**OPTION STRATEGIES – COMPLETE GUIDE**

In our guide to getting started with options trading, we went into detail about the various steps involved in trading options; including the preparation required, choosing a broker, finding opportunities to trade, and writing a trading plan. Arguably the most important step of all is planning individual trades; i.e., deciding when to enter a position and what position to enter.

You might know absolutely everything there is to know about options trading, but unless you are able to put that knowledge to use, make good decisions about what trades to make, and when you are unlikely to make much money. The hardest part of planning each individual trade, probably, is choosing which strategy to use.

This is especially true if you are relatively new to trading options, or if you don’t have a broad understanding of the different strategies that can be used. Even experienced traders can sometimes struggle to determine what the best strategy to use is, although it's fair to say that the more options trading experience you gain the easier such decisions become.

In reality, there's actually no such thing as the right strategy. There are many factors to take into consideration, and a strategy that might be suitable in one situation could be completely inappropriate for a different set of circumstances. A lot also depends on the individual too, because what is right for one trader might not be right for another.

We would never claim to be able to tell you exactly which strategy you should be using for any situation, but we can offer advice on how you can make that decision yourself. On this page, we look at a number of the considerations you need to be taking into account.

If you are relatively new to trading options, then we would suggest that you spend some time working out the best strategy to use each and every time you enter a new position. As you become more experienced, you will have a better idea about how each strategy works and the process for making a decision should become more straightforward for you.

* What is your Outlook?
* Risk versus Reward
* Single Position or Options Spread?
* Required Trading Levels
* Complexity of Strategy
* Summary

What is Your Outlook?

Your outlook on an underlying security is basically what you expect to happen to its price, such as whether you predict the price will rise or whether you predict it to fall. In many forms of investing, these are the only two outlooks that it's possible to profit from. For example, stock traders can buy stocks that they expect to go up in value or short sell stocks that they expect to go down in value; they are basically the only two ways they can generate profits.

Options traders, however, have four potential outlooks to consider: bullish (expecting the price to rise), bearish (expecting the price to fall), neutral (expecting the price not to move, or at least remain relatively stable), and volatile (expecting significant swings in price). Although this means there's a lot more to think about, it also creates plenty more opportunities to make money.

With so many strategies available, it's actually possible to fine tune your outlook to help you choose a suitable one. If you have a bullish outlook, for example, you could further categorize that outlook into either moderately bullish (expecting a small increase in price) or significantly bullish (expecting a large increase in price).

By being more precise in your outlook, it's much easier to choose a suitable strategy. For instance, if you expected an underlying security to increase significantly in price you would know not to use a strategy that returned a profit on a small price increase and didn’t keep generating profits if the price continued to rise.

You can also combine outlooks too. You might expect the price of an underlying security to be stable in the short term, for instance, but increase in the long term. Alternatively you might predict that the price would remain quite stable, but also think it possible that the price would fall. There are strategies you can use that are suitable in both those scenarios. This examples serve to illustrate just how flexible options trading is, but also highlights the importance of being as accurate as possible in your outlook and acting accordingly.

As we have already mentioned, you will naturally find it easier to choose a strategy that is suitable for your outlook as you learn more about the different types and start using them. You might find it more difficult, though, until you have gained a fair amount of experience. We have produced a selection tool that can help with you with the decision, by making recommendations based on what your outlook for an underlying security is.

You can find this tool [here](http://www.optionstrading.org/strategies/selection-tool/).

Selection Tool for Trading Strategies

One of the hardest challenges that options traders face when entering a new position is choosing the right strategy to maximize their potential profits and/or limit their potential losses.

Options trading is a very flexible form of investment, and it's possible to profit from several different outlooks over above simply expecting a financial instrument to rise or fall in price: such as stable or neutral prices, volatile prices, large or small price movements, and more. However, in order to do so a trader must choose an appropriate options trading strategy and this isn't always an obvious choice.

There isn't necessarily always a right decision in any given circumstance, because traders will have different attitudes towards risk and individual investment objectives that need to be taken into consideration. There are strategies, though, that are particularly suitable for certain outlooks. For example, if you are expecting a moderate fall in the price of an underlying security, then there are a few that are specifically constructed to profit from such an expectation.

We have compiled this straightforward, yet very useful, selection tool to help you choose an options trading strategy that is well suited for whatever your outlook on an underlying security is. To use the tool, you simply need to look at the table below and click on the relevant outlook you have for an underlying security.

The outlooks are divided into four broad categories – price increase, price fall, stable/neutral price, and volatile price – and each of these four categories consists of a number of more precise expectations. Clicking on the relevant expectation will take you to a list of strategies that we recommend for that particular outlook. You can then choose which of the recommendations you feel is best for you.

Please be aware that our lists are by no means exhaustive and there may well be other strategies that are more suitable for your own personal circumstances. This tool is purely meant as a guide to give you our advice on what we think the best trading strategies are for any given outlook.

Moderate Rise

If you are expecting an underlying security to increase in price, but only expect a small increase, then the following strategies are recommended:

[Bull Call Spread](http://www.optionstrading.org/strategies/bullish-market/bull-call-spread/)

Key Advantage - Reduces the upfront costs compared to simply buying calls.

Key Disadvantage - Profits are limited if the underlying security rises significantly.

[Bull Put Spread](http://www.optionstrading.org/strategies/bullish-market/bull-put-spread/)

Key Advantage - Can still profit if the underlying security does not rise in price.

Key Disadvantage - Limited profits if the underlying security rises significantly in price.

[Short Put](http://www.optionstrading.org/strategies/bullish-market/short-put/)

Key Advantage - Simple strategy with only one option involved, therefore low commissions.

Key Disadvantage - Significant losses possible if underlying security falls dramatically.

Significant Rise

The following strategies are recommended for when you expect the price of an underlying security to rise significantly:

[Long Call](http://www.optionstrading.org/strategies/bullish-market/long-call/)

Key Advantage - No limits to the profit that can be made.

Key Disadvantage - No protection if the price of the underlying security falls or fails to move.

[Short Bull Ratio Spread](http://www.optionstrading.org/strategies/bullish-market/short-bull-ratio-spread/)

Key Advantage - Some protection if the price of the underlying security falls or fails to move.

Key Disadvantage - Potential profits are lower than with the Long Call.

Rise to a Specific Level

If you are predicting that the price of an underlying security will rise to a specific level, you can maximize your potential profits by using the following strategies:

[Bull Butterfly Spread](http://www.optionstrading.org/strategies/bullish-market/bull-butterfly-spread/)

Key Advantage - Losses are limited if the underlying security does not perform as expected.

Key Disadvantage - Requires multiple transactions so the commissions paid will be higher.

[Bull Condor Spread](http://www.optionstrading.org/strategies/bullish-market/bull-condor-spread/)

Key Advantage - High potential return on investment.

Key Disadvantage - Higher commissions due to multiple transactions.

Moderate Fall

If you are forecasting the price of an underlying security to fall, but only by a small amount, then the following options trading strategies are recommended:

[Bear Put Spread](http://www.optionstrading.org/strategies/bearish-market/bear-put-spread/)

Key Advantage – Lower upfront costs than buying puts.

Key Disadvantage - Profits are limited if the underlying security falls significantly in price.

[Bear Call Spread](http://www.optionstrading.org/strategies/bearish-market/bear-call-spread/)

Key Advantage – Can still generate profits even if the underlying security fails to move in price.

Key Disadvantage – Limited profits if the price of the underlying security falls significantly.

[Short Call](http://www.optionstrading.org/strategies/bearish-market/short-call/)

Key Advantage – Will still make a return if the underlying security remains stable.

Key Disadvantage – Losses are unlimited if the underlying security increases dramatically in price.

Significant Fall

[Long Put](http://www.optionstrading.org/strategies/bearish-market/long-put/)

Key Advantage – Simple strategy involving just one trade, therefore low commissions.

Key Disadvantage – No protection if the price of the underlying security rises or fails to move.

[Short Bear Ratio Spread](http://www.optionstrading.org/strategies/bearish-market/short-bear-ratio-spread/)

Key Advantage – Some protection if the price of the underlying security rises or fails to move.

Key Disadvantage – Lower potential profits than the Long Put.

Fall to a Specific Level

If you are expecting the underlying security to fall in price, and are reasonably confident that it will fall to a specific level, then the following strategy can help maximize your profits:

[Bear Butterfly Spread](http://www.optionstrading.org/strategies/bearish-market/bear-butterfly-spread/)

Key Advantage – Losses are limited if the price of the underlying security does not move as expected.

Key Disadvantage – The multiple transactions required mean incurring higher commissions.

No Move

The following strategies are recommended for when you forecast that the price of an underlying security will stay the same for a period of time:

[Short Straddle](http://www.optionstrading.org/strategies/neutral-market/short-straddle/)

Key Advantage – You will receive an upfront payment when using this strategy.

Key Disadvantage – Large losses are possible if the price underlying security does move too much.

[Short Strangle](http://www.optionstrading.org/strategies/neutral-market/short-strangle/)

Key Advantage – Can also profit if the price of the underlying security does move a little.

Key Disadvantage – Profits are fairly limited.

[Butterfly Spread](http://www.optionstrading.org/strategies/neutral-market/butterfly-spread/)

Key Advantage – This strategy has low upfront costs.

Key Disadvantage – The multiple transactions this strategy requires mean higher commission costs.

No Move or Small Move in Either Direction

The following strategies are suitable for when you believe the price of the underlying security will remain relatively stable but might move a little in either direction.

[Short Gut](http://www.optionstrading.org/strategies/neutral-market/short-gut/)

Key Advantage – Can profit from three circumstances; stable price, small increase, or small fall.

Key Disadvantage – There is the possibility of large losses from big price moves.

[Condor Spread](http://www.optionstrading.org/strategies/neutral-market/condor-spread/)

Key Advantage – The potential losses are limited.

Key Disadvantage – The potential profits are lower than comparable strategies.

[Albatross Spread](http://www.optionstrading.org/strategies/neutral-market/albatross-spread/)

Key Advantage – Can profit from a wider range of price moves than other similar strategies.

Key Disadvantage – Potential profits are limited.

Stable in Short Term with a Breakout in Long Term

If you believe that the price of an underlying security will remain relatively stable in the short term but that will move in either direction in the longer term, the following strategies are recommended:

[Calendar Strangle](http://www.optionstrading.org/strategies/neutral-market/calendar-strangle/)

Key Advantage - Potential losses are limited.

Key Disadvantage – Multiple transactions mean more paid in commission charges.

[Calendar Straddle](http://www.optionstrading.org/strategies/neutral-market/calendar-straddle/)

Key Advantage – Flexible position that can easily be adjusted if your outlook changes.

Key Disadvantage – Higher commission charges due to number of transactions involved.

Stable in Short Term with a Rise in Long Term

In circumstances where you expect the price of an underlying security to be fairly stagnant in the short term but then rise in the longer term, the following strategy is worthy of consideration:

[Calendar Call Spread](http://www.optionstrading.org/strategies/neutral-market/calendar-call-spread/)

Key Advantage – Potential losses are limited.

Key Disadvantage – There is a risk of your call options being assigned.

Stable in Short Term with a Fall in Long Term

If you believe the price of an underlying security won't move much in the short term but start to fall in the long term, the following strategy is recommended:

[Calendar Put Spread](http://www.optionstrading.org/strategies/neutral-market/calendar-put-spread/)

Key Advantage – Limit to potential losses.

Key Disadvantages – Your put options can be assigned if the price falls sooner than expected.

Stable but a Possible Rise

When you believe that the price of an underlying security is unlikely to move but may possibly rise and want to cover both outcomes, then the following strategy is recommended:

[Covered Call](http://www.optionstrading.org/strategies/neutral-market/covered-call/)

Key Advantage – Can profit from a price remaining stable and a rising price.

Key Disadvantage – Potential profits are limited.

Stable but a Possible Fall

The following strategy is suitable if you expect the underlying security to remain stable but think it may possibly fall in price:

[Covered Put](http://www.optionstrading.org/strategies/neutral-market/covered-put/)

Key Advantage – Can profit from a price remaining stable and a falling price.

Key Disadvantage – Limited profits to be made.

Significant Move in Either Direction

If you believe that an underlying security is volatile and likely to move significantly in price but you are unsure in which direction, then the following strategies are suitable to use:

[Long Straddle](http://www.optionstrading.org/strategies/volatile-market/long-straddle/)

Key Advantage – Profits are potentially unlimited.

Key Disadvantage – Will incur losses if the underlying security fails to move significantly.

[Long Strangle](http://www.optionstrading.org/strategies/volatile-market/long-strangle/)

Key Advantage – Cheaper than the Long Straddle.

Key Disadvantage- Requires a larger price move than the Long Straddle.

[Long Gut](http://www.optionstrading.org/strategies/volatile-market/long-gut/)

Key Advantage – Maximum potential losses are lower than the Long Straddle or Long Strangle.

Key Disadvantage – Higher upfront costs than the Long Straddle or Long Strangle.

[Short Butterfly Spread](http://www.optionstrading.org/strategies/volatile-market/short-butterfly-spread/)

Key Advantage – Can profit from smaller price movements than the Long Straddle or Long Strangle.

Key Disadvantage – Potential profits are limited.

Significant Move in Either Direction but Rise More Likely

The following strategies are good choices when you believe the price of an underlying security is volatile and think that a significant rise is more likely than a significant fall:

[Strap Straddle](http://www.optionstrading.org/strategies/volatile-market/strap-straddle/)

Key Advantage – Greater profits than the Long Straddle if the underlying security rises in price.

Key Disadvantage – Higher potential losses than the Long Straddle.

[Strap Strangle](http://www.optionstrading.org/strategies/volatile-market/strap-strangle/)

Key Advantage – Lower upfront costs than the Strap Straddle.

Key Disadvantage – Requires a greater price movement than the Strap Straddle to be profitable.

[Call Ratio Backspread](http://www.optionstrading.org/strategies/volatile-market/call-ratio-backspread/)

Key Advantage – No upfront costs required.

Key Disadvantages – May need a high trading level with your options broker.

Significant Move in Either Direction but Fall More Likely

If you believe the price of an underlying security is volatile think that a significant fall is more likely than a significant rise, then the following strategies are recommended:

[Strip Straddle](http://www.optionstrading.org/strategies/volatile-market/strip-straddle/)

Key Advantage – Bigger returns than the Long Straddle if the underlying security falls in price.

Key Disadvantage – Potential losses are higher than the Long Straddle.

[Strip Strangle](http://www.optionstrading.org/strategies/volatile-market/strip-strangle/)

Key Advantage – Upfront costs are lower than the Strip Straddle.

Key Disadvantage – Greater price movement required for a return compared to the Strip Straddle.

[Put Ratio Backspread](http://www.optionstrading.org/strategies/volatile-market/put-ratio-backspread/)

Key Advantage – No upfront costs required.

Key Disadvantage – Your broker may require you have a high trading level for this strategy.

Risk Versus Reward

Risk management is something that you need to consider when choosing which strategies to use. The risk profiles of the various strategies can be very different; some come with unlimited risk, while others have fixed maximum losses. You can help determine whether a risk profile suits your own attitude to risk by learning [how to use risk graphs](http://www.optionstrading.org/improving-skills/advanced-terms/risk-graphs-and-risk-to-reward/). You also need to take into account the risk to reward ratio too, because this will basically show you how much you can potentially profit in relation to how much you can potentially lose.

Single Position or Options Spread?

Options trading strategies mostly involves creating spreads, which means you combine multiple positions to effectively enter one overall position. The biggest benefits of using these spreads is that they can be used to limit risk, reduce the upfront costs of taking a position, or create a position that can benefit from more than one outcome.

As such, there's usually a good case for using spreads rather than entering a single position. Entering a single position, which is basically just buying or writing one type of options contract, does have a couple of advantages too though.

First, as there are fewer transactions involved, the commissions you will pay for entering a single position will be less than for creating spreads. This can make a significant difference to the profitability of trades, particularly if you are making relatively small ones. Also, spreads can sometimes limit the potential profitability of a trade whereas taking a single position might generate higher returns. Therefore, although we would suggest that spreads are generally the better choice, there will be occasions where a single position is worth considering.

Required Trading Levels

Your account with your broker will be assigned a trading level, and this will to some extent determine which you use. Brokers assign a trading level to accounts for regulatory reasons and to protect their customers from taking higher risks than they should; this is based largely on their experience and financial situation. A low trading level will only allow you to use certain strategies, because the ones that carry a high level of risk will require a higher trading level. As such, this is something you clearly need to take into account when deciding upon your approach in any given situation.

Complexity of Strategy

Options trading strategies come with varying degrees of complexity. There are a number that are relatively simple, typically those that involve just one or two transactions. There are also some that are more complicated too, requiring three or more transactions. The complexity of a strategy is definitely something that you need to think about when deciding which one to use, as it affects a number of aspects of your trading.

For one thing, as we have already mentioned above, the more transactions that are required, the more you will pay in broker commissions. This can have a big impact on your potential returns, particularly if you are trading on a small budget, so you really need to take this into account.

