Serial Option: a futures option for which there is no corresponding futures contract expiring in the same month. The underlying futures contract is the next futures contract out in time. Example: There is no March gold futures contract, but there is an April gold futures contract, so March gold options, which are serial options, are options on April gold futures.

Series: all option contracts on the same underlying stock having the same striking price, expiration date, and unit of trading.

Skew: *See* Volatility Skew.

Specialist: an exchange member whose function it is both to make markets—buy and sell for his own account in the absence of public orders—and to keep the book of public orders. Most stock exchanges and some option exchanges utilize the specialist system of trading.

Spread Order: an order to simultaneously transact two or more option trades. Typically, one option would be bought while another would simultaneously be sold. Spread orders may be limit orders, not held orders, or orders with discretion. They cannot be stop orders, however. The spread order may be either a debit or a credit.

Spread Strategy: any option position having both long options and short options of the same type on the same underlying security.

Standard Deviation: a measure of the volatility of a stock. It is a statistical quantity measuring the magnitude of the daily price changes of that stock. *See also* Volatility.

Stop Order: an order, placed away from the current market, that becomes a market order if the security trades at the price specified on the stop order. Buy stop orders are placed above the market, while sell stop orders are placed below.

Stop-Limit Order: similar to a stop order, the stop-limit order becomes a limit order, rather than a market order, when the security trades at the price specified on the stop. *See also* Stop Order.

Straddle: the purchase or sale of an equal number of puts and calls having the same terms.

Strangle: a combination involving a put and a call at different strikes with the same expiration date.

Strategy: with respect to option investments, a preconceived, logical plan of position selection and follow-up action.

Striking Price: *see* Exercise Price.

Striking Price Interval: the distance between striking prices on a particular underlying security. For stocks, the interval is normally 2.5 points for lower-priced stocks and 5 points for higher-priced stocks. For indices, the interval is either 5 or 10 points. For futures, the interval is often as low as one or two points.

Structured Product: a combination of securities and possibly options into a single security that behaves like stock and trades on a listed stock exchange. Structured products are created by many of the largest financial institutions (banks and brokerage firms). Many of the more popular ones are known by their acronyms, created by the institutions that issued them: MITTS, TARGETS, BRIDGES, LINKS, DINKS, ELKS, and PERCS. *See also* PERCS.

Subindex: *see* Narrow-Based.

Suitable: describing a strategy or trading philosophy in which the investor is operating in accordance with his financial means and investment objectives.

Support: a term in technical analysis indicating a price area lower than the current price of the stock, where demand is thought to exist. Thus, a stock would stop declining when it reached a support area. *See also* Resistance.

Synthetic Put: a strategy constructed by shorting the underlying instrument and buying a call. The resulting position has the same profit and loss characteristics as a long put option.

Synthetic Stock: an option strategy that is equivalent to the underlying stock. A long call and a short put is synthetic long stock. A long put and a short call is synthetic short stock.

Technical Analysis: the method of predicting future stock price movements based on observation of historical stock price movements.

Term Structure: a term used to describe the relationship of option implied volatilities, or of the prices of volatility futures, over a number of months. In a bullish market the term structure generally consists of a rising sequence of prices (contango); while in a bearish market, the term structure is usually a declining sequence of prices (backwardation).

Terms: the collective name denoting the expiration date, striking price, and underlying stock of an option contract.

Theoretical Value: the price of an option, or a spread, as computed by a mathematical model.

Theta: the measure of how much an option's price decays for each day of time that passes.

Time Spread: *see* Calendar Spread.

Time Value Premium: the amount by which an option's total premium exceeds its intrinsic value.

Total Return Concept: a covered call writing strategy in which one views the potential profit of the strategy as the sum of capital gains, dividends, and option premium income, rather than viewing each one of the three separately.

Tracking Error: the amount of difference between the performance of a specific portfolio of stocks and a broad-based index with which they are being compared. *See* Market Basket.

Trader: a speculative investor or professional who makes frequent purchases and sales.

Trading Limit: the exchange-imposed maximum daily price change that a futures contract or futures option contract can undergo.

