CR
300	500

Thus, the **Short ABC Nov 60 Call** would be the dominant leg of the strategy, with the **Long ABC Sep 60** position serving as a hedge. An investor would establish this time-spread position if he expected the gap between the two premiums to narrow, presumably as the price of the underlying stock went down.

Alternatively, the premium of the long position can exceed the income received for the short sale. In this case, the goal is for the two premiums to widen with time, presumably as the price of the underlying stock went up. You'd be selling a short-term option and buying a longer-term one. Thus, the ideal scenario would be for the short-term option (the option with the nearer expiration date) to expire worthless, while the long-term option could be sold "in-the-money." This way, you'd use the income from the initial sale of the short-term option to subsidize the purchase of your longer-term option.

Diagonal Spreads

Finally, there are diagonal spreads, which combine the features of both price and time spreads. Thus, they have the same underlying stock but different strike prices *and* different expiration dates. Again, it's important to note that with all spreads, the purpose of the recessive leg (the one that has the lower premium) is to subsidize or hedge the dominant leg (the one that has the higher premium). Using a diagonal-options strategy just increases the possibilities of offsetting the cost or risk of one position by buying or selling another.

Important Concepts to Remember

- **Spreads** are two-options strategies that make sense for traders who don't own the underlying stock in question.
- A **credit spread** is one in which you receive more income for the short-sale half of the spread than you pay for the long position. With a **debit spread**, the opposite is true.
- With a credit spread, you make money if the premiums of the long and short positions **narrow** over time and expire worthless.
- With a debit spread, you make money if the premiums of the long and short positions **widen** over time and expire in the money.
- A **price spread** involves long and short positions on the same type of option (call or put) of the same underlying stock, with the same expiration dates but different strike prices.
- A **time spread** involves long and short positions on the same type of option (call or put) of the same underlying stock, with the same strike prices but different expiration dates.
- A **diagonal spread** involves long and short positions on the same type of option (call or put) of the same underlying stock, with different strike prices *and* different expiration dates.
- The general purpose of any type of spread is to use one half of the position to hedge or subsidize the other half of the position. For example, you might sell a call to reduce the out-of-pocket expense of buying another call, etc.

Chapter 7: Straddles and Combinations

The final pair of two-options strategies is **straddles** and **combinations**. Whereas spreads involved buying and selling the same kind of options (i.e. calls or puts), straddles and combinations both involve *either* buying or selling a call-put combo. First, let's look at straddles.

Straddles

A straddle is composed of a call and a put with the same strike price and expiration month. Straddles can be either long (when an investor buys a call and a put) or short (when an investor sells a call and a put).

Example: Williams-Sonoma was trading at \$50 on October 13, 2017. Its October calls and puts (expiring October 20, 2017) looked like this on that date:

CALLS							OCT 20 '17			PUTS						
Trade	Quote	Open Interest	Volume	Net Change	Last	Bid	Ask	Strike Price	Bid	Ask	Last	Net Change	Volume	Open Interest	Quote	Trade
Trade	Details	17	0	0.00	6.76	7.40	7.90	42.50	0.00	0.05	0.05	0.00	0	1,459	Details	Trade
Trade	Details	185	0	0.00	6.27	4.70	5.30	45.00	0.00	0.05	0.01	-0.04	2	3,592	Details	Trade
Trade	Details	707	7	1.27	2.75	2.50	2.90	47.50	0.00	0.15	0.10	-0.20	61	2,324	Details	Trade
Trade	Details	2,500	0	0.00	0.30	0.70	0.90	50.00	0.60	0.85	0.66	-1.06	4	562	Details	Trade
Trade	Details	2,232	132	0.17	0.22	0.05	0.15	52.50	2.40	2.70	1.50	0.00	0	312	Details	Trade
Trade	Details	724	63	-0.01	0.02	0.00	0.05	55.00	4.80	5.10	3.50	0.00	0	13	Details	Trade
Trade	Details	1	0	0.00	0.05	0.00	0.10	60.00	9.80	10.20	0.00	0.00	0	0	Details	Trade

An investor could create a **long straddle** by buying (long) **WSM Oct 50 Call at 0.90** and buying (long) **WSM Oct 47.50 Put at 0.10**. The total spent would be \$100 (\$90 for the call contract and \$10 for the put contract).

