OPTIONS TRADING FOR NEWBIES

HOW TO WIN MORE TRADING OPTIONS

ERIC LEVITT

Welcome To Options Trading For Newbies

Hi, I'm Eric Levitt, the founder of TheOptionsNerd.com.

I was right where you are today and I know firsthand that for newbies, options can be both scary and frustrating.

After 15 years of witnessing thousands of investors take control over their financial future, I feel confident saying that when used correctly, options can be the most profitable tool you have to make money in today's fast moving stock market!

The statement might be bold, but after you consider the lessons I teach in this guide, you will get it!

Most of the negativity surrounding options trading are based on myths from back when there was little regulation. That has changed over the past 25 years.

Absolutely anyone can learn the basics of options and start making money pretty quickly!

All you need is to develop a foundation, learn a few simple strategies and you will be off to the races.

Of the thousands of investors I've helped over the years, most of them started with no experience. My mission has been to help them develop the tools they need to go out, and take control over their financial future.

The goal of my guide is to teach anyone, regardless of their skill level, how to use options safely and effectively.

Hopefully, after reading this guide you will understand how to increase your income using this great tool.

Options have a financially transformative power unlike anything else I come across.

This guide has a lot of unique ideas, as well as some ideas I pulled from the fantastic resources I personally rely upon day in, and day out.

Enjoy this guide. Share it and remember - I have your back.

Eric Levitt, TheOptionsNerd.com

How To Find The Perfect Options Strategy
The 3-Step Options Strategy Process

Most stocks traders are guilty of doing one of the following:

A) Buying a stock, praying that it goes up

or

B) Dumping every options strategy they know onto the table, hoping that one of them works out.

Does this describe anyone you know?

We all started out gravitating towards the tools we understood and the ones we felt most comfortable using.

Up until now, you have probably been trading the underlying shares of stock.

You bought stock when you assumed it was a great value and hoped to sell it for more down the road.

“Buying stock is not always the best way to generate profits."

As you make your first tracks into options trading, the universe of options strategies now expands your "toolbox" exponentially.

The 'options' are endless.

You could trade a long call, bear credit spread, bull debit spread, iron condor, straddle, butterfly, calendar spread, and on and on.

Up until now you dumped them all out on the table and worked with the strategy you picked that day, rather than taking the time to understand which strategy would have been the best for the job at hand.

Great craftsman know which tools help leverage their energy and time best and take the extra couple minutes to find the right tool.

You could chisel a board in half, but it would take days. Why not take the extra few minutes to find a saw get it done quickly and efficiently.

Great options traders are no different. They recognize that not all option strategies work well in all market situations.

They take the extra couple minutes to analyze the setup, eliminate the strategies that clearly won't work, and choose the best options strategy from what remains.

There are always going to be good and bad options strategies for every market setup.

This guide will introduce you to a 3-step process designed to help you quickly and easily find the right options strategies to use.

I have little doubt that when it comes to choosing the best options strategy, you're probably overthinking the problem.

We've all been there.

It is natural to weigh the risk and reward.

The main goal is to become formulaic in your approach to finding and utilizing the right options trade.

You've heard many other discuss their own 3-step process, so by now, it must seem cliche.

It's my mission to simplify the act of finding a workable strategy down to its bare bones.

I taught myself how to shoot par golf in under two seasons by focusing only on what I needed to know.

That has no importance to this, but I tell that to anyone who listens.

(There is only one course left on my bucket list. Any Augusta National members who are reading this, I am available 24/7/365. I'll buy the beers and pay for the caddies!)

Believe me when I say, if we could get through how to trade successfully in just two steps that would make my heart sing.

Here we go.

Step 1. What Direction Do You Think The Stock Is Headed?

Where do you think this stock is headed?

Are you bearish or bullish?

Answering this question is the first step to finding the right options strategy.

It doesn't matter how you arrive at your answer, but to be effective, you should have a rough idea of the direction.

The craziest part of high probability options trading is that it doesn't matter.

Ultimately the market's efficiency balances risk and reward on both sides of a very simple coin flip.

Stock traders, sorry for this, you trade with about a 50% chance of success.

How profitable do you expect to be when the best outcome you can hope for approximately 50%.

The #1 reason why buy and hold stock picking is so hard is that it just random.

If you can accept that as a fact, you can move on to something much more fun and profitable. Options!!!!

If you think I am full of BS, ask a full-time trader their opinion.

The most significant thing about options trading is that you can choose any probability of success - if you know how.

Let's say you want a 50%, 60%, 70% or even a 90% chance of success; you can learn to build strategies that will win at these levels.

Want a high % of winning; you can learn option selling strategies with strike prices far out-of-the-money.

Briefly looking at the options pricing table above for NFLX you'll notice that the probability of NFLX never going higher than $200 thru $215 from where it is currently at $189 is 69.47% and 87.98%, respectively.

So if you sold the $200 strike call options, you'd have roughly a 70% chance of winning. Sell the $215 strike call options, which even though it is a little further away from the current price, you've got roughly a 90% chance of winning on the trade.

Is this too good to be true?

Options trading is like trading equities directionally, but instead of a 50/50 bet, you are working with a massive margin of error.

Even if you are entirely wrong about the direction of the stock, you can still make money.

What other investments allow you to be wrong and still make money?

Well schooled investors say that trading options give you a constant unfair advantage against trading stocks.

Keep in mind that this does not mean you can make the same profit with each probability you choose.

That would be sheer lunacy.

Since the markets are 'fair,' when you have a 90% chance of making money, you are naturally going to accept a smaller profit then choosing a trade with a 70% probability of success.

On the chart above, take a look at the bid/ask price for each of the strike prices.

Notice that the $200 strike call options are worth $470 each and the $215 strike call options are worth $145 each.

It's all fair and efficient, but the key here is that picking the right direction doesn't matter as much with options trading.

Your goal is to be as balanced and neutral as you can with your portfolio.

And keep in mind not every trade needs to be a neutral trade.

If you trade five stocks directionally higher or bullish, try to build five different positions in five different stocks that you play directionally lower or bearish.

Don't make the similar bets over and over again.

Stop thinking like all the other stock traders.

Spread your risk out across different stocks, and directional plays as much as you can.

You'll still win 70% of the time overall, or whatever probability level you target, which is what you're after in the first place.

2. The Mathematical Edge Options Gives To The... Seller's (Find a Stock's IV Rank)

It's happening now, we are in uncharted territory for most of you, but yes, for every options trade, there is a buyer and a seller.

Every successful business on Earth has an edge that gives them a long-term competitive advantage. In options that edge is all about the math, and more specifically something called implied volatility.

Using a casino as a model to showcase how math factors into probability, let's first look at how they make money.

In almost every case, they make money on small, theoretical probability imbalances. They can achieve this through the reduction in payouts or reduced odds of winning.