Using the more complicated strategies can also make it harder to work out what the potential profits and losses of a trade are, and what price movements will be best for you. Deciding upon the ideal entry and exit points of a position is a key part of planning a trade, and this is generally a lot easier to do when you are using the simpler strategies. This isn't to say that you should never use the complex ones, because they can often be the best choice, but you should be aware of the added difficulties this can create.

The more complicated ones also give you something else to think about, whether to carry out all the required transactions simultaneously, or whether to place each order individually. A number of online brokers include functionality that allows you to simply select your preferred strategy, and then the orders that it requires will automatically be executed at the same time. This makes life a lot easier.

However, if you choose to use [legging](http://www.optionstrading.org/improving-skills/advanced-terms/legging/), the process for placing each order involved individually, you will need to determine the best point to place each order. This does make things a little more complicated, but legging into, and out of, positions can help you generate higher profits if you get the timing right.

Summary

If you want to be truly successful at options trading, consistently making money, maximizing your potential profits and limiting your potential losses, then being able to accurately predict price movements of financial instruments is unlikely to be enough by itself.

If you can do this, and buy and sell options based on those financial instruments accordingly, then there is of course money to be made. However, to make the most out of your predictions and control your exposure to risk at the same time you really need to be able to choose the most appropriate strategy for any given situation.

Unfortunately, there's no single best way to decide what that might be and you need to take many factors into account. We should also point out that you don’t have to use a pre-determined strategy and you can always develop your own. However, we would suggest that you only start developing your own once you have been trading for a while and been reasonably successful.

As a very general rule, we would advise beginners to stick to the more basic strategies, but that still leaves plenty of choice. As you get more experienced, you will almost certainly want to consider some of the more advanced and complex ones, giving you even more to choose from.

The best advice we can give is that you learn as much as you can about the most commonly used options trading strategies, and try and get a good idea of how each of them works and their advantages and disadvantages. Then, whenever you identify an opportunity, you'll be able to determine which strategy is the most suitable based on your outlook and your own personal circumstances and objectives.

Remember, you can always refer to our selection tool for help in finding a suitable strategy for the various outlooks you may have. We also provide detailed information on most of the strategies you will ever need to use, divided into the following categories:

* [Bullish Outlook](http://www.optionstrading.org/strategies/bullish-market/)
* [Bearish Outlook](http://www.optionstrading.org/strategies/bearish-market/)
* [Neutral Market](http://www.optionstrading.org/strategies/neutral-market/)
* [Volatile Market](http://www.optionstrading.org/strategies/volatile-market/)
* [Other Options Trading Strategies](http://www.optionstrading.org/strategies/other/)

# Bullish Options Trading Strategies

Bullish options trading strategies are strategies that are suitable for when you expect the price of an underlying security to rise. The obvious, and most straightforward, way to profit from a rising price using options is to simply buy calls. However, buying calls options isn't necessarily the best way to make a return from a moderate upwards price movement and doing so offers no protection should the underlying security fall in price or not move at all.

By using strategies other than simply buying calls, it's possible to gain some notable advantages. On this page, we look at some of the advantages of using such strategies, as well as the disadvantages.  It also provide a list of the most commonly used ones.

* Why Use Bullish Options Trading Strategies?
* Disadvantages of Bullish Options Trading Strategies
* List of Bullish Options Trading Strategies

## Why Use Bullish Strategies?

Buying calls is a strategy in its own right, and there are certainly circumstances when a simple purchase of calls is a viable trade. There are downsides of buying calls too though. For one thing, you run the risk that the contract you buy will expire worthless and generate you no return at all, meaning you lose your entire investment.

You'll always be subject to the negative effects of time decay, and you will probably need the price of the underlying security to rise reasonably significantly in order to make any profit. This doesn’t necessarily mean buying calls is always a bad idea,  because there are risks involved in any form of investment. It is, however, possible to avoid some of those downsides by taking alternative approaches.

Each bullish trading strategy comes with its own unique characteristics, and you can select a strategy that is most likely to help you achieve whatever it is you are aiming for. For example, you could use one that reduces the cost of buying calls by also writing calls with a higher strike. This could also help you reduce the negative effect of time decay on your position, something you could also do by using a strategy that involved the writing of puts.

Another advantage is that you can create credit spreads, which return an upfront payment, rather than debit spreads, which carry an upfront cost. The main point is that by using bullish trading strategies, you can enter a position that profits from an increase in the price of the underlying security and also control other factors that may be important to you, such as the level of risk involved or the amount of capital required.

## Disadvantages

Using strategies other than a straightforward purchase of call options isn't without disadvantages though. With pretty much any form of investment, if you want to gain extra benefits from your approach, then you have to sacrifice something in return. The same is true for options trading.

The main advantage of buying calls is that your profits are theoretically unlimited, because you continue to profit the more the price of the underlying security rises. The biggest sacrifice that you make with most bullish trading strategies is that the potential profits you can make are limited to a certain amount. However, given that most options trades are based on relatively short-term price movements, and financial instruments don't frequently move in price by huge amounts; this isn't necessarily a major drawback.

Another disadvantage is the added complication of trying to choose the right strategy. The concept of buying calls is by itself relatively simple. If you think a financial instrument is going to increase in price, then you can benefit from that increase with a straightforward transaction. Complicating matters by trying to maximize your potential profits or limit your potential losses obviously involves more time and effort.

You'll typically pay higher commissions too, because most strategies require multiple transactions to create spreads. However, overall you are far more likely to be consistently successful when trading options if you get to know all about the different trading strategies and learn which ones to use and when.

## List of Bullish Options Trading Strategies

The following is a list of the most commonly used strategies that are appropriate for a bullish outlook. We have included some brief information about each one, including how many transactions are involved, whether a debit or credit spread is created and whether or not the it's suitable for a beginner.

For more detailed information on each strategy, such as how to use it, its advantages, and it's disadvantages, simply click on the relevant link. For more assistance in choosing a suitable trading strategy you may like to use our [Selection Tool for Options Trading Strategies](http://www.optionstrading.org/strategies/selection-tool/).

[Long Call](http://www.optionstrading.org/strategies/bullish-market/long-call/)

This is a single position strategy that involves only one transaction. It's suitable for beginners and comes with an upfront cost.

[Short Put](http://www.optionstrading.org/strategies/bullish-market/short-put/)

Only one transaction is required for this, and it produces an upfront credit. It isn't suitable for beginners.

[Bull Call Spread](http://www.optionstrading.org/strategies/bullish-market/bull-call-spread/)

This is a simple strategy suitable for beginners. It involves two transactions to create a debit spread.

[Bull Put Spread](http://www.optionstrading.org/strategies/bullish-market/bull-put-spread/)

This is straightforward but it's not really suitable for beginners because of the trading level required. A credit spread is created using two transactions.

[Bull Ratio Spread](http://www.optionstrading.org/strategies/bullish-market/bull-ratio-spread/)

This is complex and requires two transactions; as such it isn't suitable for beginners. It can create either a debit spread or credit spread, depending on the ratio of options bought to options written.

[Short Bull Ratio Spread](http://www.optionstrading.org/strategies/bullish-market/short-bull-ratio-spread/)

This relatively complicated trading strategy isn't ideal for beginners. Two transactions are involved, and a credit spread is created.

[Bull Butterfly Spread](http://www.optionstrading.org/strategies/bullish-market/bull-butterfly-spread/)

There are two types of bull butterfly spread: the call bull butterfly spread and the put bull butterfly spread. It's a complex trading strategy, requiring three transactions, that creates a debit spread. It isn't suitable for beginners.

[Bull Condor Spread](http://www.optionstrading.org/strategies/bullish-market/bull-condor-spread/)

There are two types of bull condor spread: the call bull condor spread and the put bull condor spread. This strategy requires four transactions and it's not suitable for beginners. It creates a debit spread.

[Bull Call Ladder Spread](http://www.optionstrading.org/strategies/bullish-market/bull-call-ladder-spread/)

This is a complex trading strategy requiring three transactions. It creates a debit spread and it's not suitable for beginners.

# Bearish Market Trading Strategies

When your outlook on an underlying security is bearish, meaning you expect it to fall in price, you will want to be using suitable trading strategies. A lot of beginner options traders believe that the best way to generate profits from an underlying security falling in price is simply to buy puts, but this isn't necessarily the case.

Buying puts isn't a great idea if you are only expecting a small price reduction in a financial instrument, and you have no protection if the price of that financial instrument doesn't move or goes up instead. There are strategies that you can use to overcome such problems, and many of them also offer other advantages.

On this page we discuss the benefits of using bearish options trading strategies, and some of the disadvantages too. We also provide a list of the ones that are most commonly used.

* Why Use Bearish Options Trading Strategies?
* Disadvantages of Bearish Options Trading Strategies
* List of Bearish Options Trading Strategies

## Why Use Bearish Options Trading Strategies?

First, we should point out that purchasing puts is indeed a bearish options trading strategy itself, and there are times when the right thing to do is to simply buy puts based on an underlying security that you expect to fall in price. However, this approach is limited in a number of ways.

A single holding of puts could possibly expire worthless if the underlying security doesn't move in price, meaning that the money you spent on them would be lost and you would make no return. The negative effect of time decay on holding options contracts means that you'll need the underlying security to move a certain amount just to break even, and even further if you are to generate a profit.

Therefore, buying puts options is unlikely to be the best strategy if you are anticipating only a small drop in price of the underlying security, and there are other downsides too. This isn't to say that you should never simply buy puts, but you should be aware of how some of the downsides can be avoided through the use of alternative strategies.

There is a range of trading strategies suitable for a bearish outlook, and each one is constructed in a different way to offer certain advantages. An important aspect of successful trading is to match a suitable strategy to whatever it is you are trying to achieve on any given trade.

As an example, if you wanted to take a position on an underlying security going down in price but didn’t want to risk too much capital, you could buy puts and also write puts (at a lower strike) to reduce some of the upfront cost. Doing this would also help you offset some of the risk of time decay.

Another way to reduce the negative effect of time decay would be to include the writing of calls. You can even use strategies that return you an initial upfront payment (credit spreads) instead of the debit spreads that have an upfront cost.

Basically, bearish options trading strategies are very versatile. By using the appropriate one you cann't only profit from the price of the underlying security falling, but you also have an element of control over certain aspects of a trade like the exposure to risk or the level of investment required.

## Disadvantages of Bearish Strategies

Although there are clear advantages to using bearish options trading strategies other than simply buying puts, you should be aware that there are some disadvantages too. Most of them usually involve a trade off in some way, in that there's essentially a price to pay for any benefit you gain.

 For example, most of them have limited profit potential; which is in contrast to buying puts where you are limited only by how much the underlying security can fall in price. While this isn't necessarily a huge problem, because it's reasonably rare for a financial instrument to drop dramatically in price in a relatively short period of time, it does highlight that to get an extra benefit (such as limited risk) you have to make a sacrifice (such as limited profit).

In some respects, the fact that there are a number of different strategies to choose from is a disadvantage in itself. Although it's ultimately a good thing that you have a selection to choose from, it's also something of an extra complication, because it takes extra time and effort to decide which is the best one for any particular situation.

Also, because most of them involve creating spreads, that require multiple transactions, you will have to pay more in commissions. In truth, though, these disadvantages are fairly minor and far outweighed by the positives. The fact is if you can become familiar with all the various strategies and adept at choosing which ones to use and when, then you stand a very good chance of being a successful trader.

## List of Bearish Strategies

Below is a list of the more frequently used strategies that are suitable for when you have a bearish outlook. There's also some brief information about each one: including the number of transactions required, whether a debit spread or a credit spread is involved, and whether it's appropriate for beginners.

You can get more detailed information on each one of these by clicking on the relevant link. If you would like additional help in choosing a strategy, then you can use our selection tool which you can find here.

[Long Put](http://www.optionstrading.org/strategies/bearish-market/long-put/)

This is a single position strategy that involves only one transaction. It's suitable for beginners and comes with an upfront cost.

[Short Call](http://www.optionstrading.org/strategies/bearish-market/short-call/)

Only one transaction is required for this single position strategy, and it produces an upfront credit. It isn't suitable for beginners.

[Bear Put Spread](http://www.optionstrading.org/strategies/bearish-market/bear-put-spread/)

This simple strategy is perfectly suitable for beginners. It involves two transactions, which are combined to create a debit spread.

[Bear Call Spread](http://www.optionstrading.org/strategies/bearish-market/bear-call-spread/)

This is relatively straightforward strategy, but it requires a high trading level so it isn't really suitable for beginners. A credit spread is created using two transactions.

[Bear Ratio Spread](http://www.optionstrading.org/strategies/bearish-market/bear-ratio-spread/)

This is complex and not suitable for beginners. It requires two transactions and can create either a debit spread or credit spread, depending on the ratio of options bought to options written.

[Short Bear Ratio Spread](http://www.optionstrading.org/strategies/bearish-market/short-bear-ratio-spread/)

This is fairly complicated and not ideal for beginners. A credit spread is created and two transactions are involved.

[Bear Butterfly Spread](http://www.optionstrading.org/strategies/bearish-market/bear-butterfly-spread/)

The bear butterfly spread has two variations: the call bear butterfly spread and the put bear butterfly spread. It's not suitable for beginners; it requires three transactions and creates a debit spread.

[Bear Put Ladder Spread](http://www.optionstrading.org/strategies/bearish-market/bear-put-ladder-spread/)

This requires three transactions to create a debit spread. It's not suitable for beginners due to its complexities.

# Neutral Market Trading Strategies

A major reason why trading options is so popular is because of the number of opportunities there are for making profits. For example, unlike other forms of investment, options give traders the chance to profit when an underlying security remains neutral  i.e. it doesn’t move in price.

This function is unique to options, because there are no other financial instruments that can be traded to generate profits from a lack of price movement. There are a large number of neutral options trading strategies (also known as non-directional strategies) that can be used when you have a neutral outlook on an underlying security, and if you can gain a good understanding of these then you will open up many opportunities for making profits.

On this page we explain the concept of a neutral trend and discuss the advantages and disadvantages of using neutral trading strategies. In addition, we provide a list of strategies that you can use to profit from a neutral outlook.

* What is a Neutral Trend?
* Advantages of Neutral Strategies
* Disadvantages of Neutral Strategies
* List of Neutral Strategies

## What is a Neutral Trend?

In investment terms, the word neutral is generally used to describe a financial instrument that doesn’t move in price. While this is technically accurate, in the context of options trading the word has a slightly broader meaning. When we talk about neutral trading strategies, we are talking about strategies that not only profit from an underlying security staying at the same price but also profit when that security moves within a tight range of prices.

When the price of a security goes up and down by small amounts over a period of time, it's said to be moving sideways. This is because if you plotted the price movements on a graph, the graph line wouldn’t show any real incline or decline, but it would basically be moving sideways. When a price is moving sideways the underlying security is in what's known as a neutral trend.

During such a trend the price of the underlying security is consistently going up and down, but not usually by a huge amount and it's always remaining with a certain range. A neutral trend will typically occur after a sustained increase in price or a sustained decrease in price when the price starts hitting levels of resistance or support accordingly.

These trends can continue for weeks or even months at a time. Stock traders and other investors will really struggle to profit under these circumstances and they will typically leave securities that are in a neutral trend alone. However, options traders can take advantage of them by using appropriate strategies.

## Advantages of Neutral Strategies

The biggest advantage of neutral options trading strategies is really the simple fact that they exist. Being able to profit from stocks and other financial instruments that remain relatively stable in price gives investors who use options many more opportunities than those who don’t.

Many financial instruments go through prolonged periods of being neutral, or in a neutral trend, and this gives options traders plenty of chances to generate returns. It's somewhat obvious that the more potentially profitable opportunities there are, the greater the chance there is of being successful on a consistent basis.

The other main advantage of these strategies is that by using them you can profit from three different outcomes. If the underlying security doesn’t move at all, you will make a profit. If the underlying security increases in price or decreases in price, you will still make a profit, providing the price movements stay within an appropriate range.

Some strategies need the price of the underlying security to remain in a very tight range to return a profit, while others can profit from a wider range. To some extent, you can control just how wide you want the range to be and this is another example of just how flexible options trading can be.

Other advantages include the fact that you can turn time decay into a positive and also control your risk exposure to some extent. When using some of the more basic strategies, it's very simple to work out the maximum potential profit and maximum potential loss, and this can be very useful for when planning trades and managing risk.

Finally, the fact that there are so many different strategies you can use means you have plenty of choice and a good chance of finding one that fits well with your personal objectives.

## Disadvantages of Neutral Strategies

There isn’t many major disadvantages when it comes to using strategies of this type. The biggest drawback is the fact that the potential profits of these is always limited, because the maximum amount of profit that can be made from any trade is essentially fixed at the moment it's executed.

Another disadvantage is that the strategies all require at least two transactions, and some of them more, so you will potentially pay a fair amount in commissions.  This is actually true of most options trading strategies. Also, some of them can be quite complicated and certainly not suitable for beginners.

These disadvantages are all relatively minor though, and it should be clear that they are far outweighed by the benefits.

