The Options

CHEAT SHEET

BY INVESTOR'S BUSINESS DAILY

What is an Option?

A stock **OPTION** is a contract that gives you the right—but not the obligation—to buy or sell shares of an underlying stock before a certain date, called an EXPIRATION DATE (or EXPIRY).

The Benefits of an Option

Lower Upfront Cost
Get exposure to lots of shares of a stock with a much smaller initial investment

Insurance
If you have an existing stock position, options can provide insurance if the trade moves against you

New Income Streams
Create a steady income stream based on assets you already own

Profit in Any Market
You can use options to profit when the market is moving up, down or sideways

The Two Basic Options

CALL

Pick **UP** and call

Call options are for when you're expecting a stock's value to go UP.

A call is the **right to buy** a stock at a predetermined price (the strike price) on or before the expiration date.

Useful for:

* Profiting from a stock's gain without paying full price for the stock
* Limiting your downside risk to the premium paid for the option

PUT

Put **DOWN** the phone

Put options are for when you're expecting a stock's value to go DOWN.

A put is the **right to sell** a stock at a predetermined price (the strike price) on or before the expiration date.

Useful for:

* Profiting when a stock loses value
* Hedging against losses in an existing position

Example Options Trade: THE BASIC CALL

Conditions:

* You're bullish on stock XYZ
* XYZ is currently trading at 50, but you think it'll go to 60 by December
* You want a small cash outlay versus buying the stock
* You want leveraged profits with limited downside risk

Maximum Risk: Premium Paid
Upside: Unlimited
Breakeven Price = Long Call Strike Price + Premium Paid

Example Options Trade: THE BASIC PUT

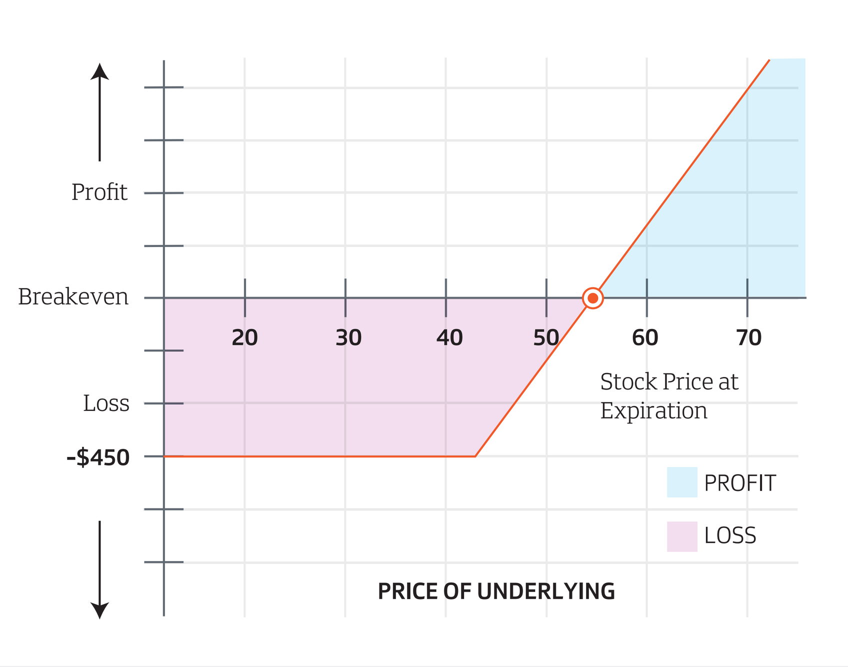
Conditions:

* You're bearish on stock ZYX
* ZYX is currently trading at 40, but you think it'll go to 30 by December
* You want to short the stock, but would prefer a lower risk if the trade goes against you

Maximum Risk: Premium Paid
Upside: Unlimited
Breakeven Price = Long Put Stock Price - Premium Paid

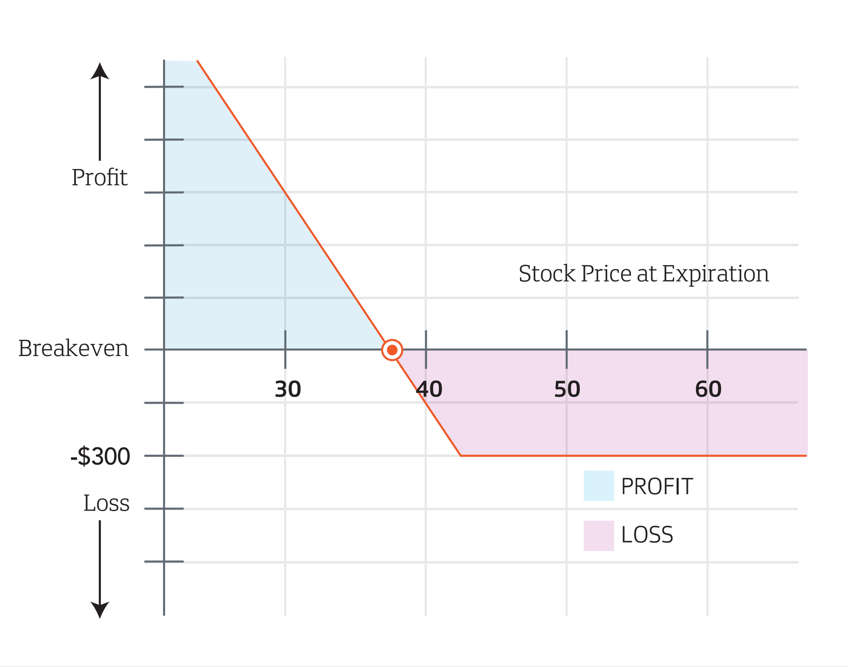
XYZ

December 50 Call Option
Premium: $4.50
1 Contract (the right to buy 100 shares of XYZ at $50/each) = **$450 Total Investment**



ZYX

December 40 Put Option
Premium: $3.00
1 Contract (the right to sell 100 shares of ZYX at $40/each) = **$300 Total Investment**



The Greeks

"The Greeks" are five common ways to measure the factors that affect the price of an options contract. They can be used as a quick way to gauge how factors like stock price, volatility, and the passing of time will affect the value of an option.

Δ DELTA
SENSITIVITY TO STOCK PRICE
Measure the options price change for every $1 increase in the underlying stock price.

Γ GAMMA
SENSITIVITY TO DELTA
Measures rate of change in Delta for every $1 increase in the underlying stock price.

V VEGA
SENSITIVITY TO STOCK VOLATILITY
Measures the options price change for every 1% increase in volatility.

Θ THETA
SENSITIVITY TO TIME DECAY
Measures the decrease in options price for every day that passes, assuming steady price and volatility.

P RHO
SENSITIVITY TO INTEREST RATES
Measures the change in options price for every 1% increase in interest rates.

FACTS ABOUT OPTIONS

Trading an option requires two parties, a BUYER and a SELLER (or WRITER). **The Buyer holds the option** to exercise the contract and can do so before the expiration date, while The Seller holds the obligation to fulfill the contract if it is exercised.

Options are a **derivative**, which means you're not trading the asset itself, but simply a contract based on the asset. Since you do not have to buy the underlying asset, options have a lower upfront cost than stocks.

The per-share price of an options contract is called the **premium**.

1 OPTIONS CONTRACT GRANTS THE RIGHT TO BUY OR SELL 100 SHARES OF A STOCK.

Expiration dates are listed in the form of month and year (e.g. March 2020), and usually expire on the **third Friday of that month**.