An option's price the some of its two components.

The first component is the options intrinsic value which is nothing more than value if it were exercised/assigned right now.

For example, if you were long a $40 strike call option, which is a bullish strategy and the stock was trading at $50 a share, you'd have $10 in intrinsic value because you could buy the stock at $40 and resell it immediately at $50 for a $10 profit.

The second component of options pricing is Extrinsic Value or more commonly referred to as Time Value.

Extrinsic value is the difference between of the market price of the option and its intrinsic value.

Extrinsic value is also the portion of the value assigned to the option by outside factors.

Generally speaking, an option contract with 100 days until expiration is more valuable than an option contract with ten days until expiration.

The price of time, therefore, is influenced by various factors in the market, such as the number of remaining days until expiration, current stock price, current strike price, and interest rates, but none of these are as significant as implied volatility.

Implied volatility is the only element or piece of an option's Extrinsic Value that is "unknown" or "estimated" by the market.

Another fancy way of saying "estimated" in finance is to use the word “implied".

If you think about it for a second, you w know the factors that contribute to the time premium of any options contract.

What we will not know is the volatility of the stock in the future.

We will always be able to calculate how many days are remaining until expiration.

We also always know the stock price relative to its strike price or the option's intrinsic value.

And, we can look up the current long-term interest rates.

“The ONLY data point in an option’s price we don't know for certain is how volatile the stock will be in the future.”

We can look back and see the historical volatility of a stock, but to know what will happen in the future would require a time machine?

Will the stock move 20% per year on average?

Will it move more than 20%?

Will it move less than 20%?

We will never know this for certain, but what we can do is estimate it's future volatility.

In simple terms, implied volatility is calculated by taking an option's current price, and shows what the market feels or "implies" about the stock's volatility in the future.

It's based on the pricing from a combination of at-the-money and out-of-the-money calls and puts on both sides. In other words, the market itself determines expected or implied volatility through the activity of the investors like you and me placing trades.

Why Do We Need To Care So Much About Implied Volatility & Options Pricing?

It's important because all else being equal, an option's price will move up and down with the rise and fall of implied volatility.

Ultimately this means an option contract could gain or lose value purely on the market's ever-changing "expectation" of volatility even, if the underlying stock itself doesn't move at all.

There are not many financial products that are priced so aggressively on the future expectation of volatility as with option contracts.

Let's use a simple example on the next page to demonstrate how it works... (thanks to tastytrade)

So if we break this down: implied volatility is directly related to the price of an option.

Options on stocks which possess high implied volatility ultimately have more premium (buyers pay more for the option and option sellers collect more premium when they sell the contract) than options on stocks with low implied volatility.

Therefore, sellers love when implied volatility is high because they get more premium/ credit and buyers enjoy lower implied volatility because they can buy the options for cheap.

This concept is important to grasp, and but it is not as important as ranking IV (implied volatility).

IV rank is a favorite tool for experienced options traders because it tells us whether implied volatility is on the high end or the low end in a specific stock based on the past year of IV data.

If a stock has IV between 30 and 60 over the past year, and IV is currently at 45, it would have a rank of 50%.

This concept is starting to become very mainstream as more traders use it to factor in their entry and exit levels.

Here is a good example to illustrate this concept.

If you were to go out and buy/sell an option in an index like the SPY (the S&P 500 index), it would typically have a lower implied volatility than a stock like NFLX.

Why is that exactly?

Sharp increases or decreases in the stocks that make up that portfolio will not impact the over price because other stocks will even it all out. Lower price swings mean lower implied volatility, which ultimately means lower IV rank.

So does this mean that sellers will always get a raw deal since IV never really gets that high?

This is where IV ranks come in!

Because an underlying stock may not reach a high level of IV, it does not mean that the option will always be cheap. Remember, pricing is relative. And what is more important is the level of IV relative to its historical levels.

Over the past 90 days, SPY has had an implied volatility level around 12 to 13%. The highest level was around 16% in the last 90 days. Typically 16% isn't considered high

for most underlying (so one would expect option prices to be cheap), but relative to where it has been, 16% is high, and the options prices will reflect that.

HOW IS IV RANK CALCULATED?

The formula for IV rank is simple. It is:

100 x (the current IV level - the 52 week IV low) / (the 52 week IV high - 52 week IV low) = IV Rank

No matter what broker you use, make sure you can find the IV Rank before you make the trade.

3. Finding The Best Option Strategy

This final step in the strategy process is simply to target the best options strategy that combines which direction you think the stock is headed in Step #1 and the implied volatility rank you found in Step #2.

In Step #3 you will start choosing the best options strategy for whatever market setup you're looking at.

To get the job done, you will have a series of options strategies after applying the direction and the IV rank.

There may be many choices, but there always be one strategy that will work just a little bit better than the others.

Just so we're clear on how to work through the steps…

Step Three of Three Options Strategy Example (INTC)

Suppose you're neutral on the future direction of INTC stock.

You don't care where it goes (up, down, left, right, etc.) nor do you have an opinion.

Well, you've now completed Step #1 and made a directional assumption. Check!

In this case, we have to be options sellers because IV rank is higher than 50, it's at 62.15.

You've now completed Step #2 and determined IV ranking. Check!

With only three options strategies to choose from, your decision just got a whole lot easier.

The three most effective strategies to use when you are neutral on the direction of a particular stock and IV rank is high is to trade a Short Straddle, Short Strangle, or an Iron Butterfly.

Each of these three strategies uses net options selling and takes full advantage of a drop in IV as well a sideways move in the stock price.

The point here is that they all will accomplish roughly the same goal.

So which options strategy should you ultimately use?

Back to our INTC example.

When you read up on the details of Short Straddles and Iron Butterflies you'll learn they are more aggressive strategies with more defined risk.

However, the Iron Butterfly is an option selling strategy whereby you have defined risk similar to an Iron Condor.

At this point, you shouldn't be comfortable selling naked options, and if you are trading in a retirement account, you will be restricted from doing so.

The most conservative strategy you have in your toolbox will be for this trade is an Iron Butterfly.

And now you have completed the third step and have the perfect options strategy.

Doesn't it feel great to have it all so clear?

I hope by now you understand the difference between trading stocks and options, and more than anything else, how much different they really are.

And once you go through the steps on a few trades of your own, you will see how incredibly effective and profitable options can be.

5 Invaluable Tips For Picking An Options Broker

Even though options trading can be complicated, picking the right broker doesn't need to be.

In most instances, after you've chosen your broker, there is a period where you will get acclimated to each one's toolset.

This advice is being offered to my readers who either haven't picked their broker, are unhappy with their broker, or generally want to know what is out there.

Here are my 5 tips for picking your options broker.