As the price of the underlying stock went up, the value of the call would go up—but the value of the put would go down, and vice versa. The goal of a long straddle is *volatility*, for if the move—up or down—is big enough, the gains from the winning position can easily outstrip the losses from the losing position. That's because when you're long an options contract, whether a call or

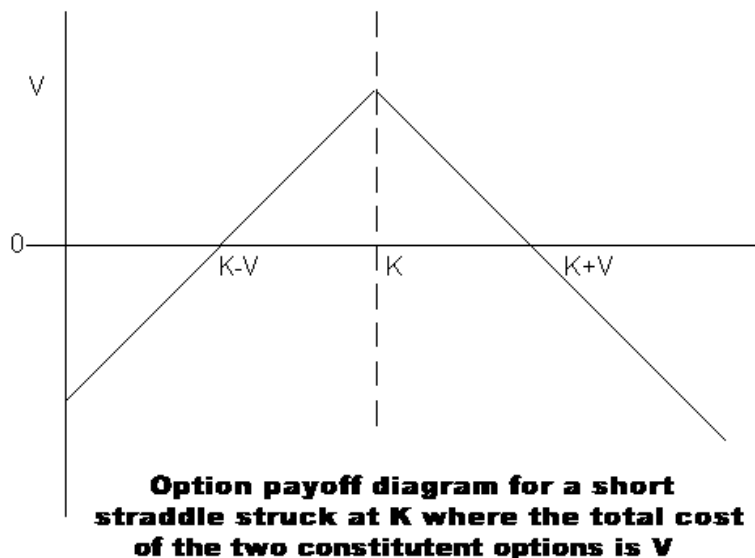
put, your potential gains are unlimited while your potential losses are limited to the premium you paid.

Break-Even on a Long Straddle

In the above example, what would be your break-even point? Well, you would have spent \$1.00 per share (\$0.90 for the call and \$0.10 for the put), so you'd need WSM to move at least \$1.01 from the strike price of \$50—in *either direction*—in order to turn a profit.

Short Straddles

The other way of entering a straddle is on the short side. For example, instead of buying the two



contracts in the previous example, you could sell them short. Thus, your straddle would consist of:

Short WSM October 50 call at 0.90 and Short WSM October 50 put at 0.10.

Whereas the goal of an investor with a long straddle is volatility, the traders who enter a short straddle position are hoping for

the *opposite*—relative calm. For just as the long-straddle buyer in the example above needed to see WSM hit \$51.01 or fall to \$48.99 in order to turn a profit, a short-straddle seller would make money if the stock stayed within the \$48 to \$51 range.

With long straddles, your potential profits are limitless while your potential losses are capped at the premiums you paid when you entered the positions. With short straddles, the reverse is true: Your potential profits are limited to the premiums you received when you sold the options on the open market, and your potential losses are limitless.

This, however, does not mean that short straddles should be avoided. Indeed, they are one of the more attractive options strategies available, since they allow you to profit from a market that's neither bullish nor bearish. But shorting any financial instrument has its risks, and when you enter a short-straddle position, you are doubling that risk by placing two short sales at once.

Straddle Calculations

Below is a table that demonstrates the maximum gain, maximum loss, and the point at which you can profit from a long straddle and a short straddle:

Calculation	Long Straddle	Short Straddle
Maximum Gain	Unlimited	Total premiums received
Maximum Loss	Total premiums paid	Unlimited
Profit if...	Stock price > strike price + both per-share premiums OR Stock price < strike price - both per-share premiums	Stock price < strike price + both per-share premiums AND Stock price < strike price - both per-share premiums

Combinations

A combination is composed of a call and a put with different strike prices, expiration dates, or both. Typically, an investor who opts to use a combination instead of a straddle does so because they are cheaper to establish if both options are out-of-the-money. Strategically, combinations work the same as straddles.

Important Concepts to Remember

- There are two types of **straddles**: Long and short.
- A **long straddle** involves buying a call and a put with the same underlying stock, strike price, and expiration date.
- A **short straddle** involves selling (short) a call and a put with the same underlying stock, strike price, and expiration date.
- You make money with a long straddle with volatility. You can make money if the price of the underlying stock goes up or down from the strike price by an amount greater than the total premiums paid.
- You make money with a short straddle from *a lack of* volatility. Your hope is for the price of the underlying stock to remain relatively stable, and you make money so long as the stock's price doesn't go up or down from the strike price by an amount greater than the premiums received.
- Short straddles offer you the opportunity to profit from a market that is neither bullish nor bearish.
- A **combination** is a two-option strategy involving a call and a put with the same underlying stock, but different strike prices or expiration dates or both. Combinations can either be long or short.