Treasury Bill/Option Strategy: a method of investment in which one places approximately 90% of his funds in risk-free, interest-bearing assets such as Treasury bills, and buys options with the remainder of his assets.

Type: the designation to distinguish between a put or call option.

Uncovered Option: a written option is considered to be uncovered if the investor does not have a corresponding position in the underlying security. *See also* Covered.

Underlying Security: the security that one has the right to buy or sell via the terms of a listed option contract.

Undervalued: describing a security that is trading at a lower price than it logically should. Usually determined by the use of a mathematical model. *See also* Fair Value, Overvalued.

Variable Ratio Write: an option strategy in which the investor owns 100 shares of the underlying security and writes two call options against it, each option having a different striking price.

Variance: a statistical term, which is essentially "standard deviation squared," or "volatility squared." Listed Variance Futures exist on the CBOE, although they have not been a successful product.

Vega: the measure of how much an option's price changes for an incremental change—usually one percentage point—in volatility.

Vertical Spread: any option spread strategy in which the options have different striking prices but the same expiration dates.

Volatility: a measure of the amount by which an underlying security is expected to fluctuate in a given period of time. Generally measured by the annual standard deviation of the daily price changes in the security, volatility is not equal to the beta of the stock. Also called historical volatility, statistical volatility, or actual volatility. *See also* Implied Volatility.

Volatility Index (VIX): an index designed to track the volatility (usually, *implied* volatility) of the options on a widely traded index, stock, or futures contract. VIX is the CBOE's Volatility Index. It is a formulaic method of calculating an estimate of 30-day implied volatility. The VIX formula was updated in 2003 to be based on two strips of prices of S&P 500 (SPX) options in the two nearest months. The "old" VIX, which is a simpler formula involving 4 series of OEX options, was replaced in 2003 and can be quoted under the symbol VXO.

Volatility Skew: the term used to describe a phenomenon in which individual options on a single underlying instrument have different implied volatilities. In general, not only are the individual options' implied volatilities different, but they form a pattern. If the lower striking prices have the lowest implied volatilities, and then implied volatility progresses higher as one moves up through the striking prices, that is called a forward or positive skew. A reverse or negative skew works in the opposite way: The higher strikes have the lowest implied volatilities.

Warrant: a long-term, nonstandardized security that is much like an option. Warrants on stocks allow one to buy (usually one share of) the common at a certain price until a certain date. Index warrants are generally warrants on the price of foreign indices. Warrants have also been listed on other things such as cross-currency spreads and the future price of a barrel of oil.

Weekly Option: a listed option that expires one week after it is listed. There are a limited number of these available—usually on the most liquid stocks and indices. They are generally listed on a Thursday to expire on the following Friday, eight calendar days later. There is no guarantee that a stock which has weekly options listed one week will have them the next, although the most active indices and stocks generally have them each and every week.

Write: to sell an option. The investor who sells is called the writer.

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Lawrence G. McMillan is the author of *Options as a Strategic Investment*, the bestselling work on stock and index options strategies. He currently authors a unique daily advisory service—*Daily Volume Alerts*—and also edits and publishes *The Option Strategist* (now in its twentieth year of publication) and *The Daily Strategist*, derivative products newsletters covering equity, index, and futures options. In these capacities, he is the president of McMillan Analysis Corporation, which he founded in 1991. He has spoken on option strategies at many seminars and colloquiums in the United States, Canada, and Europe. In addition, he trades his own account actively, and he manages option-oriented accounts for certain individuals.

McMillan is the recipient of the Sullivan Award for 2011, awarded by the Options Industry Council in recognition of his contributions to the options industry.

Prior to founding his own firm, McMillan was a proprietary trader at two major brokerage firms—Thomson McKinnon Securities and Prudential-Bache.

He initially worked for Bell Telephone Laboratories in Whippany, New Jersey, from 1972 to 1976. McMillan holds a BS in mathematics from Purdue University (1968) and an MS in applied mathematics and computer science from the University of Colorado (1972).

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