1. First and more importantly, look at their educational material

Whether you are brand new to options, somewhere in the middle, or way advanced, there will always be something new to learn. Education comes in many different forms, but here is what you should be on the lookout for:

- Online trading courses
- Both live and recorded webinars
- Additional guidance, and potentially one-to-one education services

If you are new to options, you should leave the training wheels on just a little longer than stocks. That being said, some brokers even offer simulated trading environments.

If you are a paper trader, look for those.

2. Customer service needs to be a key part of your decision

You know the old saying companies spend 5 times more to get a new customer than to keep an existing one. Well if you have ever had the privilege of dealing with your cable provider or your cell phone company, you get what I am saying.

Companies who have a customer first approach are out there and you need to find them.

In today's society, what type of customer support are you looking for?

Personally, I prefer live chat, but you might be a phone person. Look around and find what you are looking for because when you need customer service, you will be happy you did your due diligence.

3. How simple is the trading platform to use?

Time and time again I hear from traders about how much they love and/or hate their platform. You can tell the difference between who designed a platform by software engineers and who used beta groups to refine their User Interface.

If you plan on trading, make sure you can fire up your account and simply enter and exit the trades, quickly and without making mistakes.

Latency is a huge deal, don't let your trading platform play any part in missing entry prices.

4. Know the depth and the costs of your tools and data

Understand your data and research fees are a huge deal because they are the lifeblood of a traders world.

Does your broker offer updated quotes, basic charting and the ability to analyze a trade's risk and reward scenario?

Do they offer extensive screening tools?

As you enter into more advanced strategies you will need better analytical tools, customizable screeners, and real-time market data.

Check with the brokers to see if they are all included.

5 . Know your costs, but don't let the cost being your only deciding factor

Trading options is a lot different than trading stocks for many reasons, but the fee structures are totally different.

There are two components of trading commissions when you move into options.

There is the base rate which is similar to stocks, but then there is usually a per contract fee as well.

The base rate ranges between 3.99 and 9.99 whereas the per contract fees are much lower, around .15 to $1.25.

If you are new to options trading, pick a broker that either charge a flat fee for options trading or one who offers a per contract, but not both.

When you do decide on your broker, do not use commissions as the only determination because in most cases, rock-bottom prices usually come with little else. This gets into value vs cost.

I hope this helps you choose the right broker for your situation.

The 5 Laws of Options Trading Everyone Should Obey

Most new investors think the options market is a place to take small accounts and virtually overnight turn them into fortunes. This is one of the hardest things to retrain, because the truth is further from that reality.

In fact, more than 90% of options traders, unsophisticated ones, lose money. This is something that has been talked about forever but never really substantiated.

There at five trading rules that have become part of the fabric of great traders.

Now the difference between a good trader and a bad trader is as simple as this: bad traders think of ways to make money and good traders think of ways not to lose money.

Most people think they are long term investors, but in reality they act like terrible short term traders.

Here are some rules (laws) you can use to help navigate the world of options trading.

1. When you double your profits, take your profits off the table.

100% returns are rare, and since they don't happen with any type of regularity, do not be greedy.

2. If you do not want to take your profits, sell at least half of your position.

This is something I do when playing games at casinos and it is an almost foolproof way to walk away from the table a winner. When I play at blackjack for example,every time the deal pays out on a 21 or I win a big hand, I take half the bet and put it in my pocket. What's left on the table is house money. Keep putting it in your pocket and the profits will pile up.

3. If you are the buyer, time is your enemy. If you are seller, it's your friend.

Options are a depreciating asset. The closer you get to expiration, the more the price of the asset will go down. So as the the buyer, it is really helpful to keep this in mind. Some investors sit on positions even when they are loser, hoping that it comes back. Don't do that. Sell out of a loser and you will be much happier in the long run.

4. Do not get emotional about your positions.

This is one of the hardest things for a trader to do. It is so easy to fall in love with a position that more than anything else, this is the hardest rule to follow. If you are sitting on a winner and tell yourself it will get better, don't listen. Sell it, take the profits and be happy. Bears make money, bulls make money and pigs get slaughtered. Or better, don't snatch defeat from the jaws of victory.

5. Roll over little doggy.

If you must stay in the market, think about selling one position and buying another at either a higher/lower strike or a further out expiration. At least in this scenario you will take some money off of the table. You do not want to sweat a position hoping for the right conclusion. Be in control, because that's precisely why options are a great investment tool.

The key to this post is that you need to discipline. If you lack that discipline you will not bank profits. And since banking those profits is the key objective to trading, gain discipline. Makes sense doesn't it!

Why Options Should Be A Major Part of Your Lifelong Investing Strategy

Many investors who have joined me over the years have either been new to options or moderately experienced.

Once you have gained a level of experience and confidence trading stocks, it is usually time to expand your knowledge into different areas, especially options.

Why options?

There are too many reasons to list here but in my experience, there is nothing better for investors of all levels than learning how to trade options.

If you are a hands-off investor, options are not for you.

But if you are the kind of guy who likes to get his hands in the dirt, keep reading and I will try and do my best to explain how options could be a major cornerstone of your lifelong investing strategy.

Historically stocks have volatility, albeit we are seeing historic lows at the time I am writing this.

Options can be used in conservative strategies to accomplish two beneficial things for your portfolio:

Reduce the overall fluctuations in the value of your portfolio

Help you generate more income every year by employing a few strategies that will help you juice gains from existing holdings.

How options can affect your overall holdings is a matter for each different type of investor. If you are the type of investor who wants the maximum amount of return every single year, there is a good chance options are not for you.

Using options by themselves will not transform you into an investing wizard overnight, and by no means should you show up for your next round of golf claiming so.

Options at their simplest are tools and tools are there to help you complete your task.

If you find you consistently underperform the market, then options can help you juice your returns and get them more in line.

However, if you are looking for miraculous trading results, you are also barking up the wrong tree. If I had a dollar for every time I heard of an investor making millions overnight using options, I'd have about 10 dollars.

Options are not going to turn into the next bitcoin.

Investors who become successful with options are doing so in their search for reliable income, and usually off existing holdings.

There are a large variety of strategies, but for new investors, your best bet is to start small, usually with a strategy like a covered call.

An Easy Way To Make Your First Options Trade

When I talk to traders, I tend to ask them if they understand options.

About 75% of the time, I find, regardless of their experience with stocks, most traders do not trade options.

The psychology of that answer in most cases comes down to intimidation.

Options can be very intimidating, but when they are understood properly, they unlock an entire world of income generation.

Options act like cheat codes in video games.

Sure, you can play the newest game, but it is soooo much better with those codes.

There are many different strategies for options investors, and not every strategy is suitable for every trader.

Here is a step-by-step on how to accomplish two specific goals.

- Set up a covered call options trade
- Sell a small stock position at a great price.
- Do you have an existing stock portfolio?