Chapter 8: Accounts, Brokers, and Commissions

Thus far we've learned virtually everything there is to know about options, from long calls to short puts, time spreads to credit price spreads, straddles and combinations, you name it. But in order to put this information into action, you'll need an **options account** with a broker. And while we've ignored the ugliest part of trading options—the commissions—until now, we'll take a look at how those pesky fees can cut into your profits.

Having an Options Account

If you have a regular stock-trading account, you may or may not already have clearance to trade options. Typically, you have to request permission by filling out an application and signing a disclaimer saying that you understand the risks inherent in trading options.

Some brokers ask that you have a year or more of stock-trading experience before they'll clear you to play the options market. Why do they care? Because over the years, litigious traders have been able to sue their brokers, claiming they “didn't understand” what they were doing when they were trading options. Thus, brokers have to take steps to defend themselves against lawsuits, and while the disclaimer is usually enough, some particularly cautious brokers deny the option-account applications of inexperienced traders. This is not really a big deal, since there are plenty of brokers out there to choose from, and you'll almost definitely be able to find one that's right for you.

Margin Accounts

The above generally deals with going long calls and puts. In these cases, your maximum potential losses are capped at the premiums you pay when you enter the positions. When you go short, however, your potential losses are unlimited. That's why, in order to short calls and puts, you'll need special clearance and a margin account.

A **margin account** is a special type of brokerage account that allows you to take out loans against the securities you own. You may be subject to credit-score screening in order to qualify

for a margin account, and your trading experience could be of greater relevance to the broker. The risk to the broker, as it pertains to options, is that you will short a call option for which you don't own the underlying stock, and then be unable to afford buying that stock in the open market should the call get exercised. Thus, your broker might require you to have a certain value of holdings in your account to protect against potential losses. The greater your creditworthiness, the less stringent this requirement is likely to be.

However, you may not need a margin account for all short sales on options. Covered calls, for example, entail no risk to the broker, since you own the underlying stock that is to be sold in the event that the contract's exercised.

Opening an Account

We'll review brokers later in this chapter, but for now, we'll examine the process of opening an account with eTrade.com.

On this first screen below, we're asked for our country of permanent residence, the *kind* and *type* of accounts we want, and what kind of securities we want to be able to trade. The first question (country) is self-explanatory, but the second, third, and fourth require a little explanation.

As you run through the application process, you'll need things such as:

- Your driver's license,
- Your banking account information (to transfer funds, make deposits)
- Your employer information
- Your social security number

Let's use TD Ameritrade, as our example application.

Step No. 1 -- Once at the site, your first goal is to locate and click "Open New Account."

Open New Account

Log In

Step No. 2 – Begin to fill out the application to trade. Fill out all required information, including your name, e-mail address and relevant contact information. These are all essentials to help confirm who you are, as well as for federal and state tax requirements, and other record-keeping requirements demanded by the U.S. Securities and Exchange Commission (SEC).

What you'll need to open an account:

- Just a few minutes to fill out the application
- Your Social Security Number or Individual Taxpayer Identification Number (ITIN)
- Your employer name and address

Do you already have an account with us (including paperMoney®)? (optional)

If you already have an account with us, you can save time and prefill parts of your application. You'll be able to make changes if needed.

☐ Yes ☒ No

Your contact information

All fields are required, unless they are marked as optional.

Prefix (optional)

Select ▼

First name

Middle name (optional)

Last name

Suffix (optional)

Select ▼

Email address ⓘ

Re-enter email address

Best daytime phone number ⓘ

ext. [Add secondary number](#)

☐ I have a non-U.S. phone number.

You'll also be asked for your current citizenship status, as well as what kind of an account you'd like to set up. For our purposes at the moment, we'd select "Individual."

What type of account do you want to open? ⓘ

Most Common	Standard	Retirement	Education Savings	Business/Trust
-------------	-----------------	------------	-------------------	----------------

☒ Individual
☐ Joint Tenants WROS (With Rights of Survivorship)
☐ Joint Tenants in Common
☐ Joint Community Property
☐ Joint Tenants by the Entirety
☐ Guardianship or Conservatorship
☐ UTMA/UGMA

Individual
Features:

- A standard brokerage account with only one owner.
- Allows for a wide range of trading choices.
- This is NOT a tax-advantaged IRA.
- When the account owner dies, all assets are passed on to his or her estate.

You'll also be asked what you primarily want expect to use this account for. For our purposes of trading stock options, we'd choose "Actively trade stocks, ETFs, options, futures, or Forex."