## List of Neutral Strategies

Below, we have listed a range of neutral options trading strategies that are commonly used by options traders. We’ve included a little information about each one, but for further details you should click on the relevant link. If you are struggling to choose a suitable strategy, you may like to take a look at our [Selection Tool](http://www.optionstrading.org/strategies/selection-tool/).

[Covered Call](http://www.optionstrading.org/strategies/neutral-market/covered-call/)

This is relatively simple and would typically be used if you already own a security and want to profit from it being in a neutral trend. It's suitable for beginners.

[Covered Call Collar](http://www.optionstrading.org/strategies/neutral-market/covered-call-collar/)

This is fairly simple and you would generally use it if you already own a security and want to profit from it being in a neutral trend and protect it against any losses should it fall in price. It is suitable for beginners.

[Covered Put](http://www.optionstrading.org/strategies/neutral-market/covered-put/)

This is reasonably complex and combines short selling a security and writing put options. It's not suitable for beginners.

[Short Straddle](http://www.optionstrading.org/strategies/neutral-market/short-straddle/)

This is a relatively simple trading strategy, but it's not really suitable for beginners due to the high trading level required. It involves two transactions and creates a credit spread.

[Short Strangle](http://www.optionstrading.org/strategies/neutral-market/short-strangle/)

This is quite straightforward but requires a high trading level so it's not suitable for beginners. It creates a credit spread and involves two transactions.

[Short Gut](http://www.optionstrading.org/strategies/neutral-market/short-gut/)

This combines two transactions to create a credit spread. It's quite simple, but it requires a high trading level meaning it isn't suitable for a beginner.

[Calendar Call Spread](http://www.optionstrading.org/strategies/neutral-market/calendar-call-spread/)

This is simple enough to be used by beginners. Two transactions are involved and a debit spread is created.

[Calendar Put Spread](http://www.optionstrading.org/strategies/neutral-market/calendar-put-spread/)

This is straightforward and involves two transactions. It creates a debit spread and is suitable for beginners.

[Call Ratio Spread](http://www.optionstrading.org/strategies/neutral-market/call-ratio-spread/)

This is a complicated trading strategy that is not suitable for beginners. There are two transactions involved and a credit spread is created.

[Put Ratio Spread](http://www.optionstrading.org/strategies/neutral-market/put-ratio-spread/)

This is complex and not for beginners. It creates a credit spread with two transactions.

[Calendar Straddle](http://www.optionstrading.org/strategies/neutral-market/calendar-straddle/)

This involves four separate transactions to create a debit spread. It isn't suitable for beginners.

[Calendar Strangle](http://www.optionstrading.org/strategies/neutral-market/calendar-strangle/)

This creates a debit spread. There are four transactions involved and it isn't suitable for beginners.

[Butterfly Spread](http://www.optionstrading.org/strategies/neutral-market/butterfly-spread/)

This is complex and involves three transactions to create a debit spread. It isn't suitable for beginners.

[Condor Spread](http://www.optionstrading.org/strategies/neutral-market/condor-spread/)

This is complex and it creates a debit spread using four separate transactions. It isn't suitable for beginners.

[Albatross Spread](http://www.optionstrading.org/strategies/neutral-market/albatross-spread/)

This involves four transactions and is complicated. It creates a debit spread and is not suitable for beginners.

[Iron Butterfly Spread](http://www.optionstrading.org/strategies/neutral-market/iron-butterfly-spread/)

This is complex and creates a credit spread. It involves four transactions and it's not suitable for beginners.

[Iron Condor Spread](http://www.optionstrading.org/strategies/neutral-market/iron-condor-spread/)

This is complex, involving four transactions, and it's not suitable for beginners. It creates a credit spread.

[Iron Albatross Spread](http://www.optionstrading.org/strategies/neutral-market/iron-albatross-spread/)

This is complicated and not suitable for beginners. It involves four transactions and creates a credit spread.

# Volatile Options Trading Strategies

Options trading has two big advantages over almost every other form of trading. One is the ability to generate profits when you predict a financial instrument will be relatively stable in price, and the second is the ability to make money when you believe that a financial instrument is volatile.

When a stock or another security is volatile it means that a large price swing is likely, but it's difficult to predict in which direction. By using volatile options trading strategies, it's possible to make trades where you will profit providing an underlying security moves significantly in price, regardless of which direction it moves in.

There are many scenarios that can lead to a financial instrument being volatile. For example, a company may be about to release its financial reports or announce some other big news, either of which probably lead to its stock being volatile. Rumors of an impending takeover could have the same effect.

What this means is that there are usually plenty of opportunities to make profits through using volatile options trading strategies. On this page, we look at the concept of such strategies in more detail and provide a comprehensive list of strategies in this category.

## What are Volatile Options Trading Strategies?

Quite simply, volatile options trading strategies are designed specifically to make profits from stocks or other securities that are likely to experience a dramatic price movement, without having to predict in which direction that price movement will be. Given that making a judgment about which direction the price of a volatile security will move in is very difficult, it's clear why such they can be useful.

There are also known as dual directional strategies, because they can make profits from price movements in either direction. The basic principle of using them is that you combine multiple positions that have unlimited potential profits but limited losses so that you will make a profit providing the underlying security moves far in enough in one direction or the other.

The simplest example of this in practice is the long straddle, which combines buying an equal amount of call options and put options on the same underlying security with the same strike price.

Buying call options (a long call) has limited losses, the amount you spend on them, but unlimited potential gains as you can make as much as price of the underlying security goes up by. Buying put options (a long put) also has limited losses and almost unlimited gains. The potential gains are limited only by the amount which the price of the underlying security can fall by (i.e. its full value).

By combining these two positions together into one overall position, you should make a return whichever direction the underlying security moves in. The idea is that if the underlying security goes up, you make more profit from the long call than you lose from the long put. If the underlying security goes down, then you make more profit from the long put than you lose from the long call.

Of course, this isn't without its risks. If the price of the underlying security goes up, but not by enough to make the long call profits greater than the long put losses, then you'll lose money. Equally, if the price of the underlying security goes down, but not by enough so the long put profits are greater than the long call losses, then you will also lose money.

Basically, small price moves aren't enough to make profits from this, or any other, volatile strategy. To reiterate, strategies of this type should only be used when you are expecting an underlying security to move significantly in price.

## List of Volatile Options Trading Strategies

Below is a list of the volatile options trading strategies that are most commonly used by options traders. We have included some very basic information about each one here, but you can get more details by clicking on the relevant link. If you require some extra assistance in choosing which one to use and when, you may find our Selection Tool useful.

[Long Straddle](http://www.optionstrading.org/strategies/volatile-market/long-straddle/)

We have briefly discussed the long straddle above. It's one of the simplest volatile strategies and perfectly suitable for beginners. Two transactions are involved and it creates a debit spread.

[Long Strangle](http://www.optionstrading.org/strategies/volatile-market/long-strangle/)

This is a very similar strategy to the long straddle, but has a lower upfront cost. It's also suitable for beginners.

[Strip Straddle](http://www.optionstrading.org/strategies/volatile-market/strip-straddle/)

This is best used when your outlook is volatile but you think a fall in price is the most likely. It's simple, involves two transactions to create a debit spread, and is suitable for beginners.

[Strip Strangle](http://www.optionstrading.org/strategies/volatile-market/strip-strangle/)

This is basically a cheaper alternative to the strip straddle. It also involves two transactions and is well suited for beginners.

[Strap Straddle](http://www.optionstrading.org/strategies/volatile-market/strap-straddle/)

You would use this when your outlook is volatile but you believe that a rise in price is the most likely. It is another simple strategy that is suitable for beginners.

[Strap Strangle](http://www.optionstrading.org/strategies/volatile-market/strap-strangle/)

The strap strangle is essentially a lower cost alternative to the strap saddle. This simple strategy involves two transactions and is suitable for beginners.

[Long Gut](http://www.optionstrading.org/strategies/volatile-market/long-gut/)

This is a simple, but relatively expensive, strategy that is suitable for beginners. Two transactions are involved to create a debit spread.

[Call Ratio Backspread](http://www.optionstrading.org/strategies/volatile-market/call-ratio-backspread/)

This more complicated strategy is suitable for when your outlook is volatile but you think a price rise is more likely than a price fall. Two transactions are used to create a credit spread and it is not recommended for beginners.

[Put Ratio Backspread](http://www.optionstrading.org/strategies/volatile-market/put-ratio-backspread/)

This is a slightly complex strategy that you would use if your outlook is volatile but you favour a price fall over a price rise. A credit spread is created using two transactions and it is not suitable for beginners.

[Short Calendar Call Spread](http://www.optionstrading.org/strategies/volatile-market/short-calendar-call-spread/)

This is an advanced strategy that involves two transactions. It creates a credit spread and is not recommended for beginners.

[Short Calendar Put Spread](http://www.optionstrading.org/strategies/volatile-market/short-calendar-put-spread/)

This is an advanced strategy that is not suitable for beginners. It involves two transactions and creates a credit spread.

[Short Butterfly Spread](http://www.optionstrading.org/strategies/volatile-market/short-butterfly-spread/)

This complex strategy involves three transactions and creates a credit spread. It isn't suitable for beginners.

[Short Condor Spread](http://www.optionstrading.org/strategies/volatile-market/short-condor-spread/)

This advanced strategy involves four transactions. A credit spread is created and it isn't suitable for beginners.

[Short Albatross Spread](http://www.optionstrading.org/strategies/volatile-market/short-albatross-spread/)

This is a complex trading strategy that involves four transactions to create a credit spread. It isn't recommended for beginners.

[Reverse Iron Butterfly Spread](http://www.optionstrading.org/strategies/volatile-market/reverse-iron-butterfly-spread/)

There are four transactions involved in this, which create a debit spread. It's complex and not recommended for beginners.

[Reverse Iron Condor Spread](http://www.optionstrading.org/strategies/volatile-market/reverse-iron-condor-spread/)

This advanced strategy creates a debit spread and involves four transactions. It isn't suitable for beginners.

[Reverse Iron Albatross Spread](http://www.optionstrading.org/strategies/volatile-market/reverse-iron-albatross-spread/)

This is a complex trading strategy that is not suitable for beginners. It creates a debit spread using four transactions.

# Other Options Trading Strategies

The most commonly used options trading strategies are those that are designed to try and generate profits when a trader has a specific outlook on a financial instrument:bullish, bearish, neutral or volatile. Options are very versatile trading instruments though and there's a range of additional ways that they can be used to make money, and also for other purposes such as hedging or adjusting an existing position.

While you may not use most of these additional strategies too often, it's certainly useful to familiarize yourself with them because there may be times when you will want to utilize them. We have provided information on a number of alternative trading strategies, in several different categories. You can see below for more details.

## Arbitrage Strategies

In very simple terms, arbitrage defines circumstances were price inequalities means that an asset is effectively underpriced in one market and trading at a market price in another. Basically, arbitrage exists if it's possible to simultaneously buy an asset and then sell it immediately for a profit.

Such scenarios are obviously hugely sought after, because they provide the potential for making profits without taking any risk; however these scenarios are somewhat rare and are often spotted earlier by professionals at the big financial institutions.

They do occur occasionally in the options market though, primarily when an option is mispriced or when accurate put call parity is not maintained, and it's possible to find them and take advantage.

For more information on arbitrage and put call parity, along with details of options trading strategies that are specifically designed to profit from arbitrage opportunities such as strike arbitrage, the box spread, and reversal arbitrage please visit [this page](http://www.optionstrading.org/strategies/other/arbitrage/).

## Synthetic Trading Strategies

Synthetic trading strategies are essentially an extension of synthetic positions. A synthetic position is essentially a position that recreates the characteristics of another trading position by using different financial instruments such as an options position that has the same characteristics as holding stock.

Strategies that use a combination of options and stock to emulate other trading strategies are said to be synthetic. They are typically used to adjust an existing strategy when the outlook changes without having to make too many additional transactions.

The three most commonly used ones are the synthetic straddle, the synthetic short straddle, and the synthetic covered call. For more information on these please [click here](http://www.optionstrading.org/strategies/other/synthetic/).

## Protective Puts & Protective Calls

Protective puts and protective calls are trading strategies that use options to protect existing profits that have been made, but not realized, from either buying or short selling stock.

The basic principle is that, when a long stock position or a short stock position has performed well, a trader can use a protective put or a protective call respectively to preserve the profits that already have been made in the event of a reversal, but also allow continued profitability should the stock continue to move in the right direction.

As a simple example, imagine you bought a particular stock at $10, and the price then rose to $15. If you wanted to be able to profit from further price increases, but also safeguard against the price dropping back down, then the protective put will help you do this. It's essentially a straightforward hedging technique.

For more information on protective puts and protective calls, please [visit this page](http://www.optionstrading.org/strategies/other/protective-puts-and-calls/).

## Delta Neutral Strategies

Delta is one of the five main Greeks that influence the price of options. It's in fact widely considered the most important of these, because it's a measure of how much the price of an option will change based on the price movements of the underlying security.

Delta neutral strategies are used to create positions where the delta value is zero, or close to it. Such positions aren't affected by small price movements in the underlying security, meaning there's little directional risk involved. They are typically used to hedge existing positions or to try and profit from time decay or volatility.

Please [click here](http://www.optionstrading.org/strategies/other/delta-neutral/) for more detailed information on how these strategies can be used.

## Gamma Neutral Strategies

Gamma is another of the Greeks; the gamma value of an option measures the sensitivity of the option’s delta value compared to price changes in the underlying security. Gamma neutral strategies are designed to create trading positions where the gamma value is zero or very close to zero; which would mean that the delta value of those positions should remain stable regardless of what happens to the price of the underlying security.

They can be used for a number of purposes, such as reducing the volatility of a position or attempting to profit from changes in implied volatility. They can also be combined with delta neutral strategies for more stable hedging. You find out more information on them [here](http://www.optionstrading.org/strategies/other/gamma-neutral/).

## Stock Replacement

Stock replacement is an investment technique that aims to closely match the potential returns of holding stocks by using a different financial instrument, or combination of financial instruments. It's typically used for one or more of a number of reasons that include reducing the amount of capital required, increasing the potential profits, limiting losses, and freeing up extra funds that can be used for hedging purposes.

One of the most commonly used stock replacement strategies involves buying calls instead of buying stock, and this has a number of advantages. It's actually a very simple strategy, and even complete beginners should have no problem using it. More advanced traders can also use hedging techniques to further limit the risks and volatility that are involved.

You can read about using options for [stock replacement here](http://www.optionstrading.org/strategies/other/stock-replacement/).

## Stock Repair

Even the best investors will make trades that don’t turn out as planned from time to time, and a key part of successful investing is recognizing that limiting losses is just as important as maximizing profits. Although sometimes it's best to simply cut your losses and exit a losing position, equally there will be occasions when there are alternatives that may be worth considering.

Stock repair is a technique that stock traders can employ, using options, to increase the chances of recovering from being long on a stock that has fallen in price. When used correctly, it's possible to break even from a smaller price increase in the stock than would otherwise be possible, without having to commit any more capital.

Although this sounds like it might be quite hard to do, in reality stock repair using options is actually quite simple. To find out more about how and when to use this technique, please visit [this page](http://www.optionstrading.org/strategies/other/stock-repair/).

## Married Puts, Fiduciary Calls & Risk Reversal

The final three strategies we have included are married puts, fiduciary calls, and risk reversal strategies. These aren't among the most widely used so we haven't covered them in a great deal of detail. However, you may have an occasion to use them so it's worth spending a little time familiarizing yourself with them. They are all relatively straightforward and have fairly specific purposes.

The married put combines a long stock position with a long put options position on the same stock. It is, in essence, the same as a protective put but it's executed differently and is not used for precisely the same reasons. It involves making the two required transactions (buying stocks and writing puts) at the same time, and is used primarily to limit the potential risks involved in buying stocks.

The fiduciary call involves buying calls and also investing capital into a risk free market such as an interest bearing deposit account. In some respects, it's a stock replacement technique, but again it actually serves a slightly different purpose, beecaus its chief function is to effectively reduce the costs involved with buying and exercising calls.

Risk reversal is a phrase that has two meanings in investment terms. It can be used to refer to a strategy involving options that is employed, commonly in commodities trading, because it's a hedging technique used to protect against a drop in price. It's also used in forex options trading as a term to describe the difference in implied volatility between similar call options and put options.

# Married Puts, Fiduciary Calls & Risk Reversal Strategies

On this page we look at three options trading strategies that are some of the less commonly used by options traders: married puts, fiduciary calls, and risk reversal. Although they aren't among the most widely used strategies, they do still have their purposes.

There may well be circumstances when they could be suitable strategies to use, and it's a good idea to familiarize yourself with them. Below you will find information on each one of these three strategies, with details on why you might choose to use them and exactly what is involved in implementing them.

* Married Puts
* Fiduciary Calls
* Risk Reversal

## Married Puts

The married put is a strategy that's used for hedging purposes when investing in stocks. It's actually very similar to the protective put, another hedging strategy, but there are some key differences between these two strategies. Primarily, these are the reasons for using each strategy and the point at which they are used.