I expect if you are reading this, you have already mastered the art of buying and selling stocks and have some positions you've held for a long time. Unless you are strictly

looking for dividends, you probably expected the stock price to rise so you could sell it for a profit.

Many investors who get started trading options fall into a simple trap, buying long calls.

Long calls are great for speculative plays, but end up being a major disappointment since time is working against the buyer.

The best way for most stock traders to get started trading options happens to be selling covered calls. The reason is that it is in line with what you are hoping will happen: price appreciation with an added bit of premium. It's the cherry on top of a delicious sundae. And since selling 'covered calls' are fairly easy to be set up by most trading companies, you can get started right away.

Let's review how to set up a covered call:

Identify the position you would like to use.

Find a stock position where you have at least 300-400 shares, the more the better. It would be best to find a stock that is already trading for more than you paid and also does not pay dividends. Large dividend payers add an additional element that I won't be covering here. We are going to start off selling 1 covered call contract.

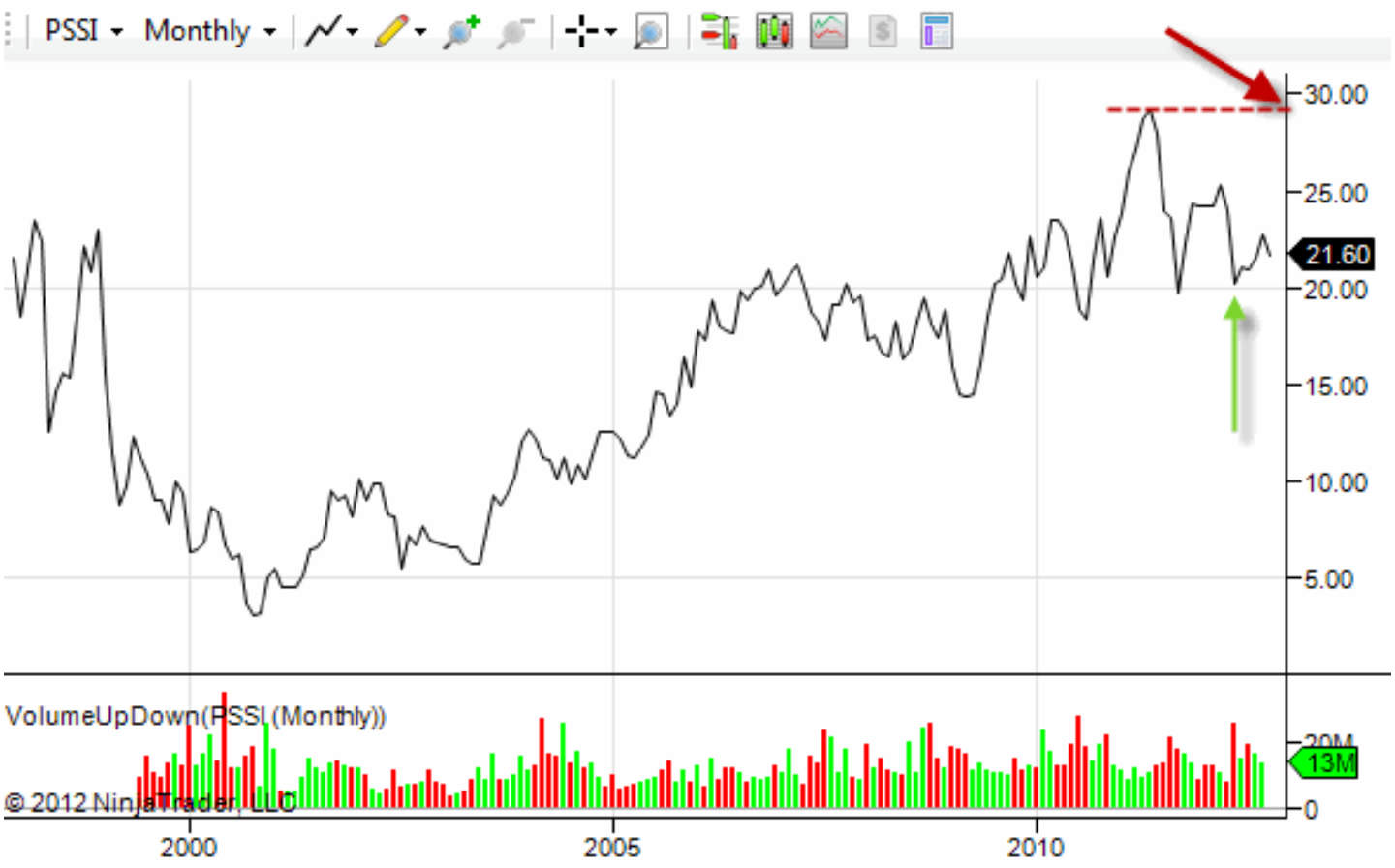
Determine the price you would sell your shares for

After you have found the position you would like to sell 100 shares of within the next 30 to 60 days, it's time to go to the chart.

We are going to use an old chart that perfectly illustrates my point.

As you can see on the chart below:

The current price of the stock is 21.60
The stock has traded within a 10 point margin over the past 12 months.
The highest price it reached over this time was just under $30.



You could always attempt to see 100 shares of this stock by entering what is called a GTC sell order for a limit price of about $29.00 and wait. If PSSI reaches that target again over the next 60 days, the shares will be sold. If it doesn't reach that number the sell order will be canceled. You might meet your goal of selling some of your stock at a profit, it does not accomplish your goal of completing an options trade.

Consider Selling a Covered Call

Another way to potentially accomplish your goal of making an options trade and also generating a larger profit from your holding would be to sell one covered call.

Simply put, a covered call is a strategy investors can use to generate income from their existing stock holdings. You sell one contract worth 100 shares of stock. That is why for your first covered call, you should have at least 300 shares.

In exchange for selling the call option, you receive option premium.

That premium you just collected comes with an obligation because you are now the seller of an option contract.

If that call option is exercised by the buyer, you may be obligated to deliver your shares of the underlying stock. Since you own the stock, you are covered, hence the name covered call.

The reason for writing calls is you hope to keep the shares while generating extra income off of the premium. You will want to stock price to remain under the strike price you sold the call contract for and if that happens you keep the premium and the stock.

Smart option traders will also take money off of the table in the middle of a trade, meaning if the stock you hold gets hit hard, and sells off, the value of that call will drop. Many times, even in my own trading, I would rather close out the position without keeping the entire premium.

Stocks generally trade between their support and resistance, and if you are a patient investor, which I know you are, you will do very well with covered calls.

GLOSSARY

The following Glossary will give you all of the terms used to trade options. You don't need to memorize them, but you can always glance at them to solve a definition problem.

ALL OR NONE (AON) ORDER - A type of order that spe cifies that the order can only be activated if the full order will be filled. A term used more in securities markets than futures markets.