At this point, you'll be shown a link to the broker privacy statement. Clicking "continue" will take you to the next part of the application process. You'll find the application process is the same on all of the broker sites.

At this time, I primarily expect to:

- ☐ Buy, hold, and occasionally trade stocks, mutual funds, ETFs, or bonds
- ☒ **Actively trade stocks, ETFs, options, futures, or forex**
- ☐ I'm not sure

We'll help you get started by providing useful information, including:

- Details about multi-leg/complex options, futures, and foreign exchange markets
- Specialized trader support
- Access to thinkorswim and Trade Architect platforms

Are you new to investing? (optional) ☐ Yes ☐ No

Offer code (optional) 

220

[Show offer terms and conditions](#)

☐ I have read the [TD Ameritrade Privacy Statement](#) 

Continue

Important Information about procedures for opening a new account:

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, we will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also utilize a third-party information provider for verification purposes and/or ask for a copy of your driver's license or other identifying documents.

You will also be asked for your social security number. All broker sites ask for this information. It's encrypted and protected. The SEC requires that all brokers maintain up-to-date account of your personal information. It's also required per anti-terrorist and money laundering laws.

In fact, your information is crosschecked to make sure you're one of the good guys, and not a terrorist or criminal involved in money laundering.

With that knowledge, enter your social security number, date of birth, marital status, your mother's maiden name, dependents, as well as your home address.

Personal Information

Social Security Number/Individual Taxpayer Identification Number (ITIN) ⓘ

Date of birth

Marital status

Mother's maiden name

Number of dependents ⓘ

Home address

Country

Physical street address ⓘ

City

State

ZIP code

☐ I would like to use a different mailing address. ⓘ

You will also be asked to enter information on your employment, and current financial information, such as net worth, and annual income. In addition, you'll be asked about personal affiliations to ward off any signs of potential insider trading issues.

It's all done in an effort to keep good records with SEC requirements.

Employment information

Employment status

 ▼**Financial information**

Approximate annual income ⓘ

 ▼

Approximate net worth ⓘ

 ▼

Approximate liquid net worth ⓘ

 ▼**Personal affiliations**

1. Are you, or is your spouse, or is any member of your immediate family licensed by, employed by, or associated with a broker-dealer firm, a financial services regulator, a securities exchange, or a member of a securities exchange? ⓘ ☐ Yes ☐ No
2. Are you, or is your spouse, or is any member of your immediate family, or are any of your personal or business associates a senior political figure? ⓘ ☐ Yes ☐ No
3. Are you, or is your spouse, or is any member of your immediate family a member of the board of directors, a 10% shareholder, or a policy-making officer of a publicly traded company? ⓘ ☐ Yes ☐ No

Continue

Verify that all information is correct. Click “continue.”

Please make sure all information is correct. You don’t want to be delayed for approval.

Click “continue” and move to the next page.

On the next page, oftentimes, you will be offered links to your client agreement, your account handbook, as well as a Business Continuity Plan statement, which discusses security and reliability of your accounts with your chosen broker.

Important Account Information

The following account-related documents and disclosures are delivered electronically.

-  [Client Agreement](#) ⓘ
-  [Account Handbook](#) ⓘ
-  [Business Continuity Plan Statement](#) ⓘ

☒ **By checking this box, I am acknowledging that:**

- I accept electronic delivery of these documents.
- I have read, printed, and/or saved these documents and don't need them mailed to me.

You can also find these documents under **Client Services > Forms and Agreements** when you log in to your account.

Click the next box acknowledging receipt of said documentation.

Typically, your next step will be to confirm your IRS Form W-9 information. This is for tax purposes. You are taxed on capital gains and dividends, too. The last thing you want to do here is enter false information. It's considered perjury.

On the next page, you want to create a username and password that is unique to you. Do not share it with any one. You'll also be asked to create security questions in case you forget your username and password and need to reset your account information.

For security reasons, you must create a unique UserID and password. If you already have an existing TD Ameritrade account, please create another log-in for this account. Afterwards, you'll be able to link your accounts and access all of them using a single log-in.

UserID

Password

Re-enter password

Security questions

To better protect your account and personal information, select and answer the four security questions below.

Question #1



Answer #1

Question #2



Answer #2

Question #3



Answer #3

Question #4



Answer #4

Click “continue” and verify your information on the next page.

Again, click “continue” and that’s it.

Print out a copy of your full application if you’d like, as well as the current for your records.