The protective put is used to protect profits that have already been made from a long stock position, and ones that would be used at some point after the long stock position has been established and the price has gone up. The married put, however, is used to limit potential losses from a long stock position and is used at the same time as entering a long stock position.

A trader would typically use a married put as a form of insurance when buying stock, to cover any potential losses should the price of the stock fall instead of going up. There's a cost associated with taking that insurance, but the married put essentially offers the best of both worlds: the potential for unlimited profit should the stock price go up and limited downside should it go down.

It's a really easy strategy to use too; you simply buy enough at the money put options to cover the shares you are buying. The cost of these options is basically the cost of using the married put, but if the stock does go down in value, then you can exercise your option to sell the stock at the price you paid for it.

If the stock goes up then, providing the increase in the price of the stock is greater than the cost of the puts, you will make a profit. The only real downside of the married put is that the cost will eat into those profits a bit and if the price of the stock doesn’t move at all you will lose the money you spent on the options. However, that's the price you pay for limiting your potential losses.

## Fiduciary Calls

The fiduciary call is very similar to a simple long call, in that the only transaction involved is buying call options. In many respects it's also similar to a stock replacement strategy, in that it is used as an alternative to buying stock, although the real purpose of it is essentially to reduce the costs involved in buying and exercising call options instead of buying stock.

To create a fiduciary call you would buy at the money calls based on a stock that you wish to invest in. You would then invest the balance of the capital that would be required if you were actually buying the stock and putting it into a risk free interest bearing account.  As an example, let’s say you were thinking about buying one thousand shares of Company X stock when it's trading at $25 but decide to use a fiduciary call instead.

In the money calls on Company X stock, with a strike of $25, are trading at $2, so you spend $2,000 to cover one thousand shares instead of the $25,000 you would need to spend on actually buying one thousand shares directly. This leaves a balance of $23,000 compared to what it would have cost for you to buy the shares.

You would then invest the $23,000 into some form of interest bearing account. The idea is that, by the time the options expire, you'll have made enough interest to at least partially cover the cost of buying them. Therefore if they expire worthless you will have offset some of the losses, and if they expire in the money you will have offset some of the cost of exercising them: thus increasing your profits.

Really, the fiduciary call is just about putting your capital to good use if you choose to buy call options based on a stock rather than actually buying that stock.

## Risk Reversal

Risk reversal can actually be used to mean two different things in an investment sense. It's a term used, typically in forex options trading, to describe the difference in volatility between call options and put options. When the term risk reversal is used in this way it's not a trading strategy, but it's a measurement that can be used as a way of evaluating sentiment in the market.

When there's positive risk reversal (i.e. calls are more expensive than puts), it suggests that the market on the underlying security is generally bullish. When there's negative risk reversal (i.e. calls are cheaper than puts), it suggests that the market on the underlying security is bearish.

The term risk reversal can also be used to describe a hedging strategy, commonly used by commodities traders, to protect against potential unfavorable price movements in an owned asset. The risk reversal strategy is used by selling out of the money calls and buying out of the money puts options based on an underlying security that is already owned.

Risk of the security falling in value is then limited, because if it falls below the strike price of the put options, they will make enough profit to cover any further losses. However, the flip side is that it limits profits if the security goes up in price.  If the security rise above the strike price of the call options, then the underlying security could be called away.

Therefore the risk reversal strategy is best used if you own an asset that you think will increase moderately in price, but you want to limit your losses should it fall in price. The strategy shouldn't cost anything to put on, because the idea is that the cost of the puts you buy should be covered by the money received for writing the calls.

Understanding Risk Graphs & Risk to Reward Ratio

To be successful and profitable when trading options, it's vital that you control your exposure to risk, primarily to ensure that you protect your investment capital and don’t expose yourself to the possibility of losing everything. While it's ultimately necessary to take some risk in order to make profits, you should always keep it at a level you are comfortable with.

There are a number of ways that you can do this when trading options, and on this page we look at two particular ways of doing this: using risk graphs and understanding the risk to reward ratio.

What are Risk Graphs?

Risk graphs are often referred to as profit/loss diagrams.  In other words, they are graphical representations of the profit or loss that you might incur on a single option position or an option spread depending on what happens to the price of the underlying security.

They are relatively simple diagrams that are made up of two axis; the vertical axis represents the profit/loss and the horizontal axis represents the price of the underlying security. The center point of the graph is usually the current price of the underlying security, and the graph line then indicates the profit or loss that a position will make according to what happens to the price of the underlying security.

The most basic graphs are as simple as that, and you could easily plot such graphs yourself. It's just a matter of working out what your profit or loss would be based on a range of the different prices of the underlying security and then compiling the graph with that information.

There's a slight flaw with these simple graphs as you may have realized. They effectively only take into account how much profit or loss you will make as the price of the underlying security moves.  Options are of course affected by more than just the price of the underlying security, with factors such as time also having an effect. Despite this limitation, basic graphs still have their uses, as we explain later in this article.

Serious traders will often use detailed graphs that contain specific information to get a more precise idea about the risk profile of certain positions. While the simple graphs are easy to produce, the detailed graphs are more sophisticated and are typically produced using specialist software.

At most of the leading online brokers you will find tools for producing simple graphs, while some will also include tools for producing detailed ones too. Some online brokers will also display simplified graphs that don’t include any numbers; this shows the risk and reward profile for various well known spreads. Once you have a solid understanding of the various trading strategies, you should also be able to produce such profiles yourself.

Using Risk Graphs

Being able to use risk graphs is a valuable skill that most traders will benefit from. The main purpose of them is to illustrate the risk and reward characteristics of any particular position: whether its buying or selling a single option or combining multiple positions by using spreads. They are basically an easy way to view what the potential profits and losses of a position are likely to be, based on expectations of how the price of the underlying security will change.  They are a great tool for managing risk.

For example you might you predict that, over a fixed period of time, the price of an underlying security would possibly fall by up to 5% and possibly rise by up to 10%. By looking at the risk graph of taking a specific position based on that underlying security, you could determine whether taking that position would expose you to a suitable level of risk but also have suitable potential profitability.

These graphs can also help you compare the general risk and reward profiles of different spreads and trading strategies. By studying the basic graphs associated with various strategies, you can get a solid idea of how a trade will perform depending on price movements of the underlying security. This can be a great help when you are trying to select a strategy for a particular trade and want to ensure you are comfortable with the risks involved.

If you have made forecasts about how the underlying security is likely to perform, you can compare the profiles of different strategies and select the one that suits you the best in terms of potential losses and potential profits.

Essentially, these graphs are all about making your life easier when trading options, because it can be difficult to work out how a trade will perform without carrying out a number of different calculations. By using them, it's much easier to instantly visualize and appraise the potential maximum risk and the potential profits of entering a specific trade. This can save a lot of time when deciding which trades to make, and it ultimately makes those decisions easier.

What is Risk to Reward Ratio?

The risk to reward ratio is a straightforward ratio that basically compares the anticipated returns of entering a position with the potential losses that may be incurred by entering that position. It is calculated by simply dividing the expected amount of profit by the amount of potential losses.

For example, if you bought calls worth $100 and you were expecting to be able to sell those at some point in the future for $300 then you are risking a total of $100 (if they expired worthless, then you would lose the whole $100). To potentially make $200 (if you did manage to sell them for $300). To calculate the risk to reward ratio you just divide the $200 by the $100, giving you 2.  Therefore, the risk to reward ratio is 2:1.

This is something of a simplified example, because in options trading you would typically be working out the potential losses and profits of a spread rather than a single position. However, it does serve to highlight the basic principle. Working out the risk to reward ratio of a spread is not particularly difficult.  It's about discovering a number of spreads' maximum profits and/or maximum losses.

The risk to reward ratio is a bit of a misnomer, because the ratio actually depicts the reward to risk.  In the example above, 2 is the reward while 1 is the risk. There are some people that believe it should be referred to as the reward to risk ratio, and that risk to reward ratio is actually calculated by dividing the amount of potential losses by the amount of potential profit.

However, this is really an unnecessary complication that you don’t need to worry about. As long you know what the ratio is what it means, it doesn’t matter how you refer to it.

Using Risk to Reward Ratio

The main purpose of using this ratio is to help you make decisions about which trades to make, and most serious options traders will work out the ratio of any position before going ahead and entering that position. It is actually not that uncommon for traders to enter a position and then not make the money they expected, even if the underlying security moves as predicted, but this can be avoided by studying the ratio of potential trades first.

It's possible to gain a much clearer idea of what the expected returns of those trades are, and this can be a huge help when it comes to planning individual trades and managing the risk involved. Many options traders will set a minimum ratio, such as 4:1 for example, that must exist in order for them to enter a position.

You should always remember just how it important it is to be in control of your risk exposure when trading options. They can be very volatile financial instruments and your trades won't always work out as planned. Even if you are an experienced trader and you generally make good decisions, the market will sometimes behave in ways that you don't expect.

Because of this, you should think carefully about employing methods to control the maximum losses you are exposed to. Risk graphs and the risk to reward ratio are by no means the only tools you can use, but it's certainly useful to understand them and how they can help you.

Stock Replacement Using Options

The stock replacement strategy is essentially exactly what the name suggests. It's a strategy that uses other financial instruments to effectively recreate the position of owning stocks. It has been used for by investors and traders for a very long time and in recent years it has become especially popular using options.

Using options for stock replacement is really quite simple, and it offers a couple of key benefits relating to leverage. There are also benefits relating to hedging, although this makes the strategy somewhat more complex. We have explained more about this strategy and the benefits of using it below.

* Using the Stock Replacement Strategy
* Benefits Related to Leverage
* Benefits Related to Hedging
* Summary

Using the Stock Replacement Strategy

The basic idea of the stock replacement strategy using options is that instead of buying stock that you have highlighted as being a worthwhile investment, you buy calls with stock as the underlying security. The calls you buy should have a strike price that is significantly lower than the current trading price of the underlying security i.e. they should be deep in the money.

The reason you buy deep in the money calls is because they have a delta value of 1, or very close to 1. Delta value is one of the options greeks which can be used to measure how the price of options changes, and it's something you should be familiar with. Please [read this page](http://www.optionstrading.org/improving-skills/greeks/) if you aren't.

A delta value of 1 means that the price of the deep in the money calls should move approximately in line with the price of the underlying security. Therefore owning these contracts is effectively recreating the position of owning the actual underlying stock. We highlight how this works in the below example.

* Company X stock is trading at $50 per share.
* Calls based on Company X stock with a strike of $30 are available at $21.
* Person A owns 100 shares (valued at a total of $5,000)
* Person B owns 100 of the calls (valued at a total of $2,100)
* If Company X stock moves to $55 per share, the calls would be worth approximately $26 each.
* In the above scenario, Person A’s investment would be worth $5,500, for an increase of $500. Person B’s investment would be worth $2,600, also an increase of $500.
* If Company X stock moves to $45 per share, the calls would be worth approximately $16 each.
* In the above scenario, Person A’s investment would be worth $4,500, for a decrease of $500. Person B’s investment would be worth $1,600, also a decrease of $500.

As you can see, the net effect in absolute terms of the price changes is approximately the same from owning the calls as it is from owning the shares. Person B has recreated the position of Person A without actually buying any of the stock.

It's also apparent from the above example that Person B has invested significantly less than Person A. This is one of the main advantages of the stock replacement strategy.

Benefits Related to Leverage

Using options as a stock replacement strategy helps to unlock the potential of leverage. As we pointed out in the example we provided above, Person B has spent less on their investment than Person A. They can still benefit at roughly the same rate from any increase in the price of Company X shares though.

The ability to make similar amounts of money with less investment is an obvious advantage, and it's a primary reason why many people are choosing to buy options as an alternative to the underlying security. You get the full benefit of any appreciation in the security, but have invested less. You have the potential to make a higher return relative to the amount invested.

Additionally to this, the maximum possible loss is reduced. If Company X stock dropped significantly in price, to $20 for example, then Person A would see a $3,000 drop in the value of their investment. The options bought by Person B would have little to no value with that price drop, but they would have only lost their initial investment of $2,100 as opposed to $3,000. If the share price dropped even further Person A would lose even more, but Person B would still be limited to a loss of $2,100.

If you like using simple strategies, then these advantages are really all you need to know about the stock replacement strategy. There are, however, further advantages too, but it gets a little more complicated if you wish to take advantage of them.

Benefits Related to Hedging

Another benefit of this strategy is that it can be used to hedge a position. This isn't something that we advise beginners or inexperienced traders and investors to attempt, but it may appeal to those with some decent experience behind them.

The basic principle is that you can use the money you effectively save by buying calls instead of the underlying stock to hedge against the possibility of the price of the stock falling or remaining the same. You can do this writing out of the money call options or short selling the underlying stock. Typically you would do the former if you wanted to hedge against a small drop or no move at all, and the latter if you wanted to hedge against a significant drop.

The exact way you implement these hedging techniques will depend on how much you want to spend to protect your position and what level of protection you desire. This requires some in depth thought and is why we only recommended that more experienced traders undertake this aspect of the strategy.

Summary

The benefits of the stock replacement strategy using options are relatively clear. Beginner investors can certainly use it as a simple alternative to buying shares if they want to reduce the maximum possible loss or take advantage of the power of leverage. It isn't without its downsides, because you can lose money if the share price doesn’t move at all and you don’t get the benefit of any dividends that are paid, but in the right circumstances it can very much be the best strategy to use.

For more experienced traders the ability to be able to hedge the position if circumstances change and choose to what extent the position is hedged can be very appealing.

Protective Puts & Protective Calls

Protective puts and protective calls are options trading strategies that can be used to protect profits that have been holding a long or short stock position. The idea is to use these strategies when a stock position has made you a profit, but you don’t want to realize that profit right away and you would rather keep your position open.  At the same time, you also have some protection against the position reversing.

In simple terms, if you own stock and it goes up in value, then you can use a protective put to enable you to hold on to it and reduce the risk should it fall back down in value. The protective call is used in opposite circumstances.  If you have short sold stock and the stock has gone down in value, a protective put enables you to keep the short position open and reduce the risks involved should the stock go back up in value.

On this page we provide more detail about protective puts and protective calls, including why you would use them, the advantages and disadvantages of using them, and how you use them.

* Why Use Protective Puts & Protective Calls

Quite simply, protective puts and protective calls are hedging strategies that are, usually, used by stock traders that don’t want to liquidate a profitable position but want their profits protected if that position should reverse.

For instance, if a trader or investor had bought stock in Company X at $20 and it then rose to $25, they have made a profit of $5 per share owned. However, that profit isn't realized until they sell those shares, and selling them would mean they were unable to make any further profits if the stock should continue to rise. If the trader believed that it would probably continue to rise, but was also concerned it could start dropping back down in price, then using a protective put would be an ideal solution.

It's basically an insurance policy.  There is a cost to put it on, but if the stock falls in value the trader’s previously made profits are effectively covered. If the stock remains at the same price or increases in price then the cost is lost, but that's the price paid for having the insurance.

The protective call is used for very similar reasons, but it's useful when the trader holds a short stock position where the stock has fallen in value and wants to protect against the stock rising up again.

These are among the simplest hedging strategies in existence, and they are commonly used by stock traders.

Advantages & Disadvantages of Protective Puts & Protective Calls

The biggest advantage of these strategies is quite simply that they allow you to keep a profitable position open so you can possibly make further profits, while also ensuring that you don't lose the profits already made from that position. It's hedging in the purest sense really, in that you are basically hedging against the risk of losing money that you have already effectively made.

The biggest disadvantage of this protection is that there's a cost involved in using it, and this cost can then eat into your profit margin. It's ultimately down to you to decide whether the cost is worth it for the protection offered.

Another, less considered, advantage of these strategies is that they can easily be converted into a synthetic straddle if your outlook changes and you believe the stock has become volatile. The synthetic straddle is a synthetic position that is used to emulate the pay-off characteristics of the long straddle, a popular strategy for a volatile market.

Although traders won't necessarily be thinking about such an outcome when using a protective put or call, it's definitely an advantage that might sway you in favor of using these strategies.

How to Use a Protective Put

The protective put is more commonly used than the protective call, simply because stock traders tend to hold long positions more often than short positions. It really is essentially very similar to a long put, because the only transaction involved is buying puts.

However, the long put is used when you are speculating on a security going down in value whereas the protective put is used for the hedging purposes mentioned above or when you have an open long stock position. To create a protective put, you just have to use the buy to open order to purchase enough at the money puts to cover the amount of shares that you own.

So, if you owned 100 shares that were trading at $20, then you would buy one put options contract (each contract typically covers 100 shares) with a strike price of $20. It's usually advisable to buy options that have a few months until expiration.

It really is that simple. If the stock you own continues to go up in price, then obviously your put options would expire worthless, but you would of course make more profits from the stock position. If it went down in price, then your put options would increase in value and cover the losses from the stock position.

You could then exercise the options and sell your stock at the higher price to close your position entirely. Alternatively, you could sell your put options at a profit, and keep the stock position open. Of course, by doing this you would have no further protection if the stock continued to fall in price.