AMERICAN STYLE OPTION - A call or put option contract that can be exercised at any time before the expiration of the contract.

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ASK, ASKED PRICE - This is the price that the trader making the price is willing to sell an option or security.

ASSIGNMENT - Notification by The Options Clearing Corporation (OCC) to a clearing member and the writer of an option that an owner of the option has exercised the option and that the terms of settlement must be met. Assignments are made on a random basis by the OCC. The writer of a call option is obligated to sell the underlying asset at the strike price of the call option; the writer of a put option is obligated to buy the underlying at the strike price of the put option.

AT PRICE - When you enter a prospective trade into a trade parameter in the Matrix, the "At Price" (At.Pr) is automatically computed and displayed. It is the price at which the program expects you can actually execute the trade, taking into account "slippage" and the current Bid/Ask, if available.

AT-THE-MONEY (ATM) - An at-the-money option is one whose strike price is equal to (or, in practice, very close to) the current price of the underlying.

BACK MONTH - A back month contract is any exchange-traded derivatives contract for a future period beyond the front month contract. Also called FAR MONTH.

BEAR, BEARISH - A bear is someone with a pessimistic view on a market or particular asset, e.g. believes that the price will fall. Such views are often described as bearish.

BEAR CALL SPREAD - This is a net credit transaction established by selling a call and buying another call at a higher strike price, on the same underlying, in the same expiration. It is a directional trade where the maximum loss = the difference between the strike prices less the credit received, and the maximum profit = the credit received. Requires margin.

BEAR PUT SPREAD - A net debit transaction established by selling a put and buying another put at a higher strike price, on the same underlying, in the same expiration. It is a directional trade where the maximum loss = the debit paid, and the maximum profit = the difference between the strike prices less the debit. No margin is required.

BELL CURVE - See NORMAL DISTRIBUTION.

BETA - A prediction of what percentage a position will move in relation to an index. If a position has a BETA of 1, then the position will tend to move in line with the index. If the beta is 0.5 this suggests that a 1% move in the index will cause the position price to move by 0.5%. Beta should not be confused with volatility.
Note: Beta can be misleading. It is based on past performance, which is not necessarily a guide to the future.

BID - This is the price that the trader making the price is willing to buy an option or security for.

BID-ASK SPREAD - The difference between the Bid and Ask prices of a security. The wider (i.e. larger) the spread is, the less liquid the market and the greater the slippage.

BINOMIAL PRICING MODEL - Methodology employed in some option pricing models which assumes that the price of the underlying can either rise or fall by a certain amount at each pre-determined interval until expiration. For more information, see COX-ROSS-RUBINSTEIN.

BLACK-SCHOLES PRICING MODEL - A formula used to compute the value of European-style call and put options invented by Fischer Black and Myron Scholes.

BROKER - The middleman who passes orders from investors to the floordealers, screen traders, or market makers for execution.

BULL, BULLISH - A bull is someone with an optimistic view on a market or particular asset, e.g. believes that the price will rise. Such views are often described as bullish.

BULL CALL SPREAD - This is a net debit transaction established by buying a call and selling another call at a higher strike price, on the same underlying, in the same expiration. It is a directional trade where the maximum loss = the debit paid, and the maximum profit = the difference between the strike prices, less the debit. No margin is required.

BULL PUT SPREAD - This is a net credit transaction established by buying a put and selling another put at a higher strike price, on the same underlying, in the same expiration. It is a directional trade where the maximum loss = the difference between the strike prices, less the credit, and the maximum profit = the credit received. Requires margin.

BUTTERFLY SPREAD - A strategy involving four contracts of the same type at three different strike prices. A long (short) butterfly involves buying (selling) the lowest strike price, selling (buying) double the quantity at the central strike price, and buying (selling) the highest strike price. All options are on the same underlying, in the same expiration.

BUY WRITE - See COVERED CALL.

CALENDAR SPREAD - The simultaneous purchase and sale of options of the same type, but with different expiration dates. This would include: horizontal debit spreads, horizontal credit spreads, diagonal debit spreads, and diagonal credit spreads.

CALL - This option contract conveys the right to buy a standard quantity of a specified asset at a fixed price per unit (the strike price) for a limited length of time (until expiration).

CALL RATIO BACKSPREAD - A long backspread using calls only.

CANCELED ORDER - A buy or sell order that is canceled before it has been executed. In most cases, a limit order can be canceled at any time as long as it has not been executed. (A market order may be canceled if the order is placed after market hours and is then canceled before the market opens the following day). A request for cancel can be made at anytime before execution.

CLOSING TRANSACTION - To sell a previously purchased position or to buy back a previously purchased position, effectively canceling out the position.

COLLAR - A collar is a trade that establishes both a maximum profit (the ceiling) and minimum loss (the floor) when holding the underlying asset. The premium received from the sale of the ceiling reduces that due from the purchase of the floor. Strike prices are often chosen at the level at which the premiums net out. An example would be: owning 100 shares of a stock, while simultaneously selling a call, and buying a put.

COLLATERAL - This is the legally required amount of cash or securities deposited with a brokerage to ensure that an investor can meet all potential obligations. Collateral (or margin) is required on investments with open-ended loss potential such as writing naked options.

COMMISSION - This is the charge paid to a broker for transacting the purchase or the sale of stock, options, or any other security.

COMMODITY - A raw material or primary product used in manufacturing or industrial processing or consumed in its natural form.

CONDOR - A strategy similar to the butterfly involving 4 contracts of the same type at four different strike prices. A long (short) condor involves buying (selling) the lowest

strike price, selling (buying) 2 different central strike prices, and buying (selling) the highest strike price. All contracts are on the same underlying, in the same expiration.

CONTRACT SIZE - The number of units of an underlying specified in acontract. In stock options the standard contract size is 100 shares of stock. In futures options the contract size is one futures contract. In index options the contract size is an amount of cash equal to parity times the multiplier. In the case of currency options it varies.

COST OF CARRY - This is the interest cost of holding an asset for a period of time. It is either the cost of funds to finance the purchase (real cost), or the loss of income because funds are diverted from one investment to another (opportunity cost).

COVERED - A covered option strategy is an investment in which all short options are completely offset with a position in the underlying or a long option in the same asset. The loss potential with such a strategy is therefore limited.

COVERED CALL - Both long the underlying and short a call. The sale of a call by investors who own the underlying is a common strategy and is used to enhance their return on investment. In the TradeFinder this strategy is short option (covered) using calls only.

COVERED COMBO - A strategy in which you are long the underlying, short a call, and short a put. Often used by those wishing to own the underlying at a price less than today's price.

COX-ROSS-RUBINSTEIN - A binomial option-pricing model invented by John Cox, Stephen Ross, and Mark Rubinstein.

CREDIT - The amount you receive for placing a trade. A net inflow of cash into your account as the result of a trade.

CYCLE - See EXPIRATION CYCLE.