Comparing Brokers

While we can't tell you which broker you should go with, what we can do is provide you with a list of potential ones to consider along with contact information for each. We can also detail what you should look for with each broker in order to make a well-informed choice of which to give your money to.

Some of the top brokers today, include:

- eTrade.com (etrade.com) – (800) 387-2331
- Tradestation (Tradestation.com) – (800) 808-9336
- TD Ameritrade (TDAmeritrade.com) – (800) 454-9272
- Scottrade (Scottrade.com) – (800) 619-7283
- Fidelity (Fidelity.com) – (800) 343-3548
- Interactive Brokers (InteractiveBrokers.com) – (877) 442-2757
- Charles Schwab (Schwab.com) – (800) 435-4000

With such a list, it's important that you narrow down what may work best for you.

The criteria for selecting your broker could include research into:

- Commissions
- Speed of order executions
- Ease of use
- Site security
- Reputation
- Customer support issues

Entering an Order

Options Order Form

Option	Trailing Stop	Contingent
Option Symbol		Find Chain
Action	Please Select v	
Quantity		All or None ☐
Price	☐ Market ☒ Limit \$ up ☐ Stop \$ down ☐ Stop Limit ☐ Market On Close	
Duration	Day Order v	
Advanced Orders	None v	
Preview Order Save		

Where it asks for the **Option Symbol**, you'll notice there's a link that says *Find Chain*. If you type in a stock's ticker symbol and click the *Find Chain* link, a page will load showing you all of the options for that stock.

Secondly, there is the **Action** field. This is a dropdown menu that includes the following choices:

- **Buy to Open:** This means you are buying a put or a call for which you don't already have an offsetting short position. This is a "regular" buy.
- **Buy to Close:** You select this option when you're buying a put or call not to hold, but to close out an existing short position. You do this to "cover" your short.
- **Sell to Open:** This is a short sale, where you're writing an option and selling it on the open market. The option will either expire worthless (you hope), get exercised, or you'll later *Buy to Close* (above) to close out the position

- **Sell to Close:** This means you're selling an option that you already own, and thus, closing out the position. This is what you enter to sell an option that you're not shorting.

Next, there is the **Quantity** field. Here, you enter the number of *contracts*—not shares—you want to buy or sell. Remember, of course, that each contract represents 100 shares. If you'd like, you can check the "All or None" box, which means that you only want your order executed if it can be fulfilled in full. For example, you'd select "All or None" if you wanted to sell twenty-five contracts at a certain price, but not just twenty-three.

Fourth, we have the **Price** field. Here you have the following options:

- **Market:** The trade will be executed promptly at the prevailing market price.
- **Limit:** The trade will be executed at or below (long) or at or above (short) the selected price.
- **Stop:** The trade will be executed at the prevailing market price once that market price meets or exceeds the given level.
- **Stop-Limit:** The trade will be executed at the stop-limit price, once the market price meets or exceeds a given level.
- **Market at Close:** The trade will be executed within the final thirty to sixty seconds of the trading day.

The fifth field is **Duration**, for which the options are *Day Order* and *Good Til Cancelled*. A Day Order expires at the end of the day, while Good Til Cancelled is... good until cancelled! This is mostly a concern for non-market orders (i.e. limit orders).

Essentially, all you do is fill out that form, hit submit, and usually within a few seconds, you are the proud owner of call and/or put contracts! Unless of course you sold short, in which case your account is promptly credited with the proceeds.

Important Concepts to Remember

- You must have an **options account** in order to trade options.
- Applicants for options accounts are subject to approval; however, almost everyone should be able to get approved by one broker or another.
- Taking most short positions on options contracts requires a **margin account**, which is subject to credit-approval
- People from most countries will face no additional problems in opening an options account with a U.S.-based broker.
- The process of opening an options account is fairly easy and straightforward: It only takes around five minutes.
- There are dozens of options brokers to choose from. Some charge more than others but offer better services. It's up to you to decide what's more important: Low costs or high-quality service.
- Entering options orders, once you have an account, is a simple, Web-based process.
- Commissions can take a major bite out of your trading profits if you're not careful.

Final Word

We hope you've enjoyed this eBook and found it to be both informative and useful. Trading options is one of the most exciting financial-market activities an individual can engage in, but it doesn't have to be a reckless or speculative venture, as this guide has shown.

With the knowledge contained in this manual, you're well on your way to being a fully informed options trader.

For daily actionable tips and strategies, visit our blog at www.OptionsProfitsDaily.com