How to Use a Protective Call

The protective call is used when you have an open short stock position that is in profit. Again, it's very simple to create and just the one transaction is involved. You would use the buy to open order to purchase enough call options to cover the amount of shares that you have short sold. The call options should be bought with a strike price equal to the current trading price of the stock you are short on (i.e. at the money call options) and with a few months until expiration.

You are then protected if the stock you are short on starts to rise in price, as your call options will also rise in price. If the stock does start to rise you could exercise your option to buy it, which you could then use to close your short stock position, or you could sell your call options for a profit and leave your stock position open.

Summary

These aren't options trading strategies in the sense that they are used for speculating on the market, but they are brilliant hedging tools and a great example of just how versatile options contracts are. Without options, a stock trader wishing to protect profits from an open position would essentially have to close that position and therefore potentially miss out on additional profits if the stock continued moving in the right direction.

However, by using these hedging strategies correctly it's possible to have the best of both worlds (protection against a reversal and potential for further profits) for what is a comparably cheap premium.

Options Greeks

Understanding what the options Greeks, and what they represent, is pretty much vital if you want to be successful at options trading. If you can learn how to interpret the Greeks, then you will quite simply give yourself a much better chance of making money through your trading.

The very concept of these Greeks is often something that beginners find intimidating, but when you break down what each one relates to it's really not that difficult to understand what they mean and the effect they have on the price of options. On this page, we introduce you to them and provide details of each of the five main types.

* Introduction to Options Greeks

To accurately predict what might happen to the price of individual options as the market moves isn't an easy thing to do consistently. To predict what might happen to options positions that effectively combine multiple individual positions, i.e options spreads, is even more difficult. Given that most options trading strategies involve the use of spreads, anything that that can assist you in making such predictions is something you should be familiar with.

The Greeks can be incredibly useful in helping you forecast what will happen to the price of options in the future, because they effectively measure the sensitivity of a price in relation to some of the factors that can affect that price. Specifically those factors are the price of the underlying security, time decay, interest rates, and volatility.

If you know how prices are likely to change in relation to those factors, you are essentially in a better position to know which trades to make and when. The Greeks will give you an indication of how the price of an option will move relative to how the price of the underlying security moves, and they will also help you determine how much time value an option is losing on a daily basis.

The Greeks are also risk management tools, because they can be used to work out how much risk involved in any given position and exactly where that risk lies. As such, the Greeks can be used to determine which risk factors need to be removed from a position, or portfolio of positions, and how much hedging is required.

Before you start thinking about what each Greek represents and how it can be used, you should be aware of the fact that each of the Greeks is basically theoretical. They can be used to measure the sensitivity of price, but they are an indication of how the price will move in relation to various factors.  This isn't a garantee though.  They are values that are based on mathematical models, and they are essentially only of any use if they are calculated using an accurate model.

Technically, you could learn how to calculate the Greeks yourself, but this a complex process and very time consuming. Typically, a trader would use software to carry out the required calculations. There's commercially available software that can be used for this, but most of the best online brokers automatically provide values for the Greeks in the options chains they display. Having this information readily available makes using the Greeks a lot easier.

1. Delta

Delta is arguably the most important of the Greeks, certainly for a large number of traders. The delta value of an option represents how the theoretical value of it will move in relation to a change in the price of the underlying security, assuming that all other factors are equal. It's typically expressed as a number between -1 and 1.

A delta value of 1 would suggest that the price would move by an amount equal to the amount that the price of the underlying security moves by. For example, if the price of the underlying security increased by $1, the price of an option with a delta value of 1 would increase accordingly by $1.

For more examples and further details on this particular Greek, please [click here](http://www.optionstrading.org/improving-skills/greeks/delta/).

2. Theta

Theta is also hugely important, and it's related to the effect that time decay has on the price of an option. The extrinsic value of an option effectively starts to diminish from the moment it is written, right up until the time of expiration: at which point there's no extrinsic value left. This diminishing value is known as time decay, and the rate of time decay can be predicted using the theta value of an options.

Assuming everything else is equal, the theta value indicates the rate at which the extrinsic value will diminish each day. The higher the theta value option, the faster the effect of time decay.

You can read a more detailed explanation of this Greek [here](http://www.optionstrading.org/improving-skills/greeks/theta/).

3. Gamma

Gamma is the value that measures the sensitivity of the delta value of an option to price movements of the underlying security. The delta value of an option isn't fixed and it changes as the market conditions change; the gamma value provides an indication of the rate at which the delta value moves in relation to those changes.

So while the delta value is a measure of how quickly the price of an option will move relative to the underlying security, the gamma value is a measure of how quickly the delta value itself will move relative to the underlying security. This isn't actually as confusing as it sounds.

We have provided a more detailed explanation of Gamma on [this page](http://www.optionstrading.org/improving-skills/greeks/gamma/).

4. Vega

Vega indicates how sensitive the price of an option is to changes in the volatility of the underlying security. It's essentially an indicator of how much the price of an option will move relative to movements in the implied volatility of the underlying security.

The Vega value is slightly more complex than the previously mentioned Greeks, but it's something that you should really try and understand as volatility can, and does, play a big role in options trading.

Please visit [this page](http://www.optionstrading.org/improving-skills/greeks/vega/) for more details.

5. Rho

Rho isn't as commonly used as the other four Greeks, but it's still worth learning about it to complete your knowledge of the subject. The rho value is used to measure how sensitive the price of an option is to changes in the interest rates. Therefore, it indicates the rate at which the theoretical value will move relative to interest rates.

For more information on the rho value, please [visit this page.](http://www.optionstrading.org/improving-skills/greeks/rho/)

The Greeks really can be very useful to traders, and we strongly suggest that you take the time to learn about each of the five types we have mentioned here. However, we really must stress two particular points relating to them. First, they are all indicators of how prices will theoretically move in relation to other factors and you should never assume that prices will move as specifically as any given value would suggest.

Second, each Greek value is an indication of how the theoretical value will move assuming that all other factors remain the same. In practice, there are several factors affecting the price of an option at any one time and you need to try and account for all of those factors and not just a single one. In other words, the Greeks are most useful when you use them in conjunction with each other.

Options Vega

Collectively, the Greeks are used by options traders to have a clearer idea of how various factors impact on the price of options. Vega is the value that provides a theoretical indication of the rate at which the price of will change in relation to changes in the volatility of the underlying security.

The vega value of an option shows how much, in theory, the price will change for every percentage point the implied volatility of the underlying security increases by. On this page we explain the characteristics of vega and how it can be used by traders.

To fully understand this particular subject, we would strongly recommend that you are first familiar with volatility and implied volatility and how they affect the price of options. If you need further information on this, please read [this article](http://www.optionstrading.org/improving-skills/advanced-terms/volatility/).

Characteristics of Vega

The first thing you should be aware of regarding Vega is that it relates only to the extrinsic value of an option, and not the intrinsic value. Whether you are buying calls or puts, the vega value is always positive. However, when you write options the vega value is effectively negative.

Basically, the vega value tells you how much the price of an option should increase by for every percentage point increase in the implied volatility of the underlying security. As an example, if an option had a vega value of .20 then the price would theoretically increase by $.20, and then the implied volatility of the underlying security increases by 1%. It should also fall by $.20 if the implied volatility of the underlying security decreased by 2%.

As with all the Greeks, the effect of Vega is based on all other factors that affect the price of the option being equal.

Vega is affected by two factors: moneyness and the amount of time left until the expiration date. It's typically at its highest when an options contract is at the money, and then reduces if the contract moves into the money or out of the money. As a general rule, the further away the price of the underlying security is from the strike price the lower the vega value of that contract will be. As the extrinsic value of an option tends to be higher the closer it is to the money, and the vega value only affects extrinsic value, it stands to reason that this would be the case.

For similar reasons, the vega value will be higher when there is a long time until expiration and lower when there is less time until expiration.  The extrinsic value will reduce as the expiration date of that option approaches, it once again makes sense that the vega value will reduce accordingly. Vega is also closely related to gamma. When the gamma value of an option is high, you can expect the vega value to also be high.

Putting Vega to Use

Traders tend to pay more attention to the delta, theta, and gamma values of options than they do the vega value. However, out of all the Greeks, vega is second only to delta in terms of the level of effect it (theoretically) has on prices. It's probably so widely ignored largely due to the fact that it's slightly more complex to understand, and because it requires a fundamental understanding of volatility and implied volatility: which is far from a simple subject itself.

Also, a large number of traders are far more concerned with how the price movements of the underlying securities affect the price of options than anything else.

Given that vega can be very useful in forecasting how the price of an option is likely to move, it really is worth putting in some time to understanding just what volatility and implied volatility is all about. Once you have a clear idea of how the price of options is affected by implied volatility, and changes in implied volatility, you will be much better positioned to gauge the risks involved in any possible trades you identify, and may even find opportunities based on the volatility of particular underlying securities.

There are certain trading strategies for a volatile market that can be used to profit from changes in volatility, even when the price of the underlying asset remains static. If you wish to use such strategies, such as the long straddle or the short straddle, then a good knowledge of Vega and what it means is essential.

Volatility & Implied Volatility

Most forms of investing are affected by volatility to some degree, and it's something that options traders should definitely be familiar with. The basic definition of volatility in a general sense is the propensity of something to change or fluctuate dramatically. In investment terms, it relates to the rate at which the price of a financial instrument moves up or down.

A financial instrument that has a relatively stable price is said to have low volatility, while an instrument that is prone to sharp price movements, in either direction, is said to have high volatility. The volatility of financial markets as a whole can also be broadly measured; when a market is hard to predict and prices are changing rapidly and regularly, it's known as a volatile market.

Volatility in options trading is very important because it has a significant effect on the price of options. Many traders, particularly beginners, don't fully understand the implications of it and this can lead to problems. It's not impossible to make any kind of accurate forecasts about how the price of options will move without having a clear insight into volatility and the impact it has.

More specifically, without knowing the role implied, volatility plays an important role in determining the price of options.  It's very difficult to be successful in options trading because of this. On this page we provide a guide to this subject, covering the following:



What is Volatility?

As we have mentioned above, volatility is essentially a measure of the speed and amount of changes. In a financial sense, it's basically the rate at which the price of a financial instrument moves. Before entering a trade of any kind, it's obviously useful to have an idea about how the price of the instrument, or instruments, being traded is likely to change. This is why volatility is so important to traders, as it's one of the main factors that help with forecasting what is going to happen to the price of any given security.

When it comes to options, it's a key part of how they are priced and valued and there are actually two different types that are relevant. Historical volatility, as the name suggests, is a measure of past volatility, i.e. it measures the rate of changes in price that have happened over a given period of time. Implied volatility is a projection of what the rate of change is expected to be in the future. Below, we explain more about these two different types.

Historical/Statistical Volatility

Historical volatility is also commonly known as statistical volatility and often referred to simply as SV. It measures the price changes of the underlying security of options, so it is based on real and actual data.

SV basically shows the speed at which the price of the underlying security has moved; the higher the SV, the more the underlying security has moved in price during the relevant time period. Theoretically a higher SV means that that the underlying security is more likely to move significantly in the future, although it's an indication of future movements rather than a guarantee.

An important thing to note about SV is that it doesn't necessarily provide any insight into which direction an underlying security will move. A high SV may mean that the underlying security has been going up and down rapidly over a period of time, but it may not have actually moved very far from its original price. Equally, a low SV may mean that the underlying security hasn't been moving much in price, but it could be going steadily in one direction.

SV is basically used by traders to get an idea of how much the price of an underlying security will move, based on its speed of change in the past, rather than predicting an actual trend.

It can be measured over any period such as a week, a month, or a year, and there are a number of ways it can be calculated. However, when trading options you will rarely have to worry about actually calculating it yourself because there are various tools available that can do this for you. They are commonly available at most of the best online brokers.

Implied Volatility

In addition to SV, traders should also know all about implied volatility, which can also be known as projected volatility, but commonly referred to as IV. Whereas SV is a measure of the past volatility of an underlying security, IV is an estimation of the future volatility of an underlying security.

It's basically a projection of how much, and how fast, the underlying security is likely to move in price. Many traders think only of moneyness (i.e. the strike price in relation to the price of the underlying security) and the amount of time until expiration when they consider the factors that affect the value of an option, but IV also a very important factor.

IV is a variable that is used in most options pricing models, such as the Black Scholes model or the Binomial model. Given that the Black Scholes model is a highly regarded mathematical formula for calculating the fair price of options, it's clear just how relevant IV is to the price and value of options contracts.

The IV of an option is determined by taking a number of factors into account: the strike price, the price of the underlying security, the SV, the length of time until expiration, and the current interest rate. It's possible to calculate the IV that has been factored into the price option, and some online brokers provide a tool for this purpose.

As the IV of an option provides an indication of how much the underlying security might move in price, the price is typically higher when the IV is higher. This is because, in theory, there's potentially more profit to be made if the underlying security is likely to move dramatically in price. Price can often change quite substantially even when there's no move in the price of an underlying security; this is often due to the IV.

For example, if there was a lot of speculation that Company X was about to release news of an exciting new product, then the IV of options on Company X stock could be very high, as there would probably be an expectation that the price of Company X stock would move a lot when the news gets released. The news could be really well received and the stock might shoot up, or the new product could be really disappointing and the stock might drop quickly.

However, the stock price itself might not move much, as investors may be waiting for the news before buying the stock, or selling it. In such a situation, you could see the extrinsic value of both calls and puts increasing, and either could potentially be very profitable if there is indeed a big change in the price.

The options are therefore increasing in price because there is a big change expected in the price of the Company X stock, rather than any actual movement. This is basically the effect of IV in action.

If you were forecasting that the value of the underlying stock would increase dramatically once the news was released, you may decide that buying at the money calls would be the best way to take advantage of that increase. If Company X did indeed release news of a new product, and that news was well received and the stock went up significantly, then the calls option would obviously gain in intrinsic value.

The IV, though, would be probably lower because once the news had been released and the stock had moved accordingly there may no longer be an expectation of a big move in price as it has already happened.  The extrinsic value of the calls could fall substantially and offset a lot of the profit made through the intrinsic value increasing.

Now imagine that you had instead decided to write in the money puts to profit from an increase in the value of Company X stock instead of buying calls. At the time of writing the in the money puts options, you would benefit from the higher extrinsic value because of the high IV. If you wrote puts with the right strike price the increase in the value of the underlying security could move them out of the money.  With the extrinsic value falling due to the IV becoming lower once the announcement had been made, they would be worth significantly less than at the time of writing them.

You could then either use a buy to close order to buy them back and close your position for a profit, or wait and hope the contracts expire worthless. Either way, you have profited from both the change in the value of the underlying security and the change in the IV. Had you bought the calls, you would have profited from the change in the value of the underlying security, but the change in the IV would have reduced those profits.

This is why an understanding of IV is so important, as it can have a huge impact on the profitability of a trade. To be successful at options trading you absolutely need to recognize the potential pitfalls that IV can lead to. There are ways to profit from IV in options trading, but it isn't just as simple as buying when the IV is low and selling when the IV is high, We will come to that a little later in this article, but first there are a couple of other aspects of volatility that need explaining.

Volatility Crunch

The term volatility crunch is used to describe an occurrence where a high IV drops dramatically and quickly. It typically happens to stocks following a significant event that was expected such as the release of earnings reports or important news (like in the above example). A volatility crunch can have a huge impact on the extrinsic value of options and it means a sharp decline in price.

This is why owning options with a high IV can be considered quite risky; a crunch could significantly reduce their value, even if the underlying security moves in the right direction for you.

Volatility Skew &Volatility Smile

As the effect of volatility on the price of options can be quite significant, it should be no surprise that many traders choose to analyze it before entering trades. This can be done in many ways, but one of the most common is to chart the IV across options that are based on the same underlying security but with different strike prices.

By creating a chart that shows this information, it's possible to get an idea of how the IV of specific options changes depending on their moneyness. Patterns can appear in these graphs, and there are two particular patterns that traders can look for to try and gain some useful information.

A volatility smile appears where the line that shows the IV across the different options forms a U shape, similar to a smile. When this appears, it shows that the IV is at its lowest when the options are at the money, and gets higher when they get further into the money or out of the money. This suggests that there is more demand for options that are in the money or out of the money, and less demand for those that are at the money. In turn, this suggests that large price movements are expected in the underlying security.

A volatility skew appears when the line that shows the IV across the different options is skewed to one side. It can be skewed to either side, and would mean that the IV is increasing, because the options contracts are either moving further into the money or out of the money.

Skews and smiles aren't extremely important unless you are specifically entering trades based on IV. If this is a form of trading that you are considering, then you should learn how it's possible to profit from volatility.

Profiting from Volatility

The basic principle of trading options contracts based on volatility is that you look to buy contracts that are expected to increase in IV and write contracts that are expected to fall in IV. This is a simplified take on IV, and in reality it's a little more complex than that.

Now that you have an understanding of volatility in general, you might want to think about exactly how you can put knowledge into use and profit from it.  There are actually a number of strategies that can be used for this specific purpose. You can find a list of suitable strategies, with detailed information on how to use them on the following page: [Options Trading Strategies for a Volatile Market](http://www.optionstrading.org/strategies/volatile-market/).