DAY ORDER - An order to purchase or sell a security, usually at a specified price, that is good for just the trading session on which it is given. It is automatically canceled on the close of the session if it is not executed.

DEBIT - The amount you pay for placing a trade. A net outflow of cash from your account as the result of a trade.

DELTA - Measures the rate of change in an option's theoretical value for a one-unit change in the underlying. Calls have positive Deltas and puts have negative Deltas.

Delta for non-futures based options is the dollar amount of gain/loss you should experience if the underlying goes up one point. For futures-based options, Delta represents an equivalent number of futures contracts times 100.

DELTA NEUTRAL - A strategy in which the Delta-adjusted values of the options (plus any position in the underlying) offset one another.

DIAGONAL CREDIT SPREAD - A type of calendar spread. It is a debit transaction where options are purchased in a nearer expiration and options of the same type are sold in a farther expiration, on the same underlying. It is diagonal because the options have different strike prices.

DIAGONAL DEBIT SPREAD - Type of calendar spread. It is a credit transaction where options are sold in a nearer expiration and options of the same type are purchased in a farther expiration, on the same underlying. It is diagonal because the options have different strike prices.

DIRECTIONAL TRADE - A trade designed to take advantage of an expected movement in price.

EARLY EXERCISE - A feature of American-style options that allows the owner to exercise an option at any time prior to its expiration date.

EQUITY OPTION - An option on shares of an individual common stock. Also known as a stock option.

EUROPEAN STYLE OPTION - An option that can only be exercised on the expiration date of the contract.

EXCHANGE TRADED - The generic term used to describe futures, options and other derivative instruments that are traded on an organized exchange.

EXERCISE - The act by which the holder of an option takes up his rights to buy or sell the underlying at the strike price. The demand of the owner of a call option that the number of units of the underlying specified in the contract be delivered to him at the specified price. The demand by the owner of a put option contract that the number of units of the underlying asset specified be bought from him at the specified price.

EXERCISE PRICE - The price at which the owner of a call option contract canbuy an underlying asset. The price at which the owner of a put option contract can sell an underlying asset. See STRIKE PRICE.

EXPIRATION, EXPIRATION DATE, EXPIRATION MONTH - This is the date by which an option contract must be exercised or it becomes void and the holder of the option ceases to have any rights under the contract. All stock and index option contracts expire on the Saturday following the third Friday of the month specified.

EXPIRATION CYCLE - Traditionally, there were three cycles of expiration dates used in options trading:

JANUARY CYCLE (1): January / April / July / October **FEBRUARY CYCLE** (2):

February / May / August / November **MARCH CYCLE** (3): March / June / September

/ December

Today, equity options expire on a hybrid cycle which involves a total of four option series: the two nearest-term calendar months and the next two months from the traditional cycle to which it has been assigned.

FAIR VALUE - See THEORETICAL PRICE, THEORETICAL VALUE.

FAR MONTH, FAR TERM - See BACK MONTH.

FILL - When an order has been completely executed, it is described as filled.

FILL OR KILL (FOK) ORDER - This means do it now if the option (or stock) is available in the crowd or from the specialist, otherwise kill the order altogether. Similar to an all-or-none (AON) order, except it is "killed" immediately if it cannot be completely executed as soon as it is announced. Unlike an AON order, the FOK order cannot be used as part of a GTC order.

FOLLOW-UP ACTION - Term used to describe the trades an investor makes

subsequent to implementing a strategy. Through these adjustments, the investor transforms one strategy into a different one in response to price changes in the underlying.

FRONT MONTH - The first month of those listed by an exchange - this isusually the most actively traded contract, but liquidity will move from this to the second month contract as the front month nears expiration. Also known as the NEAR MONTH.

FUTURE, FUTURES CONTRACT - A standardized, exchange-traded agreement specifying a quantity and price of a particular type of commodity (soybeans, gold, oil, etc.) to be purchased or sold at a pre-determined date in the future. On contract date, delivery and physical possession take place unless the contract has been closed out. Futures are also available on various financial products and indexes today.

GAMMA - Gamma expresses how fast Delta changes with a one-point increase in the price of the underlying. Gamma is positive for all options. If an option has a Delta of 45 and a Gamma of 10, then the option's expected Delta will be 55 if the underlying goes up one point. If we consider Delta to be the velocity of an option, then Gamma is the acceleration.

GOOD 'TIL CANCELED (GTC) ORDER - A Good 'Till Canceled order is one that is effective until it is either filled by the broker or canceled by the investor. This order will automatically cancel at the option's expiration.

GREEKS - The Greek letters used to describe various measures of the sensitivity of the value of an option with respect to different factors. They include Delta,Gamma, Theta, Rho, and Vega.

HISTORIC VOLATILITY - A measure of the actual price fluctuations of the underlying over a specific period of time. Also known as "statistical volatility".

HORIZONTAL CREDIT SPREAD - A type of calendar spread. It is a credit transaction where you buy an option in a nearer expiration month and sell an option of the same type in a farther expiration month, with the same strike price, and in the same underlying asset.

HORIZONTAL DEBIT SPREAD - A type of calendar spread. It is a debit transaction where you sell an option in a nearer expiration month and buy an option of the same type in a farther expiration month, with the same strike price,
and in the same underlying asset.

ILLIQUID - An illiquid market is one that cannot be easily traded without even relatively small orders tending to have a disproportionate impact on prices. This is usually due to a low volume of transactions and/or a small number of participants.

IMMEDIATE-OR-CANCEL (IOC) ORDER - An option order that gives the trading floor an opportunity to partially or totally execute an order with any remaining balance immediately canceled.

IMPLIED VOLATILITY (IV) - This is the volatility that the underlying would need to have for the pricing model to produce the same theoretical option price as the actual option price. The term implied volatility comes from the fact that options imply the volatility of their underlying, just by their price. A computer model starts with the actual market price of an option, and measures IV by working the option fair value model backward, solving for volatility (normally an input) as if it were the unknown.

In actuality, the fair value model cannot be worked backward.

INDEX - The compilation of stocks and their prices into a single number, e.g. The S&P 500.

INDEX OPTION - An option that has an index as the underlying. These are usually cash-settled.

IN-THE-MONEY (ITM) - Term used when the strike price of an option is less than the price of the underlying for a call option, or greater than the price of the underlying for a put option. In other words, the option has an intrinsic value greater than zero.

INTRINSIC VALUE - Amount of any favorable difference between the strike price of an option and the current price of the underlying (i.e., the amount by which it is in-the-money). The intrinsic value of an out-of-the-money option is zero.

LAST TRADING DAY - The last business day prior to the option's expiration during which purchases and sales of options can be made. For equity options, this is generally the third Friday of the expiration month.

