What Is An Option?

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1 What is an Option?

Options consist of five compenents:

1. Financial Contract
   - A option is a financial contract, meaning that it trades on option markets. These markets are usually safe, orderly, and standardized. Very accessable from your broker/online investment firm.
2. An Underlying
   - This finacial contract comes with what is called an Underlying. An Underlying is the stock, ETF, Futures contract, etc. which is being sought to buy or sell. In this course we will focus mostly on equity options (i.e. options on stocks).
3. Right to Buy or Obligation to Sell
   - When buying options, this finacial contract gives either the right to buy or sell the Underlying, or, when selling options, this financial contract obliges you to sell the Underlying. When this financial contract is related to the buying of the Underlying, the option is called a Call Option. When this financial contract is related to the selling of the Underlying, the option is called a Put Option.
4. A Certain Price
   - This financial contract comes with a set Buy or Sell price referred to as the Strike price. The Strike price is different from the Market price.
   - For Calls
     - If Strike price > Market Price we say the Call Option is Out of the Money (OTM).
     - If Strike price = Market Price we say the Call Option is At the Money (ATM).
     - If Strike price < Market Price we say the Call Option is In the Money (ITM).
   - For Puts (it is the opposite)
     - If Strike price > Market Price we say the Call Option is In the Money (ITM).
     - If Strike price = Market Price we say the Call Option is At the Money (ATM).
     - If Strike price < Market Price we say the Call Option is Out of the Money (OTM).
5. By Certain Date
   - This finacial contract always comes with a date of expiration. This date signifies the last date at which you can Buy/Sell the Underlying. After this date the option stops trading and loses all of its value. This is very different from trading stocks as stocks do not become valueless unless the company becomes valueless.
6. You can either:
   - Buy the Call (Right)
   - Sell the Call (Obligation)
   - Buy the Put (Right)
   - Sell the Put (Obligation)
7. Options are displayed as:

   [The Underlying (ticker), The Strike Price, The Expiration Date, And whether the option is a Call or Put]