Options Trading Glossary of Terms

The basic fundamentals of options trading are relatively easy to learn, but this is a very complex subject once you get into the more advanced aspects. As such it's no surprise that there is a fair amount of terminology and jargon involved that you may not be familiar with. We have compiled this comprehensive glossary of terms to be a useful reference tool for anyone learning about trading options.

Although we always try and explain any terminology we use in the context that we are using it in any particular page or article we write, there may be occasions when you come across a term that you don't understand. This glossary of terms is here to be used if you ever require an explanation for what a particular word or phrase means.

**A**

**Albatross Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use an Albatross Spread](http://www.optionstrading.org/strategies/neutral-market/albatross-spread/).

**All Or None Order:** Often abbreviated as AON, this is a type of order that must be either filled entirely or not at all.

**American Style Option:** A contract that gives the holder the flexibility of choosing to exercise their option at any point between buying the contract and the contract expiring. [More on American Style](http://www.optionstrading.org/basics/option-types/american-style/).

**Approval Levels:** See Trading Levels.

**Arbitrage:** Taking advantage of price discrepancies by buying and selling to create a risk free trade.

**Arbitrage Trading Strategies:** Strategies that involve the use of arbitrage. Read more at [Arbitrage Strategies](http://www.optionstrading.org/strategies/other/arbitrage/).

**Ask Price:** The price it costs to buy an option.

**Assignment:** When the writer of a contract is required to fulfill their obligations under the terms of that contract – for example buying the underlying security if they have written calls or selling the underlying security if they have written puts. The writer will be issued with an assignment notice in such circumstances.

**At the Money Option:** An option where the price of the underlying security is the same as the strike price.

**Automatic Exercise:** The process by which in the money options are automatically exercised if they are in the money at the point of expiration.

**Auto Trading:** A trading method that involves using a third party to select your trades and having your broker automatically execute them. Read more on [Auto Trading](http://www.optionstrading.org/improving-skills/advanced-terms/auto-trading/).

**B**

**Basket Option:** A type of option that is based on a group of underlying securities rather than just one.

**Barrier Option:** A type of option that can come into existence or go out of existence based on specific criteria is usually related to the price of the underlying security. [More about Barrier Options](http://www.optionstrading.org/basics/option-types/barrier/).

**Bear Butterfly Spread:** This is an advanced strategy that can be used when the outlook of an underlying security is bearish. Learn [how to use a Bear Butterfly Spread](http://www.optionstrading.org/strategies/bearish-market/bear-butterfly-spread/).

**Bear Call Spread:** A simple strategy, using calls, that can be used when the expectation is that the underlying security will decline in price. Learn [how to use a Bear Call Spread](http://www.optionstrading.org/strategies/bearish-market/bear-call-spread/).

**Bearish:** An expectation that an option, or any financial instrument, will decrease in price.

**Bearish Trading Strategies:** Strategies that can be used to profit from a downward move in the price of a financial instrument. [List of Bearish Strategies](http://www.optionstrading.org/strategies/bearish-market/).

**Bear Market:** When the overall market is in decline.

**Bear Put Ladder Spread:** This is an advanced strategy that can be used when the outlook on an underlying security is bearish. Learn [how to use a Bear Put Ladder Spread](http://www.optionstrading.org/strategies/bearish-market/bear-put-ladder-spread/).

**Bear Put Spread:** A simple strategy using puts that can be used when the expectation is that the underlying security will decline in price. Learn [how to use a Bear Put Spread](http://www.optionstrading.org/strategies/bearish-market/bear-put-spread/).

**Bear Ratio Spread:** This is a strategy that can be used when the outlook on an underlying security is bearish. Learn [how to use a Bear Ratio Spread](http://www.optionstrading.org/strategies/bearish-market/bear-ratio-spread/).

**Bear Spread:** A spread that is created to profit from bearish movements.

**Bear Trap:** An unconfirmed market movement which suggests a bear market, but is unconfirmed and ends up with the market moving upwards.

**Bid Price:** The price at which an option can be sold.

**Bid Ask Spread:** The difference between the bid price and the ask price of an option. An indicator of liquidity, and often referred to simply as the spread.

**Binary Option:** A type of option that pays a fixed return if it expires in the money or nothing if it expires at the money or out of the money. [More about Binary Options](http://www.optionstrading.org/basics/option-types/binary/).

**Binomial Options Pricing Model:** Can be abbreviated to BOPM; a pricing model that was developed by Cox, Ross and Rubinstein in 1979. Read more about the [Binomial Pricing Model](http://www.optionstrading.org/improving-skills/advanced-terms/binomial-model/).

**Black Scholes Options Pricing Model:** A pricing model that is based on factors that include the strike price, the price of the underlying security, the length of time until expiration, and volatility. Read about the [Black Scholes Pricing Model](http://www.optionstrading.org/improving-skills/advanced-terms/black-scholes-model/).

**Box Spread:** An advanced strategy that involves the use of arbitrage.

**Break Even Point:** The price or price range of the underlying security at which a strategy will break even, with no profits and no losses.

**Breakout:** When the price of a security moves above an existing resistance level or below an existing support level. The expectation is that the security will continue to move in the prevailing direction.

**Broker:** An individual or a company that executes orders to buy and sell financial instruments on behalf of clients.

**Broker Commissions:** The charge from a broker for executing orders on behalf of clients.

**Bull Butterfly Spread:** This is a strategy that can be used when the outlook on an underlying security is bullish. Learn [how to use a Bull Butterfly Spread](http://www.optionstrading.org/strategies/bullish-market/bull-butterfly-spread/).

**Bull Call Ladder Spread:** This is a strategy that can be used when the outlook on an underlying security is bullish. Learn [how to use a Bull Call Ladder Spread](http://www.optionstrading.org/strategies/bullish-market/bull-call-ladder-spread/).

**Bull Call Spread:** A simple strategy, involving calls, which can be used when the expectation is that the underlying security will increase in price. Learn [how to use a Bull Call Spread](http://www.optionstrading.org/strategies/bullish-market/bull-call-spread/).

**Bull Condor Spread:** This is an advanced strategy that can be used when the outlook on an underlying security is bullish. Learn [how to use a Bull Condor Spread](http://www.optionstrading.org/strategies/bullish-market/bull-condor-spread/).

**Bullish:** An expectation that an option, or any financial instrument, will increase in price.

**Bullish Trading Strategies:** Strategies that can be used to profit from an upward move in the price of a financial instrument. [List of Bullish Strategies](http://www.optionstrading.org/strategies/bullish-market/).

**Bull Market:** When the overall market is moving upwards.

**Bull Put Spread:** A simple strategy, involving puts, which can be used when the expectation is that the underlying security will increase in price. Learn [how to use a Bull Put Spread](http://www.optionstrading.org/strategies/bullish-market/bull-put-spread/).

**Bull Spread:** A spread that is created to profit from bullish movements.

**Bull Trap:** An unconfirmed market movement which suggests a bull market, but is unconfirmed and ends up with the market moving downward.

**Butterfly Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Butterfly Spread](http://www.optionstrading.org/strategies/neutral-market/butterfly-spread/).

**Buy to Close Order:** An order that is placed when you want to close an existing short position through buying contracts that you have previously written. Read more about the [Buy to Close Order](http://www.optionstrading.org/basics/order-types/buy-to-close/).

**Buy To Open Order:** An order that is placed when you want to open a new position through buying contracts. Read more about the [Buy to Open Order](http://www.optionstrading.org/basics/order-types/buy-to-open/).

**C**

**Calendar Call Spread:** This is a simple strategy that can be used to profit from an underlying security remaining neutral. Also known as a Time Call Spread. Learn [how to use a Calendar Call Spread](http://www.optionstrading.org/strategies/neutral-market/calendar-call-spread/).

**Calendar Put Spread:** This is a simple strategy that can be used to profit from an underlying security remaining neutral. Also known as a Time Put Spread. Learn [how to use a Calendar Put Spread](http://www.optionstrading.org/strategies/neutral-market/calendar-put-spread/).

**Calendar Spread:** A type of spread that is created using multiple contracts with different expiration dates. Also referred to as a time spread. Read more about [Calendar Spreads](http://www.optionstrading.org/basics/spreads/calendar/).

**Calendar Straddle:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Calendar Straddle](http://www.optionstrading.org/strategies/neutral-market/calendar-straddle/).

**Calendar Strangle:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Calendar Strangle](http://www.optionstrading.org/strategies/neutral-market/calendar-strangle/).

**Call:** See Call Option. Call is often used instead of the full term.

**Called Away:** The process that takes place when the writer of calls is required to fulfill their obligation and sell the underlying security at the agreed strike price.

**Call Option:** A type of option which grants the holder the right, but not the obligation, to buy the relevant underlying security at an agreed strike price. Read more about [Calls](http://www.optionstrading.org/basics/option-types/call/).

**Call Ratio Backspread:** An advanced strategy that can be used for profit in a volatile market, when there is a bullish outlook. Learn [how to use a Call Ratio Backspread](http://www.optionstrading.org/strategies/volatile-market/call-ratio-backspread/).

**Call Ratio Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Call Ratio Spread](http://www.optionstrading.org/strategies/neutral-market/call-ratio-spread/).

**Carrying Cost:** The implied cost of using capital to purchase financial instruments based on interest incurred from borrowing that capital or interest lost from taking that capital from an interest bearing account.

**Cash Settled Option:** A type of option in which any profits due to the holder at the point of exercise or expiration are paid in cash rather than an underlying security being transacted. Read more about [Cash Settled Options](http://www.optionstrading.org/basics/option-types/cash-settled/).

**Chain:** Tables that are used to show various information related to specific options. Read more about [Chains](http://www.optionstrading.org/introduction/terms-phrases/table-and-chains/).

**Chooser Option:** A type of option that allows the holder to choose whether it's a call or a put at some point during the term of the contract.

**Close:** The point at the end of a trading day when the market closes and final prices are calculated.

**Closing Order:** An order which is used to close an existing position. See Buy To Close Order or Sell To Close Order.

**Combination Order:** A type of order that combines multiple orders into one.

**Commodity Option:** A type of option where the underlying security is either a physical commodity or a commodity futures contract.

**Compound:** A type of option where the underlying security is another contract.

**Condor Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Condor Spread](http://www.optionstrading.org/strategies/neutral-market/condor-spread/).

**Contingent Order:** A type of order that allows for the trader to set specific parameters for exiting a position.

**Contract Neutral Hedging:** A technique for hedging that involves a trader buying as many options as units of the underlying security they own.

**Contract Range:** The range between the highest and lowest price that an option contract has been traded at.

**Contract Size:** The number of units of the underlying security that are covered by a contract. The typical contract size is 100. It should be noted that prices are displayed based on one unit of underlying security. So if an option is listed with an ask price of $2.00, and the contract size is 100, it would actually cost $200 to buy one contract covering 100 units of the underlying security.

**Conversion & Reversal Arbitrage:** An advanced strategy that involves the use of arbitrage. Read more on conversion & reversal arbitrage at [Arbitrage Strategies](http://www.optionstrading.org/strategies/other/arbitrage/).

**Covered Call:** This is a simple strategy that can be used to make a profit from existing stock holdings when they are neutral and they are protected against a short term drop in their price. Learn [how to use a Covered Call](http://www.optionstrading.org/strategies/neutral-market/covered-call/).

**Covered Put:** This is an advanced trading strategy that can be used in conjunction with short selling stock to profit if the stock remains neutral; it also protects against a short term rise in their price. Learn [how to use a Covered Put](http://www.optionstrading.org/strategies/neutral-market/covered-put/).

**Credit:** Money that is received into a trading account.

**Credit Spread:** A type of spread that is cash positive – i.e. you receive more for writing the options involved in the spread than you spend on buying the options involved in the spread. Read more about [Credit Spreads](http://www.optionstrading.org/basics/spreads/credit/).

**Currency Option:** A type of option where the underlying security is a specific currency.

**D**

**Day Order:** A type of order that is cancelled at the end of a trading day if it hasn't been filled.

**Day Trader:** A trader who enters and exits their trading positions within one trading day, often holding onto positions for just a few minutes or hours.

**Day Trading:** The style of trading used by day traders, where positions are entered and exited within the same trading day. Read more about [Day Trading](http://www.optionstrading.org/basics/trader-types/day-trading/).

**Debit:** Money that is paid out from a trading account.

**Debit Spread:** A type of spread that is cash negative  i.e. you spend more on buying the options involved in the spread that you receive for writing the options involved in the spread.

**Delta Neutral Hedging:** A strategy that is used to protect an existing position from small movements in price. This can be used to hedge existing positions in stocks or other financial instruments. Read more about [Delta Neutral Hedging](http://www.optionstrading.org/strategies/other/delta-neutral/).

**Delta Neutral Trading:** A strategy designed to create trading positions which will neither profit nor loss if there are small movements in the price of the underlying stock, but will return profits if the price of the underlying security moves significantly in either direction. Read more about Delta Neutral Trading.

**Delta Value:** One of the Greeks, the delta value measures the theoretical effect of changes in the price of the underlying security on the price of the option. Also referred to as [Options Delta](http://www.optionstrading.org/improving-skills/greeks/delta/).

**Derivative:** A financial instrument which derives its value primarily from the value of another financial instrument. Options are a type of derivative.

**Diagonal Spread:** A type of spread that is created by using multiple contracts with different expiration dates and different strike prices. Read more about [Diagonal Spreads](http://www.optionstrading.org/basics/spreads/diagonal/).

**Directional Risk:** The risk of loss from the price of a security moving in an unfavorable direction. For example, if you write calls you exposed to the directional risk of the underlying security possibly increasing in price.

**Directional Outlook:** The expectation of which direction, if any, that the price of a security will move in. For example, if you are expecting a security to increase in price you have a bullish outlook.

**Discount Broker:** A type of broker that carries out transactions at a low price, but generally offers little in the way of additional services. For more information please read [Full Service Brokers vs Discount Brokers](http://www.optionstrading.org/brokers/full-service-vs-discount/).

**Discount Option:** An option that is trading for less than its intrinsic value.

**Dividend:** A payment that can be made by a company to its shareholders, representing their share of profits.

**Dynamic Position:** A position which is constantly adjusted as required to serve its purpose.

**E**

**Early Assignment:** When the writer of contracts is required to fulfill their obligations under the terms of those contracts prior to the expiration date; early assignment happens when contracts are exercised early.

**Early Exercise:** When an American style is exercised prior to the expiration date.

**Employee Stock Options:** A type of option that is based on stock in a company and issued to employees of that company: typically as a form of remuneration, bonus, or incentive. Read more about [Employee Stock Options](http://www.optionstrading.org/basics/option-types/employee-stock/).

**European Style Option:** An options contract that can only be exercised at the point of expiration and not before. Read more about [European Style Options](http://www.optionstrading.org/basics/option-types/european-style/).

**Exercise:** The process by which the holder of a contract uses their right under the terms of that contract to either buy or sell the relevant underlying security at the stated strike price. Learn more about [Exercising an Option](http://www.optionstrading.org/introduction/how-options-really-work/exercising-options/).

**Exercise Limit:** A limit on the number that can be exercised that may be imposed on the holder.

**Exercise Price:** See Strike Price

**Expiration Date:** The date on which a contract expires and effectively ceases to exist. Options must be exercised on or before this date, or they will expire worthless.

**Expire Worthless:** When a contract reaches the expiration date and has no value i.e. it's either at the money or out of the money at the point of expiration.

**Expiry:** See Expiration Date.

**Extrinsic Value:** The component of a price that is affected by factors other than the price of the underlying security, such as time left until expiration. Read more on the following page: [Price of Options](http://www.optionstrading.org/introduction/how-options-really-work/price/).

**F**

**Fiduciary Call:** A strategy that is designed to effectively cover the costs of exercising a call. Read more about [Fiduciary Calls](http://www.optionstrading.org/strategies/other/married-puts-fiduciary-calls-and-risk-reversal/).

**Fill or Kill Order:** Often abbreviated to FOK, this is a type of order that must be either completely filled with immediate effect or cancelled.

**Financial Instrument:** A real or virtual asset that has an inherent monetary value and/or transfers monetary value. Stocks, shares, options, currencies, futures, and commodities are all forms of financial instruments.

**Fundamental Analysis:** A style of analyzing the value of a financial instrument by studying certain specific factors that relate to the true value of that security. Studying the financial reports of a company would be a way to carry out fundamental analysis on stock in that company.

**Futures Option:** A type of option where the underlying security is a future contract.

**Full Service Broker:** A type of broker that offers expert advice and professional guidance in addition to executing orders for a client; they typically charges higher fees and commissions.

**G**

**Gamma Neutral Hedging:** A hedging technique that involves creating positions where the overall gamma value is as close to zero as possible so that the delta value of the positions should remain static whether or not the price of the underlying security moves up or down. Read more about [Gamma Neutral Hedging](http://www.optionstrading.org/strategies/other/gamma-neutral/).