LEAPS - Long-term Equity Anticipation Securities, also known as long-dated options. Calls and puts with expiration as long as 2-5 years. Only about 10% of

equities have LEAPS. Currently, equity LEAPS have two series at any time, always with January expirations. Some indexes also have LEAPS.

LEG - Term describing one side of a spread position.

LEGGING - Term used to describe a risky method of implementing or closing out a spread strategy one side ("leg") at a time. Instead of utilizing a "spread order" to ensure that both the written and the purchased options are filled simultaneously, an investor gambles a better deal can be obtained on the price of the spread by implementing it as two separate orders.

LEVERAGE - A means of increasing return or worth without increasing investment. Using borrowed funds to increase one's investment return, for example buying stocks on margin. Option contracts are leveraged as they provide the prospect of a high return with little investment. The % Double parameter for each option in the Matrix is a measure of leverage.

LIMIT ORDER - An order placed with a brokerage to buy or sell a predetermined number of contracts (or shares of stock) at a specified price, or better than the specified price. Limit orders also allow an investor to limit the length of time an order can be outstanding before canceled. It can be placed as a day or GTC order. Limit orders typically cost slightly more than market orders but are often better to use, especially with options, because you will always purchase or sell securities at that price or better.

LIQUID - A liquid market is one in which large deals can be easily traded without the price moving substantially. This is usually due to the involvement of many participants and/or a high volume of transactions.

LONG - You are long if you have bought more than you have sold in any particular market, commodity, instrument, or contract. Also known as having a long position, you are purchasing a financial asset with the intention of selling it at some time in the future. An asset is purchased long with the expectation of an increase in its price.

LONG BACKSPREAD - A strategy available in the Trade Finder. It involves selling one option nearer the money and buying two (or more) options of the same type farther out-of-the-money, using the same type, in the same expiration, on the same underlying. Requires margin.

LONG OPTION - Buying an option. See LONG.

LONG STRADDLE - See STRADDLE. **LONG STRANGLE** - See STRANGLE.

LONG SYNTHETIC - See SYNTHETIC.

LONG UNDERLYING - Buying the underlying (i.e. stock). See LONG.

MARGIN - See COLLATERAL.

MARKET MAKER - A trader or institution that plays a leading role in a market by being prepared to quote a two-way price (Bid and Ask) on request - or constantly in the case of some screen-based markets during normal market hours.

MARKET-NOT-HELD ORDER - A type of market order that allows the investor to give discretion regarding the price and/or time at which a trade is executed.

MARKET-ON-CLOSE (MOC) ORDER - A type of order which requires that an order be executed at or near the close of a trading day on the day the order is entered. A MOC order, which can be considered a type of day order, cannot be used as part of a GTC order.

MARKET ORDER - Sometimes referred to as an unrestricted order. It's an order to buy or sell a security immediately at the best available current price. A market order is the only order that guarantees execution. It should be used with caution in placing option trades, because you can end up paying a lot more than you anticipated.

MARKET PRICE - A combination of the Bid, Ask, and Last prices into a single representative price. Bid, Ask, and Last are all available, the default formula for MARKET PRICE is (10*Bid + 10*Ask + Last) / 21.

MARK TO MARKET - The revaluation of a position at its current market price.

MID IMPLIED VOLATILITY (MIV) - Implied volatility computed based on the mid-point between the Bid and Ask prices. See IMPLIED VOLATILITY.

NAKED - An investment in which options sold short are not matched with a long position in either the underlying or another option of the same type that expires at the same time or later than the options sold. The loss potential of naked strategies can be virtually unlimited.

NEAR TERM - See FRONT MONTH.

NORMAL DISTRIBUTION - A statistical distribution where observations are evenly distributed around the mean. Studies have shown that stock prices are very close to being log normally distributed over time. When you choose bell curve as a price target in the program, a lognormal distribution based on price, volatility, and time until valuation date is constructed.

NOT-HELD ORDER - An order that gives a broker discretion as to the price and timing in executing the best possible trade. By placing this order, a customer agrees to not hold the broker responsible if the best deal is not obtained.

OFFER - See ASK.

ONE-CANCELS-THE-OTHER (OCO) ORDER - Type of order which treats two or more option orders as a package, whereby the execution of any one of the orders causes all the orders to be reduced by the same amount. Can be placed as a day or GTC order.

OPENING TRANSACTION - An addition to, or creation of, a trading position.

OPEN INTEREST - The cumulative total of all option contracts of a particular series sold, but not yet repurchased or exercised.

OPEN ORDER - An order that has been placed with the broker, but not yet executed or canceled.

OPTION CHAIN - A list of the options available for a given underlying.

OUT-OF-THE-MONEY (OTM) - An out-of-the-money option is one whose strike price is unfavorable in comparison to the current price of the underlying. This means when the strike price of a call is greater than the price of theunderlying, or the strike price of a put is less than the price of the underlying. An out-of-the- money option has no intrinsic value, only time value.

PREMIUM - This is the price of an option contract.

PUT - This option contract conveys the right to sell a standard quantity of a specified asset at a fixed price per unit (the strike price) for a limited length of time (until expiration).

PUT/CALL RATIO - This ratio is used by many as a leading indicator. It is computed by dividing the 4-day average of total put VOLUME by the 4-day average of total call VOLUME.

PUT RATIO BACKSPREAD - A long backspread using puts only.

REALIZED GAINS AND LOSSES - The profit or losses received or paid when a closing transaction is made and matched together with an opening transaction.

REVERSAL - A short position in the underlying protected by a synthetic long.

RHO - The change in the value of an option with respect to a unit change in the risk-free rate.

RISK-FREE RATE - The term used to describe the prevailing rate of interest for securities issued by the government of the country of the currency concerned. It is used in the pricing models.

ROLLOVER - Moving a position from one expiration date to another further into the future. As the front month approaches expiration, traders wishing to maintain their positions will often move them to the next contract month. This is accomplished by a simultaneous sale of one and purchase of the other.

ROUND TURN - When an option contract is bought and then sold (or sold and then bought). The second trade cancels the first, leaving only a profit or loss. This process is referred to as a round turn. Brokerage charges are usually quoted on this basis.

SHORT - An obligation to purchase an asset at some time in the future. You are short if you have sold more than you have bought in any particular market, commodity, instrument, or contract. Also known as having a short position. An asset is sold short with the expectation of a decline in its price. Can have almost unlimited risk. Uncovered short positions require margin.

SHORT BACKSPREAD - It involves buying one option nearer the money and selling two (or more) options of the same type farther out-of-the-money, with the same expiration, on the same underlying. Requires margin.

SHORT OPTION (COVERED) - See COVERED CALL.

SHORT OPTION (NAKED) - Selling an option you don't own. See SHORT.
SHORT STRADDLE - See STRADDLE. **SHORT STRANGLE** - See STRANGLE.

SHORT SYNTHETIC - See SYNTHETIC.