**Gamma Value:** One of the Greeks, the gamma value measures the theoretical effect of changes in the price of the underlying security on the delta value of that option. Also referred to as [Options Gamma](http://www.optionstrading.org/improving-skills/greeks/gamma/).

**Going Long:** Taking a long position on a financial instrument with the expectation that it will increase in price over time. Buying a contract is going long on that option.

**Going Short:** Taking a short position on a financial instrument with the expectation that it will decrease in price. Writing a contract is going short on that option.

**Good Until Cancelled:** Often abbreviated to GTC, this is a type of order that stays active until it is either filled or cancelled.

**Greeks:** A series of values that can be used to measure the sensitivity of an option to changes in market conditions and the theoretical changes in the price of an option caused by specific factors such as the price of the underlying security, volatility, and time left until expiry. Read more about the [Greeks](http://www.optionstrading.org/improving-skills/greeks/).

**H**

**Hedge / Hedging:** An investment technique used to reduce the risk of holding a specific investment. Options are commonly used as hedging tools: protecting another's existing position or a position in another financial instrument such as stock.

**Historical Volatility:** Often abbreviated to HV, a measure of the volatility of the price a financial instrument over a specified period of time in the past.

**Holder:** The owner of options contracts.

**Horizontal Spread:** A type of spread that's created using multiple contracts with different expiration dates, but with the same strike price. Read more about [Horizontal Spreads](http://www.optionstrading.org/basics/spreads/horizontal/).

**I**

**Immediate or Cancel Order:** Often abbreviated to IOC, this is a type of order that must be partially or completely filled immediately or cancelled. If the order is only partially completed, the balance of the order is cancelled.

**Implied Volatility:** Often abbreviated to IV, it's a measure of the estimated volatility of the price a financial instrument at the current time. Read more about [Volatility and Implied Volatility](http://www.optionstrading.org/improving-skills/advanced-terms/volatility/).

**Index Option:** A type of option where the underlying security is an index, such as the S & P 500.

**In the Money Option:** An option where the price of the underlying security is in a favorable position, relative to the strike price, for the holder: meaning it has intrinsic value. A call is in the money when the price of the underlying security is higher than the strike price and a put is in the money when the price of the underlying security is lower than the strike price.

**Intrinsic Value:** The component of a price that's affected by the profit that is effectively built into a contract when it's in the money – i.e. the amount of theoretical profit that could be realized by exercising the option.

**Iron Albatross Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn how to use an [Iron Albatross Spread](http://www.optionstrading.org/strategies/neutral-market/iron-albatross-spread/).

**Iron Butterfly Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use an Iron Butterfly Spread](http://www.optionstrading.org/strategies/neutral-market/iron-butterfly-spread/).

**Iron Condor Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use an Iron Condor Spread](http://www.optionstrading.org/strategies/neutral-market/iron-condor-spread/).

**L**

**LEAPS:** The acronym for Long Term Equity Anticipation Securities. These are contracts that expire several months, or longer, in the future.

**Leg:** When an options position is made up of a combination of multiple positions, each of the individual positions is known as a leg.

**Legging:** The process of entering or exiting a position that is made up of a combination of multiple positions by transacting each position individually. Read more about [Legging](http://www.optionstrading.org/improving-skills/advanced-terms/legging/).

**Legging In:** See Legging; the process of entering a position using legging.

**Legging Out:** See Legging; the process of exiting a position using legging.

**Level II Quotes:** Also known as Level 2 Quotes. Real time quotes that are provided by exchanges detailing the exact bid ask spreads being offered by market makers. Typically used by very active traders to get the best possible prices at any given time.

**Leverage:** The use of specific financial instruments, such as options, to get a greater potential return on invested capital, or the use of borrowed capital to achieve potentially greater profits. Read more about [Leverage](http://www.optionstrading.org/introduction/terms-phrases/leverage/).

**Limit Order:** A type of order used to buy or sell financial instruments at a specified maximum or minimum price respectively.

**Limit Stop Order:** Also known as a stop limit order, an order to close a position when a certain price is reached, if the order can be filled within a specified limit.

**Liquidity:** A measure of the ease with which a financial instrument can be bought or sold without impacting the price, or the ease with which a financial instrument can be converted to cash.

**Listed Option:** A type of option that is listed on an exchange, with fixed strike prices and expiration dates.

**Long:** You are long on a financial instrument if you own that instrument and/or you stand to gain from it increasing in price.

**Long Call:** This is a simple strategy that can be used when the outlook on an underlying security is bullish. Learn [how to use a Long Cal](http://www.optionstrading.org/strategies/bullish-market/long-call/)l.

**Long Gut:** This is a simple strategy that can be used when price of the underlying security is volatile and expected to move significantly, but the direction of the move is unclear. Learn [how to use a Long Gu](http://www.optionstrading.org/strategies/volatile-market/long-gut/)t.

**Long Position:** The position of being long on a financial instrument. If you own options contracts, then you hold a long position on them.

**Long Put:** This is a simple strategy that can be used when the outlook on an underlying security is bearish. Learn [how to use a Long Put](http://www.optionstrading.org/strategies/bearish-market/long-put/).

**Long Straddle:** This is a simple strategy that can be used when the price of the underlying security is volatile. Learn [how to use a Long Straddle](http://www.optionstrading.org/strategies/volatile-market/long-straddle/).

**Long Strangle:** This is a simple strategy that can be used when price of the underlying security is volatile and expected to move significantly, but the direction of the move is unclear. Learn [how to use a Long Strangle](http://www.optionstrading.org/strategies/volatile-market/long-strangle/).

**Long Term Equity Anticipation Securities:** See LEAPS

**Look Back Option:** A type of option that allows the holder to exercise the option at the best price that underlying security reached during the life of the option. Read more about [Look Back Options](http://www.optionstrading.org/basics/option-types/look-back/).

**M**

**Margin:** Margin has multiple meanings depending on the context that it's being used in. Margin related to buying stocks is the process of borrowing capital from a broker to buy stocks. Margin related to options trading is the amount of cash required to be held in a trading account when writing contracts. Read more about [Margin](http://www.optionstrading.org/introduction/terms-phrases/margin/).

**Market Makers:** Professional, high volume traders that are generally employees of financial institutions and are responsible for ensuring there's adequate depth and liquidity within the market in order for it to run efficiently. Read more about [Market Makers](http://www.optionstrading.org/basics/trader-types/market-makers/).

**Market On Close Order:** Often abbreviated to MOC, this is a type of order that is filled at the end of a trading day.

**Market Order:** A type of order used to buy or sell financial instruments at the current market price. A market order will always be filled providing there's a corresponding seller or buyer.

**Market Stop Order:** Also known as a stop market order, an order to close a position at market price when a certain price is reached.

**Married Puts:** A hedging strategy that uses stocks and options. Read more about [Married Puts](http://www.optionstrading.org/strategies/other/married-puts-fiduciary-calls-and-risk-reversal/).

**Max Pain / Max Option Pain:** See Option Pain.

**Model:** See Pricing Model

**Moneyness:** A method used to measure the relationship of the strike price of an option to the current price of the underlying security. Read more about [Moneyness](http://www.optionstrading.org/introduction/terms-phrases/moneyness/).

**Morphing:** The changing of one position into another position with just one order, typically used with synthetic positions.

**N**

**Naked Option:** Also known as an uncovered option, this is where the writer of a contract doesn'tt have a corresponding position in the underlying security to protect them against unfavorable price movements. For example, writing calls without owning enough of the underlying security is writing naked options or taking a naked position.

**Near The Money Option:** An option where the price of the underlying security is very close to the strike price.

**Neutral Market:** When the overall market is relatively stable it's either bullish or bearish.

**Neutral Outlook:** An expectation that the market, or a specific financial instrument, will remain relatively stable in price.

**Neutral Trading Strategies:** Strategies that can be used to profit from the price of a financial instrument not moving, or moving only slightly. [List of Neutral Strategies](http://www.optionstrading.org/strategies/neutral-market/).

**O**

**One Sided Market:** A market where the buyers significantly outnumber the sellers or the sellers significantly outnumber the buyers.

**One Cancel Other Order:** Often abbreviated to OCO, this is a type of combination order where one order is cancelled when the other one is filled.

**One Trigger Other Order:** Often abbreviated to OTO, this is a type of combination order where one order is automatically executed when the other one is filled.

**Online Broker:** A broker that enables you to enter your orders using an online trading platform.

**Opening Order:** An order that is used to open a new position. See Buy To Open Order or Sell To Open Order.

**Open Interest**: A measurement of the total number of open positions relating to a particular option. Read more about [Open Interest](http://www.optionstrading.org/improving-skills/advanced-terms/open-interest/).

**Optionable Stock:** Stock that has options based on it.

**Option / Options Contract:** The right to buy or sell a specified underlying security at a fixed strike price within a specified period of time.

**Option Pain:** The theoretical price of an underlying security that will result in the highest number of traders losing the highest amount of money due to options contracts expiring out of the money. Also known as Max Pain. Read more about [Option Pain](http://www.optionstrading.org/improving-skills/advanced-terms/option-pain/).

**Options Broker:** An individual or a company that executes orders to buy and sell options contracts on behalf of clients. [List of the Best Brokers](http://www.optionstrading.org/brokers/).

**Options Trader:** Any investor that buys and/or sells options contracts.

**Options Trading:** The process of buying and/or selling options contracts as a form of investment, to make short term profits, or to hedge existing positions.

**Options Symbol:** Effectively the name of an option; a string of characters that defines specific options contracts.

**Out of the Money Option:** An option where the price of the underlying security is in an unfavorable position, relative to the strike price, for the holder: meaning it has no intrinsic value. A call is out of the money when the price of the underlying security is lower than the strike price and a put is out of the money when the price of the underlying security is higher than the strike price.

**Outlook:** An expectation on which direction, if any, the market or a specific underlying security will move.

**Over The Counter Option:** A type of option that is only sold over the counter (OTC) and not on the public exchanges. They are typically highly customized options with specific parameters.

**P**

**Physical Option:** An option where the underlying security is a physical asset that is neither stock nor futures contracts.

**Physically Settled Option:** A type of option in which the underlying security changes hands between the holder and the writer of the options when it's exercised.

**Portfolio:** The combined holdings of any financial instruments owned by an individual, group, or financial institution.

**Position Trader:** A trader who uses the unique opportunities that options offer to profit from factors such as time decay and volatility.

**Position Trading:** The style of trading used by position traders, who are usually very experienced traders, to take advantage of the opportunities for profit that are created by the mechanics of options trading. Read more about [Position Trading](http://www.optionstrading.org/basics/trader-types/position-trading/).

**Premium:** A term that can be used to describe the whole price of an option or the extrinsic value of an option. Read more about [Premium](http://www.optionstrading.org/introduction/terms-phrases/premium/).

**Premium Value:** See Extrinsic Value

**Pricing Model:** A mathematical formula that is used to value or price an option contract based on specific factors. See Black Scholes Pricing Model or Binomial Pricing Model for examples.

**Pricer:** A specific type of chain that displays the five main Greeks in addition to other standard information.

**Protective Call:** A strategy that is used to protect profits in a short stock position. Learn how to use a [Protective Call](http://www.optionstrading.org/strategies/other/protective-puts-and-calls/).

**Protective Put:** A strategy that is used to protect profits in a long stock position. Learn [how to use a Protective Put](http://www.optionstrading.org/strategies/other/protective-puts-and-calls/).

**Put:** A type of option which grants the holder the right, but not the obligation, to sell the relevant underlying security at an agreed strike price. Read more about [Put Options](http://www.optionstrading.org/basics/option-types/put/).

**Put Call Parity:** A concept related to pricing that's based on avoiding arbitrage by ensuring the extrinsic values of related calls and when puts are equal, or close to equal in value.

**Put Ratio Backspread:** An advanced strategy that can be used for profit in a volatile market, when there's a bearish outlook. Learn how to use a [Put Ratio Backspread](http://www.optionstrading.org/strategies/volatile-market/put-ratio-backspread/).

**Put Ratio Spread:** This is an advanced strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Put Ratio Spread](http://www.optionstrading.org/strategies/neutral-market/put-ratio-spread/).

**Q**

**Quadruple Witching:** The third Friday in the months of March, June, September, and December are the days when stock options, index options, stock futures, and index futures all reach their expiration point; this usually leads to high trading volume and increased volatility.

**Quarterly Option:** A type of option that uses a quarterly expiration cycle.

**R**

**Ratio Spread:** A type of spread that is created using multiple contracts of differing amounts. This typically involves writing a higher amount of options than is being bought, but the ratio can be either way around. Read more about [Ratio Spreads](http://www.optionstrading.org/basics/spreads/ratio/).

**Realize a Profit:** The process of taking profits when closing an existing a position. Profit that exists in an open position is unrealized profit.

**Realize a Loss:** The process of incurring losses when closing an existing position. Losses that exist in an open position are unrealized losses.

**Resistance Level:** A price point, higher than its current price, that a financial instrument has not risen above over a given period of time.

**Return On Investment:** Often abbreviated to ROI, this is the percentage of profit that's made, or could be made, on an investment.

**Reverse Iron Albatross Spread:** An advanced strategy that can be used to make returns from a volatile market. Learn [how to use a Reverse Iron Albatross Spread](http://www.optionstrading.org/strategies/volatile-market/reverse-iron-albatross-spread/).

**Reverse Iron Butterfly Spread:** An advanced strategy that can be used to make returns from a volatile market. Learn [how to use a Reverse Iron Butterfly Spread](http://www.optionstrading.org/strategies/volatile-market/reverse-iron-butterfly-spread/).

**Reverse Iron Condor Spread:** An advanced strategy that can be used to make returns from a volatile market. Learn [how to use a Reverse Iron Condor Spread](http://www.optionstrading.org/strategies/volatile-market/reverse-iron-condor-spread/).

**Rho Value:** One of the Greeks, the rho value measures the theoretical effect of changes in interest rates on the price of the option. Also referred to as [Options Rho](http://www.optionstrading.org/improving-skills/greeks/rho/).

**Risk Graph:** A graph used to illustrate the risk to reward ratio of a position. Read more about [Risk Graphs](http://www.optionstrading.org/improving-skills/advanced-terms/risk-graphs-and-risk-to-reward/).

**Risk Reversal:** A simple strategy that's typically used for the purposes of hedging. Read more about [Risk Reversal](http://www.optionstrading.org/strategies/other/married-puts-fiduciary-calls-and-risk-reversal/).

**Risk to Reward Ratio:** An indication of how much risk is involved in a position in relation to the potential rewards or profits. Read more about [Risk to Reward Ratio](http://www.optionstrading.org/improving-skills/advanced-terms/risk-graphs-and-risk-to-reward/).

**ROI:** See Return on Investment.

**Rolling Down:** The process of closing an existing position and opening a comparable position at the same time, but with a lower strike price.

**Rolling Forward:** The process of closing an existing position and opening a comparable position at the same time, but extending the time left until expiry.

**Rolling:** A trading technique used to close an existing position and open a similar one at the same time, with slightly different terms. Read more about [Rolling](http://www.optionstrading.org/improving-skills/advanced-terms/rolling/).

**Rolling Up:** The process of closing an existing position and opening a comparable position at the same time, but with a higher strike price.

**S**

**Sell To Close Order:** An order that's placed when you want to close an existing long position through selling the contracts you have previously bought. Read more about the [Sell to Close Order](http://www.optionstrading.org/basics/order-types/sell-to-close/).

**Sell To Open Order:** An order that's placed when you want to open a new position through writing new contracts. Read more about the [Sell to Open Order](http://www.optionstrading.org/basics/order-types/sell-to-open/).

**Settlement:** The process by which the terms of a contract are resolved when the option is exercised. Read more about [Settlement](http://www.optionstrading.org/introduction/how-options-really-work/settlement/).

**Short:** You are short on a financial instrument if you have short sold that financial instrument and/or you stand to gain from it falling in price.

**Short Albatross Spread:** An advanced strategy that can be used when the market is volatile. Learn how to use a Short Condor Spread.

**Short Bear Ratio Spread:** This is an advanced strategy that can be used when the outlook on an underlying security is bearish. Learn [how to use a Short Bear Ratio Spread](http://www.optionstrading.org/strategies/bearish-market/short-bear-ratio-spread/).

**Short Bull Ratio Spread:** This is an advanced strategy that can be used when the outlook on an underlying security is bullish. Learn [how to use a Short Bull Ratio Spread](http://www.optionstrading.org/strategies/bullish-market/short-bull-ratio-spread/).

**Short Butterfly Spread:** An advanced strategy that can be used when the market is volatile. Learn how to use a [Short Butterfly Spread](http://www.optionstrading.org/strategies/volatile-market/short-butterfly-spread/).

**Short Calendar Straddle:** An advanced strategy that can be used to profit from volatile market conditions. Learn how to use a [Short Calendar Straddle](http://www.optionstrading.org/strategies/volatile-market/short-calendar-straddle/).

**Short Calendar Strangle:** An advanced strategy that can be used to profit from volatile market conditions. Learn how to use a [Short Calendar Strangle](http://www.optionstrading.org/strategies/volatile-market/short-calendar-strangle/).