SHORT UNDERLYING - Selling an asset you don't own. See SHORT.

SLIPPAGE - Thinly traded options have a wider Bid-Ask spread than heavily traded options. Therefore, you have to "give" more in order to execute a trade in thinly traded options; less in heavily traded ones. This "give" is what we refer to as slippage.

SPREAD - A trading strategy involving two or more legs, the incorporation of one or more of which is designed to reduce the risk involved in the others.

SPREAD ORDER - This is an order for the simultaneous purchase and sale of two (or more) options of the same type on the same underlying. If placed with a limit, the two

options must be filled for a specified price difference, or better. It can be critical in this type of order to specify whether it is an opening transaction or a closing transaction.

STANDARD DEVIATION - The square root of the mean of the squares of the deviations of each member of a population (in simple terms, a group of prices) from their mean. In a normal distribution (or bell curve), one standard deviation encompasses 68% of all possible outcomes.

STATISTICAL VOLATILITY (SV) - Measures the magnitude of the asset's recent price swings on a percentage basis. It can be measured using any recent sample period. Regardless of the length of the sample period, SV is always normalized to represent a one-year, single Standard Deviation price move of the underlying.

Note: It is important to remember that what is needed for accurate options pricing is near-term future volatility, which is something that nobody knows for sure.

STOP ORDER - "Stop-Loss" and "Stop-Limit" orders placed on options are activated when there is a trade at that price only on the specific exchange on which the order is located. They are orders to trade when its price falls to a particular point, often used to limit an investor's losses. It's an especially good idea to use a stop order if you will be unable to watch your positions for an extended period.

STRADDLE - A strategy involving the purchase (or sale) of both call and put options with the same strike price, same expiration, and on the same underlying. A short straddle means that both the call and put are sold short, for a credit. A long straddle means that both the call and put are bought long, for a debit.

STRANGLE - A strategy involving the purchase or sale of both call and put options

with different strike prices - normally of equal, but opposite, Deltas. The options share the same expiration and the same underlying. A strangle is usually a position in out-of-the-money options. A short strangle means that both the calls and puts are sold short, for a credit. A long strangle means both the calls and puts are bought long, for a debit.

STRATEGY, STRATEGIES - An option strategy is any one of a variety of option investments. It involves the combination of the underlying and/or options at the same time to create the desired investment portfolio and risk.

STRIKE PRICE - The price at which the holder of an option has the right to buy or sell the underlying. This is a fixed price per unit and is specified in the option contract. Also known as striking price or exercise price.

SYNTHETIC - A strategy that uses options to mimic the underlying asset. The long synthetic combines a long call and a short put to mimic a long position in the underlying. The short synthetic combines a short call and a long put to mimic a short position in the underlying. In both cases, both the call and put have the same strike price, the same expiration, and are on the same underlying.

TECHNICAL ANALYSIS - Method of predicting future price movements based on historical market data such as (among others) the prices themselves, trading volume, open interest, the relation of advancing issues to declining issues, and short selling volume.

THEORETICAL VALUE, THEORETICAL PRICE - This is the mathematically calculated value of an option. It is determined by (1) the strike price of the option, (2) the current price of the underlying, (3) the amount of time until expiration, (4) the volatility of the underlying, and (5) the current interest rate.

THETA - The sensitivity of the value of an option with respect to the time remaining to expiration. It is the daily drop in dollar value of an option due to the effect of time alone. Theta is dollars lost per day, per contract. Negative Theta signifies a long option position (or a debit spread); positive Theta signifies ashort option position (or a credit spread).

TICK - The smallest unit price change allowed in trading a specific security. This varies by security, and can also be dependent on the current price of the security.

TIME DECAY - Term used to describe how the theoretical value of an option "erodes" or reduces with the passage of time. Time decay is quantified by Theta.

TIME PREMIUM - Also known as "Time Value", this is the amount that the value of an option exceeds its intrinsic value and is a parameter in the Matrix. It reflects the statistical possibility that an option will reach expiration with intrinsic value rather than finishing at zero dollars. If an option is out-of-the-money then its entire value consists of time premium.

TIME SPREAD - See CALENDAR SPREAD.

TRADE HALT - A temporary suspension of trading in a particular issue due to an order imbalance, or in anticipation of a major news announcement. An industry-wide trading halt can occur if the Dow Jones Industrial Average falls below parameters set by the New York Stock Exchange.

TRADING PIT - A specific location on the trading floor of an exchange designated for the trading of a specific option class or stock.

TRANSACTION COSTS - All charges associated with executing a trade and maintaining a position, including brokerage commissions, fees for exercise and/or assignment, and margin interest.

TRUE DELTA, TRUE GAMMA - More accurate than standard Delta and Gamma. Projects a change in volatility when projecting a change in price. Taking this volatility shift into account gives a more accurate representation of the true behavior of the option.

TYPE - The type of option. The classification of an option contract as either a call or put.

UNCOVERED - A short option position that is not fully collateralized if notification of assignment is received. See also NAKED.

UNDERLYING - This is the asset specified in an option contract that is transferred when the option contract is exercised, unless cash-settled. With cash-settled options, only cash changes hands, based on the current price of the underlying.

UNREALIZED GAIN OR LOSS - The difference between the original cost of an open position and its current market price. Once the position is closed, it becomes a realized gain or loss.

VEGA - A measure of the sensitivity of the value of an option at a particular point in time to changes in volatility. Vega is the dollar amount of gain or loss you should theoretically experience if implied volatility goes up one percentage point.

VERTICAL CREDIT SPREAD - The purchase and sale for a net credit of two options of the same type but different strike prices. They must have the same expiration, and be on the same underlying. See also BULL PUT SPREAD and BEAR CALL SPREAD.

VERTICAL DEBIT SPREAD - The purchase and sale for a net debit of two options of the same type but different strike prices. They must have the same expiration, and be on the same underlying. See also BULL CALL SPREAD and BEAR PUT SPREAD.

VOLATILITY - Volatility is a measure of the amount by which an asset has fluctuated, or is expected to fluctuate, in a given period of time. Assets with greater volatility exhibit wider price swings and their options are higher in price than less volatile assets. Volatility is not equivalent to BETA.

VOLATILITY TRADE - A trade designed to take advantage of an expected change in volatility.

VOLUME - The quantity of trading in a market or security. It can be measured by dollars or units traded (i.e. number of contracts for options, or number of shares for stocks).

WASH SALE - When an investor repurchases an asset within 30 days of the sale date and reports the original sale as a tax loss. The Internal RevenueService prohibits wash sales since no change in ownership takes place.

WRITE, WRITER - To sell an option that is not owned through an opening sale transaction. While this position remains open, the writer is obligated to fulfill the terms of that option contract if the option is assigned. An investor who sells an option is called the writer, regardless of whether the option is covered or uncovered.