**Short Call:** This is a simple strategy that can be used when the outlook on an underlying security is bearish. Learn [how to use a Short Call](http://www.optionstrading.org/strategies/bearish-market/short-call/).

**Short Call Calendar Spread:** An advanced strategy that can be used to profit from volatile market conditions. Learn [how to use a Short Call Calendar Spread](http://www.optionstrading.org/strategies/volatile-market/short-calendar-call-spread/).

**Short Condor Spread:** An advanced strategy that can be used when the market is volatile. Learn how to use a [Short Condor Spread](http://www.optionstrading.org/strategies/volatile-market/short-condor-spread/).

**Short Gut:** This is a simple strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Short Gut](http://www.optionstrading.org/strategies/neutral-market/short-gut/).

**Short Position:** The position of being short on a financial instrument. If you write contracts then you hold a short position on them.

**Short Put:** This is a simple strategy that can be used when the outlook on an underlying security is bullish. Learn [how to use a Short Put](http://www.optionstrading.org/strategies/bullish-market/short-put/).

**Short Put Calendar Spread:** An advanced strategy that can be used to profit from volatile market conditions. Learn how to use a [Short Put Calendar Spread](http://www.optionstrading.org/strategies/volatile-market/short-calendar-put-spread/).

**Short Selling:** The selling of a financial instrument that isn't currently owned, with the expectation of buying it back in the future at a lower price.

**Short Straddle:** This is a simple strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Short Straddle](http://www.optionstrading.org/strategies/neutral-market/short-straddle/).

**Short Strangle:** This is a simple strategy that can be used to profit from an underlying security remaining neutral. Learn [how to use a Short Strangle](http://www.optionstrading.org/strategies/neutral-market/short-strangle/).

**Spread:** A position that's created by buying and/or selling different contracts on the same underlying security to combine multiple positions into one effective position. Read more about the [Types of Options Spreads](http://www.optionstrading.org/basics/spreads/).

**Spread Order:** A type of order that's used to create a spread by simultaneously transacting all the required trades.

**Stock Option:** A type of option where the underlying security is stock in a publically listed company.

**Stock Repair Strategy:** A strategy that's used to recover losses from held stock that has fallen in value. Read more about [Stock Repair Strategy](http://www.optionstrading.org/strategies/other/stock-repair/).

**Stock Replacement Strategy:** A strategy that involves buying deep in the money call options instead of the underlying stock. The strategy is used to reduce the capital required to enter the position. Read more about [Stock Replacement Strategy](http://www.optionstrading.org/strategies/other/stock-replacement/).

**Stop Limit Order:** See Limit Stop Order.

**Stop Market Order:** See Market Stop Order.

**Stop Order:** A type of order that's used to automatically close a position when a specified price is reached.

**Strap Straddle:** This is a simple strategy that can be used when price of the underlying security is volatile, but the inclination occurs when the move will be to the upside. Learn [how to use a Strap Straddle](http://www.optionstrading.org/strategies/volatile-market/strap-straddle/).

**Strap Strangle:** This is a simple strategy that can be used when the price of the underlying security is volatile, but  the inclination occurs when the move will be to the upside. Learn [how to use a Strap Strangle](http://www.optionstrading.org/strategies/volatile-market/strap-strangle/).

**Strike Arbitrage:** An advanced strategy that involves the use of arbitrage. Read more about the strike arbitrage at [Arbitrage Strategies](http://www.optionstrading.org/strategies/other/arbitrage/).

**Strike Price:** The price specified in a contract at which the holder of the contract can exercise their option. The strike price of a call is the price at which the holder can buy the underlying security and the strike price of a put is the price at which the holder can sell the underlying security.

**Strip Straddle:** This is a simple strategy that can be used when the price of the underlying security is volatile, but the inclination occurs when the move will be to the downside. Learn [how to use a Strip Straddle](http://www.optionstrading.org/strategies/volatile-market/strip-straddle/).

**Strip Strangle:** This is a simple strategy that can be used when the price of the underlying security is volatile, but the inclination occurs when the move will be to the downside. Learn [how to use a Strip Strangle](http://www.optionstrading.org/strategies/volatile-market/strip-strangle/).

**Support Level:** A price point, lower than its current price, that a financial instrument hasn't fallen below over a given period of time.

**Swing Trader:** A trader who looks for relatively short term price swings and aims to profit from those swings by trading accordingly.

**Swing Trading:** The style of trading used by swing traders, where positions are usually held for a relatively short period of time in order to profit from short term price swings. Read more about [Swing Trading](http://www.optionstrading.org/basics/trader-types/swing-trading/).

**Synthetic Long Call:** A synthetic position which is essentially the same as owning calls. It involves buying puts and buying the related underlying security.

**Synthetic Long Put:** A synthetic position which is essentially the same as owning puts. It involves buying calls and short selling the related underlying security.

**Synthetic Long Stock:** A synthetic position which is essentially the same as owning stocks. It involves buying at the money calls and writing at the money puts on the relevant stock.

**Synthetic Position:** A position that's created using a combination of stocks and options, or a combination of different positions, to emulate another stock position or option position. Read more about [Synthetic Positions](http://www.optionstrading.org/improving-skills/advanced-terms/synthetic-positions/).

**Synthetic Short Call:** A synthetic position which is essentially the same as being short on call options. It involves short selling stock and then writing put options based on that stock.

**Synthetic Short Put:** A synthetic position which is essentially the same as being short on put options. It involves buying a stock and then writing call options based on that stock.

**Synthetic Short Straddle:** A synthetic strategy that essentially replicates the Short Straddle trading strategy. Read more about the synthetic short straddle at [Synthetic Strategies](http://www.optionstrading.org/strategies/other/synthetic/).

**Synthetic Short Stock:** A synthetic position which is essentially same as being short on stock. It involves the writing of at the money call options and buying at the money put options on the relevant stock.

**Synthetic Straddle:** A synthetic strategy that essentially replicates the Long Straddle trading strategy. Read more about the synthetic straddle at [Synthetic Strategies](http://www.optionstrading.org/strategies/other/synthetic/).

**T**

**Technical Analysis:** A style of analysis used to predict the future price movements of a financial instrument by studying historical data relating to the volume and price. This typically involves analyzing charts and graphs to find patterns and trends.

**Theoretical Value:** The value of a specific option, or position, that is calculated by a pricing model or other mathematical formulas.

**Theta Value:** One of the Greeks, the theta value measures the theoretical rate of time decay of that option. Also referred to as [Options Theta](http://www.optionstrading.org/improving-skills/greeks/theta/).

**Time Decay:** The process by which the extrinsic value diminishes as the expiration date of the option gets closer. Read more about [Time Decay](http://www.optionstrading.org/introduction/terms-phrases/time-decay/).

**Time Call Spread:** See Calendar Call Spread.

**Time Put Spread:** See Calendar Put Spread.

**Time Spread:** See Calendar Spread.

**Time Value:** See Extrinsic Value

**Trading Plan:** A detailed plan that a trader would prepare to lay out how they'll approach their trading. The plan would usually include defined objectives, details of methods that will be used for budget control, risk management, and which strategies will be used.

**Trailing Stop Order:** A type of order that includes a stop price which is based on a percentage or absolute change from the previous best price.

**Trading Levels:** A level that's assigned to account holders at brokers to indicate what level of risk they can be exposed to. They are used to protect traders that have insufficient capital or inadequate experience from entering trades that they shouldn’t have. Also known as approval levels. Read more about [Trading Levels](http://www.optionstrading.org/getting-started/trading-levels/).

**Trading Style:** The method and/or approach that a trader undertakes to follow; there are several specific types of trading styles. Read more about [Types of Options Trader & Trading Style](http://www.optionstrading.org/basics/trader-types/).

**Trend:** A recognizable and continued movement in a market or in the price of a specific financial instrument.

**U**

**Uncovered Option:** See Naked Option

**Underlying Asset:** See Underlying Security

**Underlying Security:** The asset, security, or financial instrument that an option is based on.

**Underlying Financial Instrument:** See Underlying Security

**V**

**Vega Value:** One of the Greeks, the vega value measures the theoretical effect of changes in the implied volatility of the underlying security on the price of the option. Also referred to as [Options Vega](http://www.optionstrading.org/improving-skills/greeks/vega/).

**Vertical Spread:** A type of spread that's created using multiple contracts with different strike prices, but it has the same expiration dates. Read more about [Vertical Spreads](http://www.optionstrading.org/basics/spreads/vertical/).

**Volatile:** A financial instrument or whole market, that's moving unexpectedly and/or dramatically is said to be volatile.

**Volatile Market:** A market that's constantly moving unexpectedly and dramatically, with a high level of price instability.

**Volatile Trading Strategies:** Strategies that can be used to profit from a volatile market and/or a volatile financial instrument. [List Of Volatile Strategies](http://www.optionstrading.org/strategies/volatile-market/).

**Volatility:** A measure of how a financial instrument is expected to fluctuate over a specified period of time. Read more about [Volatility](http://www.optionstrading.org/improving-skills/advanced-terms/volatility/).

**Volatility Crunch:** A significant drop in implied volatility.

**Volatility Skew:** When a graph that represents the implied volatility across options with the same underlying security, but different strike prices form a curve skewed to right.

**Volatility Smile:** When a graph that represents the implied volatility across options has the same underlying security but different strike prices, forms a concave similar in appearance to a smile.

**Volume:** The amount of transactions that took place involving a specified financial instrument such as a particular option. One with a high volume means it has been heavily traded.

**W**

**Weekly Option:** A type of option that uses a weekly expiration cycle.

**Writer:** The creator of new contracts to sell.

**Writing an Option:** The process of effectively creating new contracts to sell.

# Advanced Terms & Phrases

In the first part of our section on improving your options trading knowledge we have explained some of the more advanced terms and phrases that you should really understand. We do have a complete list of all the jargon that is used in options trading in our [Glossary of Terms](http://www.optionstrading.org/glossary/), but here we go into some additional detail about the important terms.

## Bear Traps & Bull Traps

You should definitely be aware of what bear traps and bull traps are, because you will want to avoid falling for them. Many of the decisions that you make when trading options will be based on whether you believe the market is in a bear state (falling prices or an expectation of falling prices) or a bull state (rising prices or an expectation of rising prices), and these traps are basically misleading indicators that can lead to you making the wrong decisions.

Predicting which way the market is going to move is obviously somewhat crucial when it comes to determining which transactions to make, and if you can accurately predict market movements then you stand a very good chance of being a successful trader. It isn't always easy to forecast which way the market is going to move, and often certain indicators will suggest a bull market or a bear market when in fact the opposite is true.

A bear trap is when the market is beginning to move downwards, or there are indications that it's beginning to do so, but it isn't a strictly confirmed bear market. Such circumstances can lead investors to be bearish in their trades, but then they get into trouble when the market doesn't move as expected.

A bull trap is basically the opposite; there are unconfirmed signs that the market is moving upwards and investors might be encouraged to be bullish. To avoid falling into such traps, it's very important to look for confirmed signals and be as sure as possible about which way the market is going to move before making the appropriate transactions.

## Arbitrage

Arbitrage is essentially the dream scenario for investors because it creates an opportunity to make profits without taking any risk whatsoever. There are a number of scenarios in which arbitrage can exist, but such opportunities are very hard to come by. They basically involve the simultaneous purchase and sale of financial instruments where there might be price discrepancies that allow you to make an instant risk-free profit.

Arbitrage is a fairly complex subject, and is usually pretty much the domain of professional traders and market makers, although there are certain [arbitrage strategies](http://www.optionstrading.org/strategies/other/arbitrage/) that can be employed by anyone that is confident and experienced enough to try them.

## Put Call Parity

Put call parity is a concept that affects how options are priced and, in theory at least, should prevent arbitrage opportunities arising. The basic principle of put call parity is that options should be priced in a way so that positions with similar risk and payoff profiles should expire with the same profit or loss.

The reason this concept should prevent the possibility of arbitrage is that if put call parity is in place then you wouldn't be able to short one position and be long on the other and be guaranteed a profit. Technically, this means that options should be priced in a way that the extrinsic value of calls and puts on the same underlying security, with the same strike price, and the same expiration date should have equal extrinsic value.

In reality, maintaining put call parity in every imaginable circumstance is essentially not feasible. It's actually the responsibility of market makers to maintain put call parity as well as is can be, but deviations are impossible to avoid completely. It is when those deviations occur that arbitrage opportunities emerge.

## Quadruple Witching

Quadruple witching is the term used in the United States to describe the third Friday of March, June, September and December. These are the days when index futures, stock futures, index futures options, and stock options all reach their final trading day. Although the final trading day for most stock options is the third Friday of every month, it is the third Friday of the last month of each quarter for the other three instruments. Therefore, the third Friday in each of the months mentioned sees the last trading day for four derivative instruments – which is why the word quadruple is used.

Quadruple witching may not necessarily have any dramatic effect on you because, the markets tend to move in the normal way overall. However, there does tend to be a significantly higher volume of transactions on these days, and higher volatility throughout the course of the day. If you are day trading options then you should be prepared for the fact that these four days of the year do see a lot more activity in the markets.

## Level II Quotes

For a large number of traders Level II Quotes (or Level 2 Quotes) aren't particularly relevant, but they can be very useful for very active investors such as those making intra-day trades. Level II Quotes are basically “real time” quotes that the exchanges provide. They detail the exact bid ask spreads that each market maker is offering, and then allows traders to transact with the market maker that has the prices best suited to their trades.

For those that make a number of transactions throughout the day who are looking to make quick trades within small margins have the ability to get the most advantageous prices by using Level II Quotes.  This can be a very helpful tool. However, Level II Quotes are largely irrelevant and an unnecessary complication to those that take slightly longer term positions, such those that are swing trading.

## Hedging

The basic definition of hedging is that it's a form of protection against potential loss; it's essentially a technique that is used to reduce, or even eliminate, risk. Car or household insurance, for example, is a form of hedging because you pay insurance premiums to prevent against loss or damage. In financial terms, it's the process of entering a position to protect another existing position.

For example, if you owned Company X stock and didn’t really want to sell that stock, but had some concerns that the stock might fall in value, you could buy puts on that stock. If the stock did then fall in value, you could exercise your option and sell your stock at a more favorable price.

Although most long term investors don’t use this technique, it's a very powerful tool for short term investors. As such, hedging is commonly used in options trading; whether it's used to protect against a portfolio of stocks or to protect against another options position. In fact, most of the strategies you will learn about actually use hedging in one form or another, and it is a concept that you should definitely try and understand.

You can read more on about hedging [here](http://www.optionstrading.org/improving-skills/advanced-terms/hedging/).

## Open Interest

Open interest refers to the number of open options positions that exist in the market at any time. It's often confused with trading volume, but it's actually quite different. Like volume, open interest is a good indicator of the liquidity of a particular contract so it is something that is well worth becoming familiar with.

You can read more about the subject on [this page](http://www.optionstrading.org/improving-skills/advanced-terms/open-interest/).

## Legging

Although it's quite possible to trade options profitably by using straightforward techniques and simply taking single positions on various contracts, the most successful traders use more complex strategies that involve multiple positions effectively combined into one. The positions that are combined are known individually as legs.

Traders will often try and execute the necessary transactions on each of the legs simultaneously, but this isn't always possible. The process for making the transactions for each of the legs separately is known as legging, and this is an important technique to understand if you are using some of the more complicated strategies.

For a more detailed explanation, please [click here](http://www.optionstrading.org/improving-skills/advanced-terms/legging/).

## Synthetic Positions

In financial terms, a synthetic position is basically creating a position using one financial instrument, or a combination of financial instruments, to replicate the position of another financial instrument. This might sound a little complicated, but the concept is actually relatively straightforward and there are a few reasons why creating a synthetic position is advantageous.

There are a number of options trading strategies that involve creating synthetic positions, and indeed many traders create synthetic positions without necessarily realizing it. It isn't really a concept that is essential to understand, depending on the style and strategies you are using or planning to use. However, it can be useful to be familiar with the basic concept.

You can read more about synthetic positions on [this page](http://www.optionstrading.org/improving-skills/advanced-terms/synthetic-positions/).

## Option Pain

Option pain, which is also known as maximum pain, is based on something of a controversial theory that the price of the underlying stock of options contracts can be, or is, manipulated in some way to ensure that the most amount of contracts expire out of the money.

Basically, the price of the underlying stock which would cause the most amount of loss to holders of contracts is known as max pain or option pain. It is a theory that is easy to discount for many, and it is certainly not a subject that you must definitely concern yourself with, although there are those that believe it is possible to profit from option pain.

For more information on this subject, please [click here](http://www.optionstrading.org/improving-skills/advanced-terms/option-pain/).

## Rolling

Rolling is a technique that essentially involves closing one options position and opening another position on the same underlying security using options contracts with different terms. There are three different forms of rolling; rolling forward, rolling up, and rolling down.  They each have their own uses. The main use of rolling is as a tool to manage positions, and it's typically to try and maximize profits.

You can read more about this technique [here](http://www.optionstrading.org/improving-skills/advanced-terms/rolling/).